

1 STATE OF NEW MEXICO  
2 ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT  
3 OIL CONSERVATION COMMISSION  
4 IN THE MATTER OF THE HEARING CALLED  
5 BY THE OIL CONSERVATION COMMISSION FOR  
6 THE PURPOSE OF CONSIDERING:  
7  
8 APPLICATION OF MATADOR PRODUCTION CASE NO. 15363  
9 COMPANY FOR A NONSTANDARD OIL SPACING (De Novo)  
10 AND PRORATION UNIT AND COMPULSORY  
11 POOLING, LEA COUNTY, NEW MEXICO.  
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14 REPORTER'S TRANSCRIPT OF PROCEEDINGS  
15 COMMISSION HEARING  
16 September 7, 2016  
17 Santa Fe, New Mexico  
18  
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21

22 BEFORE: DAVID R. CATANACH, CHAIRMAN  
23 PATRICK PADILLA, COMMISSIONER  
24 DR. ROBERT S. BALCH, COMMISSIONER  
25 BILL BRANCARD, ESQ.  
CHERYL BADA, ESQ.

18 This matter came on for hearing before the  
19 New Mexico Oil Conservation Commission on Tuesday,  
20 September 6, 2016, at the New Mexico Energy, Minerals  
21 and Natural Resources Department, Wendell Chino  
22 Building, 1220 South St. Francis Drive, Porter Hall,  
23 Room 102, Santa Fe, New Mexico.

22 REPORTED BY: Mary C. Hankins, CCR, RPR  
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<p style="text-align: right;"><b>Page 2</b></p> <p>1 APPEARANCES  2 FOR APPLICANT MATADOR PRODUCTION COMPANY:  3 JAMES G. BRUCE, ESQ.  Post Office Box 1056  4 Santa Fe, New Mexico 87504  (505) 982-2043  jamesbruc@aol.com  5 and  6 DANA ARNOLD, ESQ.  MATADOR RESOURCES COMPANY  7 Office of General Counsel  One Lincoln Centre  8 5400 LBJ Freeway, Suite 1500  Dallas, Texas 75240  (972) 371-5284  darnold@matadorresources.com  10  11 FOR PROTESTANT JALAPENO CORPORATION:  12 J.E. "GENE" GALLEGOS, ESQ.  GALLEGOS LAW FIRM, P.C.  13 460 St. Michael's Drive, Building 300  Santa Fe, New Mexico 87505  (505) 983-6686  jeg@gallegoslawfirm.net  15  16 FOR INTERVENOR THE NEW MEXICO OIL CONSERVATION DIVISION:  17 DAVID K. BROOKS, ESQ.  ENERGY, MINERALS &amp; NATURAL RESOURCES DEPARTMENT  18 STATE OF NEW MEXICO OIL CONSERVATION DIVISION  Office of General Counsel  19 1220 South St. Francis Drive  Santa Fe, New Mexico 87505  (505) 476-3463  davidk.brooks@state.nm.us  21  22  23  24  25</p>	<p style="text-align: right;"><b>Page 4</b></p> <p>1 EXHIBITS OFFERED AND ADMITTED  2 PAGE  3 Matador Production Company Exhibit  Numbers 17 through 25 29  4  5 Jalapeno Corporation Exhibit Number 8 (Revised) 106  6  7  8  9  10  11  12  13  14  15  16  17  18  19  20  21  22  23  24  25</p>
<p style="text-align: right;"><b>Page 3</b></p> <p>1 INDEX  2 PAGE  3 Matador Production Company's Case-in-Chief (Cont'd):  4 Witnesses:  5 Bradley M. Robinson:  6 Direct Examination by Mr. Bruce 5  Cross-Examination by Mr. Gallegos 32  7 Redirect Examination by Mr. Bruce 53  Cross-Examination by Chairman Catanach 55  8 Cross-Examination by Commissioner Padilla 58  Cross Examination by Commissioner Balch 63  9  10 Jalapeno Corporation's Case-in-Chief:  11 Witnesses:  12 Harvey E. Yates:  13 Direct Examination by Mr. Gallegos 69  Cross-Examination by Mr. Bruce 106  14 Cross-Examination by Commissioner Padilla 127  Cross-Examination by Chairman Catanach 133  15 Cross-Examination by Mr. Brancard 141  Redirect Examination by Mr. Gallegos 146  16 Recross Examination by Mr. Bruce 148  Recross Examination by Chairman Catanach 148  17  18 Recess 152  19 Certificate of Proceedings 153  20  21  22  23  24  25</p>	<p style="text-align: right;"><b>Page 5</b></p> <p>1 (8:30 a.m.)  2 CHAIRMAN CATANACH: Good morning. I'll  3 call the Commission meeting to order this morning. This  4 is a continuation of Case Number 15363, and I believe  5 Mr. Bruce is still -- has one more witness at this  6 point.  7 Mr. Bruce.  8 MR. BRUCE: That is correct, sir.  9 CHAIRMAN CATANACH: So you may proceed at  10 this time.  11 BRADLEY M. ROBINSON,  12 after having been previously sworn under oath, was  13 questioned and testified as follows:  14 DIRECT EXAMINATION  15 BY MR. BRUCE:  16 <b>Q. Would you please state your name for the</b>  17 <b>record?</b>  18 A. Bradley Robinson.  19 <b>Q. Who do you work for and in what capacity?</b>  20 A. I work for Matador Resources Company as the  21 senior vice president of reservoir engineering and chief  22 technology officer.  23 <b>Q. And what are your responsibilities with Matador</b>  24 <b>in that capacity?</b>  25 A. Well, I have several responsibilities. One of</p>

**2 (Pages 2 to 5)**

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<p style="text-align: right;"><b>Page 6</b></p> <p>1 my main responsibilities is to determine the amount, a  2 value of the company's reserves. I also work with our  3 geology staff looking at new prospects, evaluating the  4 economics of drilling exploration wells. I look at  5 acquisition opportunities. We rarely sell anything, but  6 if we do sell anything, I try to assign a value to that.  7 So I get involved in A and B prospects.  8 And, in general, I also work with our  9 completions team to optimize the lateral lengths, the  10 spacing of our horizontal wells or vertical wells and  11 also the completion. I get involved in the design of  12 the hydraulic fracture treatments.  13 <b>Q. Could you describe your educational and</b>  14 <b>employment background, please?</b>  15 A. Sure. I graduated in 1977 from Texas A &amp; M  16 University with a bachelor of science degree in  17 petroleum engineering. I also earned my master's degree  18 in petroleum engineering from A &amp; M in 1986.  19 After graduation, I worked a couple of  20 years for Marathon Oil Company in Midland as a  21 production engineer and was later promoted to reservoir  22 engineer in the district office there.  23 In late 1979, I went to work for one of my  24 old professors, Dr. Steven Holditch. He was starting a  25 consulting company called S.A. Holditch &amp; Associates.</p>	<p style="text-align: right;"><b>Page 8</b></p> <p>1 including the proposed spacing unit for the Airstrip  2 well in and around Section 31?  3 A. Yes, I have.  4 MR. BRUCE: Mr. Chairman, I'd tender the  5 witness as an expert in petroleum engineering matters.  6 CHAIRMAN CATANACH: Any objection?  7 MR. GALLEGOS: No objection.  8 CHAIRMAN CATANACH: He is so qualified.  9 <b>Q. (BY MR. BRUCE) You were here through the</b>  10 <b>testimony of Matador's witnesses yesterday; were you</b>  11 <b>not?</b>  12 A. Yes.  13 <b>Q. And they spoke about the differences -- some of</b>  14 <b>them anyway between a Wolfcamp well and a Bone Spring</b>  15 <b>well. Can you describe the reservoir differences</b>  16 <b>between the two?</b>  17 A. Sure.  18 I thought Dr. Frost did a great job  19 explaining some of the mineralogical differences,  20 geological, stratigraphic differences, the geochemical  21 differences. It was brought up that one of the main  22 differences between the Wolfcamp and the Bone Spring is  23 that in most areas of the Basin, the Wolfcamp is  24 geopressured, unlike the Bone Spring, which is really  25 normally pressured in almost all areas of the Basin.</p>
<p style="text-align: right;"><b>Page 7</b></p> <p>1 So I moved back to College Station, and I worked for  2 S.A. Holditch &amp; Associates until 1997 when Schlumberger  3 bought our company. I worked for Schlumberger for six  4 years as a technology advisor.  5 And then in 2003, I went to work for  6 Matador Resources as the vice president of engineering.  7 I was later promoted to my current title of senior vice  8 president of reservoir engineering and chief technology  9 officer.  10 <b>Q. Did Holditch &amp; Associates specialize in</b>  11 <b>analyzing unconventional reservoirs?</b>  12 A. Yes. Yeah. That was sort of our niche, was  13 the analysis, the completion, fracture stimulation of  14 unconventional reservoirs.  15 <b>Q. And have you previously testified before the</b>  16 <b>Oil Conservation Division?</b>  17 A. I have.  18 <b>Q. And were your credentials as an expert</b>  19 <b>petroleum engineer accepted as a matter of record?</b>  20 A. They were.  21 <b>Q. And are you familiar with the application filed</b>  22 <b>by Matador in this case with respect to the reservoir</b>  23 <b>engineering matters?</b>  24 A. I am.  25 <b>Q. And have you conducted a study of the area,</b></p>	<p style="text-align: right;"><b>Page 9</b></p> <p>1 We're not 100 percent sure that's the case  2 in the northern part of the Basin where the proposed  3 well is being drilled. We suspect it is. We have some  4 information that showed us or told us that the lower  5 Wolfcamp was geopressured in this area, but we're not  6 sure about the upper Wolfcamp.  7 You know, the lower -- the Wolfcamp in  8 general, while there are some conventional reservoirs  9 that have been drilled, is -- is more of an  10 unconventional type reservoir with organic-rich shales  11 and low permeability within it.  12 Most of the Bone Spring is more of a  13 conventional type reservoirs, especially in the sand  14 intervals. There are some tight intervals, and there  15 are some organic-rich intervals within the Bone Spring,  16 especially in the carbonate sections. But it's  17 generally looked at as more of a conventional target by  18 operators, while the Wolfcamp is more of an  19 unconventional.  20 <b>Q. In this area, is the Wolfcamp heterogeneous?</b>  21 A. Very. Very. I've never heard it pronounced  22 like that. I say heterogenous, but I'm from Texas so --  23 but I like your pronunciation. It's very good.  24 <b>Q. And when you talk heterogeneous, is that</b>  25 <b>vertical or lateral?</b></p>

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A. Both, really. It's highly laminated. They're very heterogeneous vertically and, as is the case with most unconventional reservoirs, the lateral variation are significant, wide variations in porosity, permeability, organic content and so forth.

**Q. In your opinion, is it proper to compare Bone Spring results to Wolfcamp well results?**

A. Not at all, no.

**Q. Talking about the distance to similar upper Wolfcamp wells, just looking at upper Wolfcamp wells, how did you narrow down your study to this area?**

A. We had drilled a couple of wells, as was mentioned earlier, mainly looking at the lower Wolfcamp. We actually drilled one lower Wolfcamp horizontal well, the Pickard #2H, which was mentioned yesterday.

We had seen -- we had quite a bit of success in the upper Wolfcamp in the southern part of Eddy County and certainly in our acreage down in Texas, in Loving County, so we wanted to look at the upper Wolfcamp here. So Dr. Frost and his geoscience team and some of the reservoir engineers started looking for data in this area, looking at some of the data we had gathered drilling some of the lower Wolfcamp wells and thought there was a potential there. So we decided to go ahead and put together an AFE.

**Q. And when you look at Exhibit 8, there are some good vertical Wolfcamp producers in this area; is that correct?**

A. There are a couple, yes.

**Q. A few. And I think Dr. Frost testified six, seven, eight wells out of about -- well, I forget exactly how many.**

A. I think there are roughly 40-some-odd wells that was produced out of the Wolfcamp.

**Q. So divided by 40, comes out to that success rate?**

A. Pretty much, yes.

**Q. And we're talking economic wells as opposed to just wells that produced some oil?**

A. That's correct.

And I think he also pointed out that there were probably about a dozen dry-hole drills in this area, too, so it's not a given that even that they're going to produce anything.

**Q. Then if you could refer to Exhibit 19, you mentioned the Pickard 2H well in Section 20 of -- what is that 18-34?**

A. Yes.

**Q. Could you discuss that well a little more?**

A. Sure. It was a well we drilled to evaluate.

We had acquired this acreage in the HEYCO merger, which was mentioned. It looked like it had one of the better opportunities to test the upper Wolfcamp, so we went ahead and changed the application from drilling in the 3rd Bone Spring down into the upper Wolfcamp.

**Q. Okay. Let me see if I can find the right exhibit, Mr. Robinson.**

**There was the testimony by Dr. Frost yesterday -- Exhibit 8, if you can turn to Exhibit 8, please -- that there are a number of Wolfcamp -- vertical Wolfcamp tests in this area, correct?**

A. That's correct.

**Q. Now, first of all, do you consider Matador's proposed well a wildcat well?**

A. Yes, I do.

**Q. And have there been studies conducted over the years regarding the success rate in wildcat wells?**

A. Oh, yes. There's been multiple studies, looking back in history at the statistical success of exploration wells, and I think it's a well-known fact -- in fact, there's an article in the Oil and Gas Journal that identified the normal success rate historically worldwide was around 15 percent chance of success for exploration wells.

It's called the Wolfcamp D or the lower Wolfcamp. We had gathered some data and a couple of other wells in the area that showed that it was an organically rich source rock. We drilled that well, had significant problems drilling it. I think this is one of Mr. Byrd's 100-day-plus wells, if I'm not mistaken. We had issues in the vertical well. We did not get all of the data that we'd hoped to get because of problems with the wellbore. The bar line tools got stuck. We got a key seat in the wire lines. We had to fish those out. So it was a tough well to drill both vertically and horizontally, but we got it done.

The completion on that well was tough, very high fracture gradients. The lower Wolfcamp shelf is fairly ductal as opposed to being brittle. We discussed that a little bit. We had trouble pumping quite a few of the frac stages, even pumping into the formation. So there's really no guarantee that what we're doing out here that we're going to be able to successfully drill it or complete it.

**Q. Can you please turn to Exhibit 21 and describe the reservoir risks?**

A. Yes. When we look at prospects, which I'm working with our geoscience team, particularly exploration wells or exploratory wells, we always try to

1 identify the main reservoir risk factors.

2 What we show here -- and there are many of  
3 them, but these are the key reservoir factors -- risk  
4 factors that we hone in on, permeability greater than  
5 100 nanodarcies. You know, it seems funny saying that.  
6 Five years ago we were talking millidarcies or  
7 microdarcies, but today we're talking about nanodarcies.  
8 But we've got to have at least 100 nanodarcies in order  
9 to get sufficient flow in these reservoirs to make  
10 economic wells.

11 Net thickness of at least 100 feet. We  
12 want to make sure we have sufficient oil and gas in  
13 place to justify drilling the horizontal wells. Of  
14 course, we have to have a good oil saturation, which  
15 means water has to be less than 45 percent. And that  
16 can vary depending on where you are. I've seen  
17 water-free production with water saturations as high as  
18 60 percent, but in most of these unconventional  
19 reservoirs, you want it to be down in the 40s or lower.

20 Formation pressure is one of the keys to  
21 having enough energy in these unconventional reservoirs  
22 to drive the oil or gas out of these nano-size  
23 fore-throws [phonetic].

24 And lateral continuity. You want to be  
25 able to predict reasonably well that the formation is

1 is a normal pressure. So there is a pressure seal  
2 there. And we're not sure if there is a pressure seal  
3 between the lower and upper Wolfcamp in this area.

4 **Q. And the other witnesses had similar -- the  
5 other technical witnesses had similar charts for their  
6 risk assessment. Is this how it's normally done at  
7 Matador?**

8 A. This is our normal approach, yes. We try to  
9 look at things on a relative scale between low, medium  
10 and high in terms of our risk assessment, and then we  
11 look at the overall risk in each of the major  
12 categories.

13 **Q. And what do you estimate the reservoir risk  
14 being in this well?**

15 A. We're right at about 50 percent chance of  
16 success on the reservoir.

17 We know the thickness based on logs in the  
18 area. We've done some preliminary petrophysical work  
19 that suggests the water saturation may be low, but we  
20 really don't have the mineralogical information,  
21 cementation factors, saturation exponents. All the  
22 things that go into conventional log analysis, we don't  
23 have a lot of that data, so we're making assumptions on  
24 those things based on what we know from other wells down  
25 in southern Eddy County and in Loving County. But in

1 going to be continuous over some distances. We know  
2 there are significant variations, but you hope that the  
3 changes aren't significant enough to affect the overall  
4 productivity of the well.

5 **Q. In looking at permeability, you put the risk as  
6 high. Is that due to lack of data in the upper  
7 Wolfcamp?**

8 A. Yes. We really don't have any permeability  
9 data from the Wolfcamp. I believe it was testified to  
10 that we've got a pretty good handle on the porosity, and  
11 there are some theoretical correlations to convert  
12 porosity to permeability. There are some logs that  
13 could be run to estimate the permeability. But those  
14 are, again, theoretical calculations. We have no  
15 measurement of permeability whatsoever in the upper  
16 Wolfcamp.

17 **Q. And does the same apply to the pressure  
18 gradient that you're looking for?**

19 A. That's correct, unknown here.

20 We know that the lower Wolfcamp is  
21 geopressured with about a .7 psi per foot gradient, but  
22 that's 1,000 feet deeper. And those pressure gradients  
23 can change as you go up vertically. We know in Eddy  
24 County, for example, the upper Wolfcamp is geopressured.  
25 You go 300 feet up into the 3rd Bone Spring, and there

1 this area, we're still kind of assuming some of those  
2 values.

3 But we think water saturation's going to be  
4 in the 40s, so we've got a moderate amount of risk on  
5 that, though.

6 Same thing with lateral continuity. We  
7 have a data point at the north end of the wellbore  
8 trajectory. We have one at the south end, but we don't  
9 have anything in between. So while geologically we  
10 believe that to be fairly continuous, we really don't  
11 know. So we've assigned a moderate amount of risk to  
12 that.

13 **Q. Now, in your exhibit, you say the well  
14 classifies as contingent resources and not reserves.  
15 What is the difference between those two terms?**

16 A. So the contingent resources are the  
17 classification of resources by the Petroleum Resource  
18 Management System, which was adopted by the Society of  
19 Petroleum Engineers and the Society of Professional  
20 Evaluation Engineers as to that rating, and also the  
21 AAPG, to define specific categories of reserves. That  
22 resource system was accepted by the Securities and  
23 Exchange Commission as guidelines for public companies  
24 to estimate or to categorize their reserves.

25 So in this particular case, a Wolfcamp well

<p style="text-align: right;"><b>Page 18</b></p> <p>1 in this area would fall in the contingent category</p> <p>2 because it has less than a 10 percent chance of</p> <p>3 probability that we will produce commercial quantities</p> <p>4 of oil and gas.</p> <p>5 <b>Q. And is the Petroleum Resources Management</b></p> <p>6 <b>System submitted as Exhibit 22?</b></p> <p>7 A. Yes, it is.</p> <p>8 <b>Q. And if you could, Mr. Robinson, could you turn</b></p> <p>9 <b>to page 7? And, again, just briefly talk about the</b></p> <p>10 <b>reserves resources differentiation.</b></p> <p>11 A. Sure. This shows sort of pictorially what I</p> <p>12 was talking about. Only wells or reserves that have at</p> <p>13 least a 90 percent chance of commercial production can</p> <p>14 be classified as reserves, either proved developed or</p> <p>15 proved undeveloped by the Securities and Exchange</p> <p>16 Commission.</p> <p>17 Anything less than that, particularly as</p> <p>18 you get down to the 10 percent or less probability of</p> <p>19 success, those have to be classified as contingent</p> <p>20 resources, and that basically just means there's only</p> <p>21 about a 10 percent chance of commercial success here.</p> <p>22 <b>Q. So Matador would view this well as a risky</b></p> <p>23 <b>proposition?</b></p> <p>24 A. Yes, we do.</p> <p>25 <b>Q. And other people who are familiar with publicly</b></p>	<p style="text-align: right;"><b>Page 20</b></p> <p>1 prospect.</p> <p>2 <b>Q. Now, you've seen Matador's exhibits, correct?</b></p> <p>3 A. That's correct.</p> <p>4 <b>Q. And is it fair to say that what they're doing</b></p> <p>5 <b>is adding risk rather than multiplying?</b></p> <p>6 A. Matador's?</p> <p>7 <b>Q. Not Matador's. Jalapeno.</b></p> <p>8 A. Oh. Jalapenos?</p> <p>9 <b>Q. Yeah.</b></p> <p>10 A. It appears they were adding the risk factors</p> <p>11 together, which is incorrect.</p> <p>12 <b>Q. And is multiplying risk the way it's normally</b></p> <p>13 <b>done?</b></p> <p>14 A. Yes. That's the industry standard, that you</p> <p>15 multiply the risks together because your exploration</p> <p>16 risk for a prospect is no better than the most risky</p> <p>17 category. For example, if you had a 100 percent chance</p> <p>18 of success to drill a well and you had a 100 percent</p> <p>19 chance of hitting your geologic target, but you only had</p> <p>20 a 25 percent chance of there being oil and gas present</p> <p>21 in commercial quantities, then if you would use their</p> <p>22 method, you would add 100 plus 100 plus 25. You'd have</p> <p>23 a 225 percent chance of success.</p> <p>24 In reality, you only have a 25 percent</p> <p>25 chance of success. You have to multiply those together,</p>
<p style="text-align: right;"><b>Page 19</b></p> <p>1 <b>held companies in the SEC would also view this well as a</b></p> <p>2 <b>risky proposition?</b></p> <p>3 A. I would think they would, yes.</p> <p>4 <b>Q. Let's turn to your Exhibit 23. Other witnesses</b></p> <p>5 <b>have discussed risk. How do you analyze the projected</b></p> <p>6 <b>risk for this specific well?</b></p> <p>7 A. So in this particular case and really all</p> <p>8 cases, we look at the -- there are three primary</p> <p>9 components of risk: Probability of geologic success,</p> <p>10 which we discussed yesterday; probability of reservoir</p> <p>11 success, which is what I'm looking at today; and the</p> <p>12 probability of operational success. Those are the three</p> <p>13 main ones that Matador looks at.</p> <p>14 There are others in standard risk analysis</p> <p>15 that the industry looks at. For example, I mean, if you</p> <p>16 were drilling offshore or overseas or something like</p> <p>17 that, there could be some political risk or</p> <p>18 environmental risk or things like that, that others</p> <p>19 might -- might take into account. Market risk, of</p> <p>20 course, is always an issue, which we have to deal with.</p> <p>21 But as far as just drilling the well, we</p> <p>22 look at the three primary categories here. And then in</p> <p>23 order to estimate the probability of success, you take</p> <p>24 each one of those individual risks and multiply them</p> <p>25 together, and then that gives you the total risk for the</p>	<p style="text-align: right;"><b>Page 21</b></p> <p>1 because your prospect is only as good as the most risky</p> <p>2 component of that prospect.</p> <p>3 <b>Q. Okay. So it's -- what's the right term? It's</b></p> <p>4 <b>not like a coin-flip, where you have a 50/50 chance of</b></p> <p>5 <b>coming up right every time?</b></p> <p>6 A. Well, that's not a bad analogy, too. If you</p> <p>7 had -- you know, there's a 50 percent chance, when you</p> <p>8 flip a coin, that you're going to get a heads. So if</p> <p>9 you were going to flip it three times, again using their</p> <p>10 methodology, you'd have 50 plus 50 plus 50. You'd have</p> <p>11 a 150 percent chance of getting heads, when, in reality,</p> <p>12 your chance is only 50 percent every time you flip it.</p> <p>13 And then as you continue to flip it, your chance of</p> <p>14 getting a heads goes up because the risk of getting a</p> <p>15 tail goes down. So you multiply them together. You</p> <p>16 don't add the risk.</p> <p>17 <b>Q. You'd like it if you had a 150 percent chance</b></p> <p>18 <b>of success on this one?</b></p> <p>19 A. Yeah. It's --</p> <p>20 MR. GALLEGOS: Is this a question, or are</p> <p>21 we just kind of having a discussion, Mr. Bruce?</p> <p>22 I object to -- either we have a</p> <p>23 question-and-answer process or we don't.</p> <p>24 <b>Q. (BY MR. BRUCE) Mr. Robinson, so looking at the</b></p> <p>25 <b>final thing, is there criteria for success?</b></p>

**6 (Pages 18 to 21)**

<p style="text-align: right;"><b>Page 22</b></p> <p>1 A. Right. In general, when we look at a prospect,  2 we ask ourselves several questions. Number one, does it  3 have suitable rock quality at the peak oil window? I  4 think Dr. Frost addressed this very well yesterday. We  5 look at thermal maturity. We look at the total organic  6 content. We look at, you know, the thickness, porosity.  7 We need to know that oil generation within the source  8 rock is at that peak thermal maturity to get oil. If  9 we're looking for gas, we go for more thermally mature  10 rock, but in this particular case, we're looking for the  11 peak oil window.</p> <p>12 At this depth and this cost of the  13 \$6-and-a-half million that was mentioned, we need an EUR  14 of at least 400,000 barrels to make this economic. We  15 hope to get to that level. Based on our analysis, we  16 think we can get there. We think it can be more than  17 that. But at this point, we don't know permeability.  18 We really don't know saturation in terms of calculating  19 the oil in place. So we're not sure we can get to the  20 400,000. But all the other properties, with some of the  21 assumptions we've had to make, puts us in this category,  22 and this is what we're looking for.</p> <p>23 And the last thing, of course, as Mr. Byrd  24 said, drilling and completing the well on budget or  25 under, ideally. We'd love to come under, but we think,</p>	<p style="text-align: right;"><b>Page 24</b></p> <p>1 drill that, but we've assigned a 75 percent chance of  2 success to that. And then the reservoir chance of  3 success, which we talked a little bit earlier, was  4 around 50 percent.</p> <p>5 When you multiply all those together, you  6 get a little over 9 percent cumulative chance of  7 success, which, as I mentioned a little earlier when we  8 were talking about contingent resources, you've got to  9 be at least over 10 percent chance of success to be able  10 to get out of that contingent resources category. So  11 that's where we came up with that. But the probability  12 of success here is around 9 or 10 percent, which fits in  13 really nicely -- you know, pretty much in agreement with  14 the historical exploration success of the entire  15 industry.</p> <p>16 <b>Q. And with the SEC regulations?</b>  17 A. Yes. Oh, yes. This fits all the SEC  18 guidelines.</p> <p>19 <b>Q. Now, can the success calculation be subjective,  20 or is it subjective?</b>  21 A. It is subjective. Sure.</p> <p>22 We have team meetings to discuss and to get  23 opinions from various experts within our company. We  24 often go outside the company to get opinions from  25 consultants, from service companies who have experience</p>
<p style="text-align: right;"><b>Page 23</b></p> <p>1 on this first well, particularly, we're probably going  2 to see some things we didn't expect.</p> <p>3 I know Mr. Byrd -- he's expecting  4 geopressure in the upper Wolfcamp. That doesn't mean  5 we're going to see it, but a drilling engineer would  6 expect that and design his well to account for that.  7 We've seen it in other areas of the Basin, so there is  8 good reason to hopefully see it here, but we really  9 don't know.</p> <p>10 <b>Q. In your opinion, would a well of this type  11 making -- if it produced, ultimately, 200,000 barrels of  12 oil equivalent, would that pay out?</b>  13 A. No. It wouldn't pay out.</p> <p>14 <b>Q. And would you, as the VP of reservoir  15 engineering, approve of drilling such a well in today's  16 economic climate?</b>  17 A. No, I wouldn't.</p> <p>18 <b>Q. Would you please turn to page -- Exhibit 24 and  19 describe what you believe the estimate of success for  20 this well is?</b>  21 A. Yes. So this is our actual calculation for  22 this particular prospect, where we took the chance of  23 geologic success that we discussed yesterday, which is  24 around 25 percent. The chance of operational success,  25 which we're more positive about that -- we think we can</p>	<p style="text-align: right;"><b>Page 25</b></p> <p>1 in the area. We look at the success -- the drilling  2 success, the number of dry holes drilled. As I  3 mentioned, we had identified at least 12 dry holes in  4 the Wolfcamp in this area. So we try to accumulate as  5 much information as we can from within the company and  6 outside the company from experts to get at the proper  7 probability of success.</p> <p>8 <b>Q. How long do you need to produce a well such as  9 the proposed well to determine the ultimate recovery?</b>  10 A. You need to produce these unconventional  11 reservoirs several years before we have a good handle on  12 what the true reserves are going to be.</p> <p>13 These wells follow a hyperbolic-type  14 decline, and it takes a good one to two years to  15 establish the shape of that hyperbolic decline so we can  16 match it and forecast accurately what the reserves are  17 going to be.</p> <p>18 <b>Q. And in your opinion, do these factors justify a  19 200 percent risk charge for this well?</b>  20 A. Yes, definitely, if not higher.</p> <p>21 <b>Q. And is that why you think the industry and even  22 the OCD regulations set a risk penalty at 200 percent?</b>  23 A. Yes. I think the industry very well  24 understands that exploration risk, associated with  25 unconscious conventional reservoirs -- the cost of these</p>

**7 (Pages 22 to 25)**

<p style="text-align: right;"><b>Page 26</b></p> <p>1 wells are substantially higher than what we're used to</p> <p>2 drilling in the vertical world, so the risk and the cost</p> <p>3 definitely justify the risk charge of 200 percent.</p> <p>4 <b>Q. And can you turn to Exhibit 25? Do you think</b></p> <p>5 <b>that this well fits in within the vast majority of the</b></p> <p>6 <b>cases that justify 200 percent risk charge?</b></p> <p>7 A. Yes.</p> <p>8 <b>Q. Do you think there is a specific reason to</b></p> <p>9 <b>provide a lesser charge?</b></p> <p>10 A. No.</p> <p>11 <b>Q. Now, you've been in the industry for a while.</b></p> <p>12 <b>Has the risk diminished since vertical well days?</b></p> <p>13 A. Is that another way of saying I'm old?</p> <p>14 <b>Q. But not as old as me.</b></p> <p>15 A. No. The risks of drilling exploration wells,</p> <p>16 we talked about them. There have been numerous studies</p> <p>17 done that show, historically, is around low to mid-teens</p> <p>18 in terms of the percentage of success. That's -- that's</p> <p>19 still about the same as it is or has been historically.</p> <p>20 The price of playing in these</p> <p>21 unconventional resource plays, though, has gone up.</p> <p>22 Horizontal wells, the cost are, you know, many millions</p> <p>23 of dollars. We do everything we can to keep those costs</p> <p>24 down.</p> <p>25 Everywhere we drill, we get a little bit</p>	<p style="text-align: right;"><b>Page 28</b></p> <p>1 might in drilling an offshore well or drilling overseas.</p> <p>2 You do take on the riskier type wells when you have a</p> <p>3 large upside to it.</p> <p>4 <b>Q. So if this well is successful, it will prove up</b></p> <p>5 <b>other upper Wolfcamp acreage in the area?</b></p> <p>6 A. Oh, yes. It's going to prove up a lot of</p> <p>7 acreage in the area.</p> <p>8 <b>Q. Not just Matador's?</b></p> <p>9 A. Not just Matador. There are a lot of companies</p> <p>10 that are going to benefit from having this well</p> <p>11 successful.</p> <p>12 <b>Q. Including Jalapeno's acreage?</b></p> <p>13 A. Including Jalapeno. It's going to make them</p> <p>14 very rich.</p> <p>15 <b>Q. And even if they -- even if they do not</b></p> <p>16 <b>participate in this well, they will benefit?</b></p> <p>17 A. Yes, definitely.</p> <p>18 <b>Q. What waste would occur if Matador was only</b></p> <p>19 <b>allowed to drill vertical wells on the 40-acre well</b></p> <p>20 <b>unit, as Jalapeno has suggested?</b></p> <p>21 A. We would leave a substantial amount of oil and</p> <p>22 gas in the reservoir. We would not be able to</p> <p>23 efficiently drain the oil and gas reserves from this</p> <p>24 well with vertical wells or even short -- even short</p> <p>25 laterals, for that matter. There would be significant</p>
<p style="text-align: right;"><b>Page 27</b></p> <p>1 smarter. I think there were some exhibits shown</p> <p>2 yesterday that showed our costs are decreasing. A lot</p> <p>3 of that is because of lower service cost, but it also is</p> <p>4 drilling faster, drilling smarter, optimizing our</p> <p>5 completions, our fracture treatments.</p> <p>6 We typically will go in, on some of the</p> <p>7 early wells, and overdesign the fracture treatments that</p> <p>8 we pump just to make sure we properly stimulate the</p> <p>9 reservoirs, and then we can optimize those completions</p> <p>10 as we drill additional wells. Overdesign is probably</p> <p>11 not the right word. We tend to make sure we properly</p> <p>12 stimulate the wells. The last thing we want to have</p> <p>13 happen is to second-guess ourselves. Did we pump the</p> <p>14 right fracture treatment? Did we pump enough proppant?</p> <p>15 So we make sure we don't have that as one of the issues</p> <p>16 in the event the well doesn't produce as we expected it</p> <p>17 to.</p> <p>18 <b>Q. You stated this is a risky well. It is a risk</b></p> <p>19 <b>that you are willing to take?</b></p> <p>20 A. Yes. No, there -- with our acreage position in</p> <p>21 this area and with the potential upside that we could</p> <p>22 recognize -- and everybody for that matter -- there's a</p> <p>23 tremendous amount of potential in the upper Wolfcamp</p> <p>24 here, very, very large amount of potential. And we're</p> <p>25 willing to take that risk, the same as any operator</p>	<p style="text-align: right;"><b>Page 29</b></p> <p>1 waste.</p> <p>2 <b>Q. Were Exhibits 21 through 25 prepared by you or</b></p> <p>3 <b>compiled under your direction and control?</b></p> <p>4 A. Yes, they were.</p> <p>5 <b>Q. In your opinion, is the granting of Matador's</b></p> <p>6 <b>application in the best interest of conservation and the</b></p> <p>7 <b>prevention of waste?</b></p> <p>8 A. Yes.</p> <p>9 <b>Q. And will it protect the interest owners'</b></p> <p>10 <b>correlative rights?</b></p> <p>11 A. Yes, it will.</p> <p>12 MR. BRUCE: Mr. Chairman, I'd move the</p> <p>13 admission of Matador Exhibits 21 through 25.</p> <p>14 CHAIRMAN CATANACH: Any objection?</p> <p>15 MR. GALLEGOS: No objection.</p> <p>16 CHAIRMAN CATANACH: Exhibits 21 through 25</p> <p>17 will be admitted.</p> <p>18 (Matador Exhibit Numbers 21 through 25 are</p> <p>19 offered and admitted into evidence.)</p> <p>20 MR. BRUCE: And I have one final request</p> <p>21 before I turn over the witness. I would request that</p> <p>22 the record for the Division be incorporated into the</p> <p>23 record in this proceeding.</p> <p>24 MR. GALLEGOS: I have no objection. As a</p> <p>25 matter of fact, that appears as our Exhibit 19, which is</p>

**8 (Pages 26 to 29)**



<p style="text-align: right;"><b>Page 30</b></p> <p>1 the transcript. It doesn't include the exhibits, but  2 it's a transcript of the testimony for the Division, and  3 I definitely -- I join in that request.  4 CHAIRMAN CATANACH: Okay. The record in  5 Case Number 15363 from the Division level will be  6 incorporated into this case.  7 MR. BRUCE: And I pass the witness.  8 MR. BRANCARD: Mr. Chairman, I would just  9 sort of caution you-all in using that record. Those are  10 not witnesses that you have cross-examined. Witnesses  11 may have said different things at different times in the  12 hearing below and the hearing here. I think it's  13 useful.  14 I think it might have saved a lot time if  15 you had stipulated that in the beginning. We may  16 wouldn't have had to have witnesses testify, if this  17 became a record review hearing.  18 So I just sort of caution you that really  19 what -- the people testifying before you today and the  20 other exhibits should be the primary source for this  21 hearing; otherwise we're just on a record-review process  22 here.  23 MR. GALLEGOS: Well, Mr. Chairman, I have  24 to differ because I think you have to judge credibility,  25 and I think the transcript below is going to reflect</p>	<p style="text-align: right;"><b>Page 32</b></p> <p>1 CROSS-EXAMINATION  2 BY MR. GALLEGOS:  3 <b>Q. Mr. Robinson, believe it or not, my attention</b>  4 <b>wandered a little bit from your testimony, so I'm going</b>  5 <b>to have to ask some clarification.</b>  6 <b>Did you testify that if the EUR on a well</b>  7 <b>was 250,000 barrels, that that would not result in</b>  8 <b>payout, and so you would not approve drilling a well</b>  9 <b>with that kind of expectation?</b>  10 A. I did not say that.  11 <b>Q. What -- what was the testimony about there</b>  12 <b>wouldn't be payout; you wouldn't approve drilling as far</b>  13 <b>as the projected EUR?</b>  14 A. The number was 200,000, not 250-.  15 <b>Q. All right. That's why I was trying to clarify.</b>  16 <b>200,000.</b>  17 <b>So if you looked at the circumstances and</b>  18 <b>it said to you, We think the EUR is going to be that</b>  19 <b>200,000, I should tell management, Don't drill that</b>  20 <b>well?</b>  21 A. That's correct.  22 <b>Q. Because it would not pay out?</b>  23 A. That's correct, at this cost.  24 <b>Q. At the cost of what? The \$6.4 million AFE?</b>  25 A. That's correct.</p>
<p style="text-align: right;"><b>Page 31</b></p> <p>1 definite conflicts between what has been expressed even  2 by the same witnesses before the Division and what's  3 being expressed here. And it's very valuable in that  4 respect. So we think our Exhibit 19 would provide that  5 information. But if Mr. Bruce -- and I'd join in  6 that -- wants to include the exhibits before the  7 Division, I think that entire record should be  8 considered.  9 MR. BRUCE: And, Mr. Chairman, I disagree  10 with Mr. Gallegos' characterization, but yes, I meant to  11 include the exhibits. Plus, there was a motion hearing  12 transcript regarding the issues that were discussed last  13 week, more or less the same, and I would like that -- I  14 think it was from September 5 of last year. I would  15 like that in the record, too.  16 MR. BRANCARD: It's fine to make it part of  17 the record. It's just what weight you give it, is the  18 point I'm trying to make.  19 CHAIRMAN CATANACH: All right. The  20 Commissioners are well aware of the issues involved in  21 that, so we'll incorporate the exhibits in the original  22 case and the motion -- the record of the motion of the  23 proceeding, also.  24 MR. BRUCE: Thank you.  25</p>	<p style="text-align: right;"><b>Page 33</b></p> <p>1 <b>Q. And how many EURs would you have to expect the</b>  2 <b>well to produce in order for you to recommend to</b>  3 <b>management that it would be drilled?</b>  4 A. I would recommend at least 300,000 barrels  5 be -- be required or be needed before we could justify  6 drilling the well at this cost.  7 <b>Q. At this cost?</b>  8 A. Yes, sir.  9 <b>Q. Now, we have seen some indication that lower</b>  10 <b>well costs are being experienced. Have you given any</b>  11 <b>attention as to whether or not, in view of what's</b>  12 <b>happened in the market and service company charges and</b>  13 <b>so forth, whether the 6.4 AFE would deserve some</b>  14 <b>reduction?</b>  15 A. For this well or for future wells?  16 <b>Q. For this well.</b>  17 A. I think the 6.4 is reasonable for this well  18 given the operational challenges that were described by  19 Mr. Byrd yesterday. Based on the days expected and the  20 completion that we expect, I believe the 6.4 is  21 reasonable. I approve --  22 <b>Q. With that well cost and with 300,000 being what</b>  23 <b>you would say to pay out threshold to Matador, then what</b>  24 <b>would be the amount of EURs for the well in order for</b>  25 <b>nonconsent owners subjected to a 100 percent -- 200</b></p>

**9 (Pages 30 to 33)**

1 percent penalty?

2 A. At what working interest or what revenue  
3 interest? I can't answer that without getting some more  
4 information on what the interests are of that  
5 nonparticipating --

6 Q. Whether they're 1 percent or 5 percent, I'm  
7 just asking what -- you're going to achieve -- or you  
8 expect to achieve payout at 300,000 barrels. Now you  
9 have some nonconsent owners. They're going to be  
10 subjected to a 200 percent penalty. What is the well  
11 going to have to produce for them to ever back-in and  
12 ever receive any revenue?

13 A. At what oil price?

14 Q. The oil price that you're using for your  
15 300,000 that you say will be payout for Matador, same  
16 assumptions, all the same assumptions.

17 A. Okay. So there's -- it's probably not likely,  
18 at 300,000 barrels, that a company that chose not to  
19 participate would back in because we, as operator, would  
20 likely only get our money back, like, maybe one times  
21 payout, plus a little bit more. So there's not a  
22 likelihood at a higher risk charge that a  
23 nonparticipating owner would be able to back in.

24 Q. So would the well have to make a million  
25 barrels of oil before the parties subjected to 200

1 A. Yes.

2 Q. And how many -- what's the EUR on that well?

3 A. That's confidential information. Our company's  
4 policy is not to release reserves on individual wells.

5 Q. Well, how much has it made? That's public  
6 information. How much has it cumed to date in oil and  
7 in gas?

8 A. It's produced about 35- to 40,000 barrels of  
9 oil and probably around 40 million cubic feet of gas.

10 Q. So without revealing company reserves, is this  
11 well seen by you to have the sufficient EUR to justify  
12 drilling it?

13 A. Based on what we expected at the time or what  
14 we know today?

15 Q. Based on what you expected at the time when you  
16 made the decision.

17 A. We had expected the well, at the time, would  
18 produce sufficient quantities of oil and gas to pay out  
19 that well.

20 Q. So at least 300,000 barrels?

21 A. At least 300,000 barrels, yes.

22 Q. All right. Now, in that regard -- so it was a  
23 wildcat well?

24 A. Yes.

25 Q. And with a 10 percent or less likelihood of

1 percent penalty back-in, be able to receive any  
2 compensation?

3 A. No. I don't think it would have to be that  
4 much. I haven't made that calculation, but that seems  
5 like an exorbitant amount to me.

6 Q. 900,000 --

7 A. Again, I haven't made the calculation.

8 Q. -- would do it?

9 A. And I don't know what the net revenue interest  
10 of that particular company might be. Could be they have  
11 overrides. There are a lot of factors that go into what  
12 that might be.

13 Q. Mr. Robinson, let's take a look at Matador  
14 Exhibit 19. I think that was the first one you were  
15 asked about. Do you have that before you?

16 A. Yes.

17 Q. And let's take a look at the Pickard well.  
18 Now, that well appears to be about five miles away;  
19 would you say? Five miles or so --

20 A. Yeah.

21 Q. -- from this Airstrip?

22 A. I would agree with that, yes.

23 Q. That is a lower Wolfcamp well?

24 A. Yes.

25 Q. That was a wildcat well?

1 success that you calculate for this Airstrip well --  
2 that's a wildcat well, in your opinion?

3 A. Yes.

4 Q. And if the calculations were such that the  
5 likelihood of success and Matador's criteria is 25, is  
6 that a wildcat well?

7 A. Yes. It depends on where it is, but that could  
8 qualify as a wildcat well, also.

9 Q. And if, on the other hand, the probability of  
10 success, in the Exhibit 23 criteria, is 75 percent, is  
11 that a wildcat well?

12 A. That probably would not be classified as a  
13 wildcat or exploratory well, the 75 percent chance of  
14 success.

15 Q. Okay. So where are we at 50 percent chance of  
16 success? Is that wildcat, or is that --

17 A. That's in that gray area, right in the middle.  
18 Looking at the Petroleum Resource Management criteria, a  
19 50 percent chance of success falls into a probable  
20 category. So that's, like I said, in that gray area,  
21 where, you know, if you have quite a few wells in the  
22 area that you know are producing but they're several  
23 miles away, then you may look at that as -- as not --  
24 you know, there are different levels of exploratory  
25 risk, too.

There are rank wildcats, and then there are categories that are possible or probable. So that would -- that would be in a higher category that's not considered as risky as a rank wildcat, for example, which would be probably a less than 10 percent chance of success.

So, you know, I have to look -- I can't -- without knowing more information about where the well's located, how many surrounding wells are producing from the same formation, I can't just generalize and say this is a rank wildcat and this isn't.

**Q. If Matador's technical personnel project that a well is going to have a EUR of 400,000 barrels, would you consider that as a probably successful well and not a wildcat well?**

A. No. I would still consider it a wildcat. Just because we calculate or forecast that a well might produce 400,000 barrels, we don't know that to be the case until we drill it and produce it for a while. The Pickard 2H is a great example of that. I can tell you that well's not going to pay out. You may recall Mr. Byrd taking about that well took him over 100 days to drill. I'm not going to tell you how much that cost, but it was substantially more than the AFE. It'll never pay out. Even if it had made the 400,000 barrels, it

**Q. Let's go back to the first Rustler Breaks well. What has that produced?**

A. How much has it produced?

**Q. Yes.**

A. I think that well has produced -- I didn't review it because I didn't know we were going to talk about other areas. But, you know, I think it's made about 75,000 barrels of oil and maybe a half a bcf of gas, somewhere in that range. And I'm happy to get those exact numbers for you, but that's roughly what I remember off the top of my head.

**Q. What was the second Rustler Breaks well?**

A. The second Rustler Breaks well was the Tiger well, I believe.

**Q. Was that a wildcat well?**

A. Yes, it was, because we had targeted the Wolfcamp x-y, which was a completely different zone. That was the first well in the area.

**Q. And that's what you're targeting here; are you not?**

A. No.

**Q. I thought this was designated an A-XY-zoned well. Is that incorrect?**

A. That's not correct.

**Q. What do you call the upper Wolfcamp?**

wouldn't pay out. So the risk associated with drilling these wells is pretty high.

**Q. Matador has done a number of Wolfcamp wells in what's called the Rustler Breaks play; is that correct?**

A. Yes.

**Q. What was the first Rustler Breaks well?**

A. It was our Rustler Breaks #1 well.

**Q. Was that a wildcat?**

A. Yes, it was.

**Q. And what has the result been?**

A. The results of that well were very encouraging. We have since identified better landing zones for the Wolfcamp B in that area, and subsequent wells have been much better. But we were very encouraged by that early result. That well may or may not pay out, so it remains to be seen if it's commercially successful.

But from what we've learned from the well -- and I'll -- I've always been told, Don't say more than what the question's been asked. But going back to the Pickard 2H, we learned a substantial amount from completing that well in the lower Wolfcamp. We're making oil out of the source rock. That's huge. That's worth every penny we spent drilling that well. So we learned a lot from drilling that. Even if it doesn't pay out, it was worth drilling that well.

A. This -- we're calling it the Wolfcamp A. It's the source rock associated with the upper Wolfcamp -- or what we believe to be source rock associated with the upper Wolfcamp. As Dr. Frost testified yesterday, the x-y sands are not present at the proposed location, so this is not an x-y test. It is a resistive porous interval in the upper Wolfcamp. We call it the fat because of the bulging resistivity that's associated with the log characteristics. That's not a technical term. That's something we use around the office. But it's not an x-y.

**Q. How did the Tiger well do? Is it a commercial success?**

A. A huge commercial success, yes.

**Q. And it was a wildcat?**

A. Yes.

**Q. How many barrels of oil has it made?**

A. Again, I don't have that number off the top of my head. I can get that number for you if you'd like. But it's been our best well to date -- or one of the best wells.

**Q. Well over 400,000?**

A. Not -- not so far. Cumulative, it hasn't made that much, no.

**Q. But your expectations are that it will exceed**

1 that? Is that a fact?

2 A. Expectations are, yes, that it will exceed  
3 that.

4 Q. Were there owners -- nonconsent owners subject  
5 to a 200 percent risk penalty in that well?

6 A. I don't know. I don't believe so. I think  
7 Matador has a 100 percent of that, but I can check and  
8 let you know that.

9 Q. So you use the term "commercial success," and I  
10 had some notes because I wasn't too clear on that. You  
11 use that phrase in connection, I believe, as far as SEC  
12 reserve reporting. Is that your testimony?

13 A. Yes.

14 Q. And so the definition of commercially  
15 successful is what, Mr. Robinson?

16 A. That the well will generate a rate of return of  
17 at least 10 percent for nonoperating wells and that the  
18 well will generate a positive rate of return for  
19 operated wells. It can be .1 percent rate of return.  
20 As long as it makes \$1.00 more than it cost, then it's a  
21 commercial success for operated wells.

22 Q. And the assumptions that you're presently using  
23 for the price in the \$6.4 million AFE, if the  
24 expectation of this well of EUR of 400,000 barrels is  
25 realized, is it a commercially successful well?

1 like that in this area.

2 Q. That goes up into 18 South and 19 South, for  
3 example?

4 A. Yes.

5 Q. Are some of the wells -- when it says Wolfcamp,  
6 are any of these wells Bone Spring wells on Exhibit 19?

7 A. No.

8 Q. Is the Bone -- I'm sorry. Were you finished?

9 A. No. Yeah, I was finished.

10 Q. Is the Bone Spring geopressed, high pressured  
11 like the Wolfcamp?

12 A. No. I've never seen it. That's not to say it  
13 might not be somewhere, but I've never seen a Bone  
14 Spring that has geopressure.

15 Q. So we would know that -- in drilling the  
16 Pickard, I think you said that provided a lot of  
17 educational information for Matador going forward?

18 A. Yes.

19 Q. So since it's a lower Wolfcamp, we would know  
20 that it penetrated the Wolfcamp A?

21 A. That's correct.

22 Q. So you have a full suite of logs on the  
23 Wolfcamp A in a well about five miles from the Airstrip  
24 well?

25 A. No. Unfortunately, because of the hole

1 A. We would expect it to be, yes.

2 Q. When I look at your Exhibit 15, I see the  
3 reference up at the top of "Wolfcamp Pool (Pool Code  
4 970)." Can you tell us the areal extent of that pool?

5 A. I cannot.

6 Q. Is everything that's shown on Exhibit 19 within  
7 that -- within that pool?

8 A. I don't know the answer to that question.

9 Q. You had no responsibility in the presentation  
10 of this exhibit?

11 A. I did. That was something that our land  
12 department had put on there, so I assumed that for these  
13 wells and particularly the Matador well, that that was  
14 the proper pool code. But I don't -- I couldn't state  
15 the geographic extent of that pool. I didn't study that  
16 or map that, to answer your question. So I can't tell  
17 you how large of a geographic area that pool covers.

18 Q. You refer to the -- a motivation for drilling  
19 the Airstrip well is proving up a large acreage position  
20 of Matador. Did you share with us that information?

21 A. Yes. I believe that's been made public.  
22 Matador has roughly 90,000 acres net, a little over  
23 150,000 acres gross in the Delaware Basin. Roughly  
24 one-third of that is located in the northern part of the  
25 Basin, so give or take 30,000, 25,000 acres, something

1 problems that we had, we were not able to run a full  
2 suite of logs. We got part of the data throughout most  
3 of the Wolfcamp, but the tools got stuck. And we had  
4 rotary sidewall cores. We had all the modern logging  
5 suites planned, but we didn't get to run them.

6 Q. Did you get enough logging to know the  
7 porosity?

8 A. I believe it did get up high enough to get the  
9 porosity, yes.

10 Q. That wouldn't give you permeability, I take it?

11 A. No.

12 Q. So I guess one way to get permeability would be  
13 to have some cuttings?

14 A. No. You wouldn't really be able to get  
15 permeability from the cuttings. There's been some  
16 discussion about that, but you wouldn't -- there is no  
17 guarantee that cuttings are coming from the formation of  
18 interest. It could be coming from somewhere else in the  
19 hole.

20 Q. Or they could be coming from your A zone if you  
21 have those cuttings. Wasn't there any interest --  
22 investigative interest, that you're going through the  
23 Wolfcamp A, to know something about that part of the  
24 formation when you were drilling the Pickard?

25 A. Of course.

<p style="text-align: right;"><b>Page 46</b></p> <p>1       <b>Q. What did you learn? Not about the Pickard</b>  2       <b>lower, but what did you learn about the Pickard upper?</b>  3       A. I don't remember for sure that we analyzed the  4       cuttings. I'm guessing we did, but I don't know the  5       results of that analysis.  6       <b>Q. What other good way would there be to be able</b>  7       <b>to know the permeability? Let's say you did get the</b>  8       <b>cuttings. You got that. Anything else that would help</b>  9       <b>you?</b>  10      A. Well, certainly actual rotary sidewall cores or  11      whole core that we had planned for that well would give  12      us an estimate on the permeability. There are logging  13      tools, particularly the magnetic resonance type tools,  14      that give you a good indication of permeability and  15      free-fluid saturations. So we had planned those types  16      of tools, again, to rear-end that well. We just didn't  17      get a chance to get that information.  18      <b>Q. Have you sought other log information from</b>  19      <b>wells that were drilled by EOG or anybody else who has</b>  20      <b>penetrated the Wolfcamp -- upper Wolfcamp?</b>  21      A. Oh, yes. We've bought every log we can get our  22      hands on from public logging services. It was mentioned  23      yesterday that we have invested in joining the Delaware  24      Basin Core Lab Consortium to get our hands on as much  25      log and core information as we can. And so we've spent</p>	<p style="text-align: right;"><b>Page 48</b></p> <p>1       there that are going to be very good wells for us. So  2       you don't have to drill a pilot hole to have a success  3       test.  4       We made the decision, as a management team,  5       to go ahead and drill the well instead of drilling the  6       pilot hole and spending the money for the data, and I  7       was part of that decision and agreed with it. Although  8       I would have liked to have seen a pilot hole, I didn't  9       think it was absolutely necessary.  10      <b>Q. You mentioned that Matador has done two pilot</b>  11      <b>holes in, I think you said, exploring the lower</b>  12      <b>Wolfcamp?</b>  13      A. That's correct.  14      <b>Q. Where are those wells, general area? Can you</b>  15      <b>tell us?</b>  16      A. They're roughly 10 to 15 miles southeast of the  17      current location.  18      <b>Q. In drilling those pilot holes, no attention was</b>  19      <b>given to the upper Wolfcamp, which would have been</b>  20      <b>penetrated in order to completes those pilot holes?</b>  21      A. We did gather some data in the upper Wolfcamp  22      there. I believe Mr. Frost -- or Dr. Frost testified  23      that the thermal maturity of those rocks were in  24      question at those locations. So we did have some data,  25      but it didn't meet our criteria. So we did gather</p>
<p style="text-align: right;"><b>Page 47</b></p> <p>1       a substantial amount of money and time and effort to  2       gather as much data as available.  3       <b>Q. Okay. So when you say you don't have any</b>  4       <b>permeability for this Airstrip well, that's not quite an</b>  5       <b>absolute, is it, Mr. Robinson? You do have some -- some</b>  6       <b>information.</b>  7       A. No, I don't. So what -- what information do we  8       have that I don't know about?  9       <b>Q. Well, I thought you suspected there was some</b>  10      <b>cuttings available. Maybe I misunderstood. But if</b>  11      <b>that's the situation, then why would you have any</b>  12      <b>opposition to drilling a pilot hole? Since this is a</b>  13      <b>wildcat prospect, yet so important for tens of thousands</b>  14      <b>of Matador acreage, why not drill the pilot hole and get</b>  15      <b>the information you need?</b>  16      A. I did not have opposition to that idea. I was  17      part of the team that discussed, evaluated and weighed  18      the benefits of drilling a pilot hole. We had drilled  19      two pilot holes in the area and had gathered a  20      substantial amount of information on the lower Wolfcamp.  21      As a management team, we had the decision to make. We  22      could just drill the well and complete it, as we had  23      done in many other areas. Rustler Breaks being one  24      where we successfully drilled. We still don't have a  25      pilot hole in Rustler Breaks, and we have 15-plus wells</p>	<p style="text-align: right;"><b>Page 49</b></p> <p>1       information from those wells.  2       <b>Q. Well, who -- since we've heard from -- we've</b>  3       <b>heard the druthers of Mr. Frost and I think your</b>  4       <b>druthers about a pilot hole. Who made the decision to</b>  5       <b>turn down that kind of research?</b>  6       A. The operating committee at Matador Resources,  7       which I'm a member of.  8       <b>Q. Let's take a look at Exhibit 21, Mr. Robinson.</b>  9       <b>This is a set of reservoir risk factors, and I</b>  10      <b>understand this was prepared by you or you participated</b>  11      <b>in the preparation of it.</b>  12      A. Yes.  13      <b>Q. Would we have seen exactly the same information</b>  14      <b>on, say, the first Rustler Breaks well?</b>  15      A. It would have been very similar. I wouldn't  16      say it would be exactly the same or was exactly the  17      same, but it would be very similar, I think.  18      <b>Q. And the same kind of -- the risk factor</b>  19      <b>presentation for the Tiger well was a wildcat?</b>  20      A. Again, yes, very similar.  21      <b>Q. Okay. Are you drilling this well any</b>  22      <b>differently than those wells with this same kind of</b>  23      <b>presentation?</b>  24      A. What do you mean by drilling differently?  25      <b>Q. I mean, is your approach any different?</b></p>

<p style="text-align: right;"><b>Page 50</b></p> <p>1 A. No. I would say, in general, our approach will  2 be very similar to the -- to the approach we took in  3 drilling those wells. Now, as Mr. Byrd has testified,  4 we've learned a lot about the Basin in the area. We do  5 have some vertical wells and one horizontal in this area  6 of Lea County, so our drilling department has obviously  7 learned quite a bit.</p> <p>8 There have been significant bit advances  9 for accelerating our drilling times. We've learned and  10 optimized our casing designs. We've pumped several --  11 you know, many dozens of hydraulic fracture treatments,  12 so we've tweaked our fracture designs and our  13 completions. So it won't be exactly the same, but it'll  14 be approached in very much the same manner.</p> <p>15 <b>Q. Are any of the Rustler Breaks wells in the same</b>  16 <b>section?</b></p> <p>17 A. Yes. We have multiple wells in the same  18 section.</p> <p>19 <b>Q. All right. Have you -- some of the Rustler</b>  20 <b>Breaks wells, are they four Wolfcamp wells in a section?</b></p> <p>21 A. We haven't drilled four in a section, no.</p> <p>22 <b>Q. What's the situation as far as multiple</b>  23 <b>Wolfcamp wells in the same section? Where does that</b>  24 <b>occur?</b></p> <p>25 MR. BRUCE: Object, Mr. Examiner -- or,</p>	<p style="text-align: right;"><b>Page 52</b></p> <p>1 <b>Tiger wells and the Janie?</b></p> <p>2 A. Yes.</p> <p>3 <b>Q. Well, what I -- what I was trying to understand</b>  4 <b>as far as your risk approach -- let's just say that your</b>  5 <b>Airstrip well, west half-west half, Section 31, does</b>  6 <b>turn out to be a 400,000 barrel well, good results like</b>  7 <b>the Tiger well. Now you're going to drill the second</b>  8 <b>well in Section 31. You're going to do -- you're going</b>  9 <b>to have the same risk profile, the same risk quantity</b>  10 <b>that you show on Exhibit 21?</b></p> <p>11 A. No. I would expect it to be different.</p> <p>12 <b>Q. Okay. You would expect the risk to have been</b>  13 <b>reduced substantially; would you not?</b></p> <p>14 A. I wouldn't qualify that as a substantial  15 reduction in risk. I would agree that the risk would be  16 less.</p> <p>17 <b>Q. My recollection is that you did not attend the</b>  18 <b>Division hearing in this case, did you, Mr. Robinson?</b></p> <p>19 A. No, I did not.</p> <p>20 <b>Q. Have you had an opportunity to read the</b>  21 <b>transcript or otherwise know the testimony of Mr. Juett</b>  22 <b>and Mr. Byrd?</b></p> <p>23 A. I haven't read all of it. I've read parts of  24 it, but I haven't read all of it.</p> <p>25 <b>Q. Did you find anything in their testimony that</b></p>
<p style="text-align: right;"><b>Page 51</b></p> <p>1 Mr. Chairman. I mean, what is the relevance of having  2 four wells if you're drilling one well here?</p> <p>3 MR. GALLEGOS: We're getting there.</p> <p>4 CHAIRMAN CATANACH: Go ahead. You can  5 answer.</p> <p>6 THE WITNESS: In terms of what Matador has  7 drilled or other operators?</p> <p>8 <b>Q. (BY MR. GALLEGOS) Yes, sir. Well, let's start</b>  9 <b>with what Matador's drilled.</b></p> <p>10 A. Matador has only drilled up to two wells in a  11 given section, that I can recall.</p> <p>12 <b>Q. What are the examples of those?</b></p> <p>13 A. We have drilled two wells on the Tiger section.  14 We've drilled two wells in our Janie Conner, although I  15 think we may have drilled a third well in the northern  16 part of the Janie Conner section, which I'm happy to  17 find out. I don't recall off the top of my head. We've  18 drilled two wells in our section. But I'll caution you  19 that even though there are two wells there, they're  20 different horizons. One would be in the x-y sand, and  21 one would be down in the lower -- middle Wolfcamp B, is  22 what we call it. So they're not necessarily at the  23 same -- or in the same reservoir. They're in different  24 reservoirs.</p> <p>25 <b>Q. Okay. And that's true on all of those the</b></p>	<p style="text-align: right;"><b>Page 53</b></p> <p>1 <b>you read with which you disagreed?</b></p> <p>2 A. No.</p> <p>3 <b>Q. Thank you. Those are all my questions.</b>  4 <b>By the way, you forgot. You've also</b>  5 <b>testified before this Commission before.</b></p> <p>6 A. Yeah, I know (laughter).</p> <p>7 <b>Q. You were just asked about the Division, but --</b>  8 <b>A. Yeah. No. I've testified before both, yes.</b></p> <p>9 MR. BRUCE: Just a few follow-up questions.  10 REDIRECT EXAMINATION</p> <p>11 BY MR. BRUCE:</p> <p>12 <b>Q. Mr. Robinson, the Pickard well that you</b>  13 <b>discuss, that shows how risky it is, doesn't it, to</b>  14 <b>drill a well out here?</b></p> <p>15 A. Yes. That's a very good example of the risk  16 associated with drilling wells in this area.</p> <p>17 <b>Q. You hope to get 400,000 ultimate recovery, but</b>  18 <b>just because it's a wildcat well doesn't mean it'll be a</b>  19 <b>failure -- absolute failure; is that correct?</b></p> <p>20 A. That's correct. And that was my point on the  21 Pickard 2H. We learned a substantial amount from  22 drilling that well. It's not going to pay out. But  23 it's a risk we were willing to take, and we learned a  24 substantial amount from that well.</p> <p>25 <b>Q. If you were able to get a full log suite and</b></p>

1 core, does that give you an absolute certainty of future  
2 well performance?

3 A. No, it doesn't. It would take -- it was  
4 pointed out yesterday that those tools only have a very  
5 limited radius of investigation, usually a few feet. So  
6 there's no guarantee that just because you see oil  
7 saturation and permeability and porosity at the wellbore  
8 that it's going to be 500 feet away.

9 Q. Do you even know how a well will perform  
10 without drilling it? Can you ever know that?

11 A. No, I can't. We run models. We make  
12 predictions based on what information we have, but you  
13 never know until you actually drill and complete it.

14 Q. And if a subsequent well is drilled in Section  
15 31, there are the same risk categories that you'd look  
16 at, correct?

17 A. Yes, very much the same risk categories.

18 Q. There may be fewer uncertainties in a well, but  
19 there is still risk?

20 A. Yes. Every well we drill out there has risk.

21 Q. And that would -- by its very nature, since  
22 this is only one well unit, if you drill another --  
23 whatever well you have in Section 31, that would be a  
24 separate well proposal to whoever the interest owners  
25 are, and if you can't get agreement, we're back here in

1 least about in this well?

2 A. That and permeability. We don't know if it's  
3 going to meet our threshold for permeability. That's a  
4 big unknown and the reason for the high-risk profile.

5 Q. And there is no data that you can use to try  
6 and quantify that permeability at this point?

7 A. No.

8 Q. Let me ask you: What has your experience been  
9 with other Wolfcamp wells in regards to drainage areas?  
10 Have you -- is there a correlation -- I mean, have you  
11 correlated that in some of your other wells?

12 A. We have tried to calculate that based on the  
13 performance of our other wells. It's sort of like the  
14 discussion we had earlier on EURs and estimating the  
15 reserves. You have to have pretty significant  
16 production history in terms, you know, of maybe a year  
17 or more before you can get a good estimate of the radius  
18 of drainage or the drainage area. A lot of the  
19 early-time production is just flush production from  
20 around the hydraulic fractures and around the wellbore  
21 that really -- that transient hasn't moved out far  
22 enough to find the boundaries of the drainage area.  
23 That can be years before we know. But we do modeling.  
24 We make those calculations on a regular basis in an  
25 effort to estimate the drainage area.

1 the same process?

2 A. That's true.

3 Q. Thank you.

4 MR. BRUCE: That's all I have,  
5 Mr. Chairman.

6 CROSS-EXAMINATION

7 BY CHAIRMAN CATANACH:

8 Q. Just a couple, Mr. Robinson.

9 With what you know with the data you have  
10 right now, what is your best estimate for EURs for this  
11 proposed well?

12 A. So I do think it has the potential to make up  
13 to 400,000 barrels based on the volumetrics that we've  
14 estimated and the recovery factors. Again, we're making  
15 some assumptions on oil saturation that go into those  
16 volumetric calculations. We don't really know oil  
17 saturation, so we may be -- I'm hoping we're pleasantly  
18 surprised by the low water saturation, but we may --  
19 we've produced a lot of water out of the Wolfcamp wells  
20 in other areas of the Basin, so we know there is  
21 substantial water component to it. We don't know what  
22 that's going to be here. So, you know, again, based on  
23 the volumetrics we've calculated of oil in place, we see  
24 the potential for up to 400,000 barrels.

25 Q. So is the oil saturation the fact that you know

1 What we're seeing, essentially, so far is  
2 the drainage area or the extent of the drainage area is  
3 essentially the length of your hydraulic fractures that  
4 extend away from the wellbore. We haven't seen much  
5 drainage out past those hydraulic fractures that we're  
6 creating down there.

7 Q. So what's the length of your typical hydraulic  
8 fracture?

9 A. That's a really good question. Based on the  
10 analysis that we've done, it's hard to convince  
11 management to shut these wells in so we can get a good  
12 pressure build-up test. But that's really what it takes  
13 in order to estimate the effective propped fracture half  
14 length. But based on some of the modeling we've done  
15 and the rate transient analysis -- there are some other  
16 tools we can use -- we're seeing somewhere on the order  
17 of 300 to 350 feet of effective propped fracture half  
18 length.

19 Q. Have you -- has Matador run any microseismic on  
20 any of these wells?

21 A. We did on a well down in Texas. In Loving  
22 County, we ran microseismic.

23 Q. And is that basically what you came up with; do  
24 you remember?

25 A. We -- we saw on that well -- these wells were

<p style="text-align: right;"><b>Page 58</b></p> <p>1 roughly 660 feet apart. We did see and we often see  2 fluid communication in offset wells. So we did see some  3 of the fracture stages grow from microseismic data over  4 to the offset well. That just meant some of the early  5 fluid that we pumped in reached that offset. And then  6 the proppant, of course, comes in later behind that and  7 effectively props open the hydraulic fracture. We can't  8 get a good idea on the propped fracture half length from  9 the microseismic. We can only get the created length  10 with the fluids that we pump in.</p> <p>11 <b>Q. Do you have an opinion as to how many wells it</b>  12 <b>would ultimately take to develop -- fully develop this</b>  13 <b>section in this --</b></p> <p>14 A. I don't have yet. Again, that's so dependent  15 on the permeability and how much you can drain. I won't  16 really have a good handle on that until I can better map  17 the permeability in this area.</p> <p>18 <b>Q. Okay. That's all I have.</b></p> <p>19 COMMISSIONER PADILLA: Just a couple for  20 you, Mr. Robinson.</p> <p>21 THE WITNESS: Sure.</p> <p>22 COMMISSIONER PADILLA: Thank you.</p> <p>23 CROSS-EXAMINATION</p> <p>24 BY COMMISSIONER PADILLA:</p> <p>25 <b>Q. Looking at Matador's Exhibit 24, you testified</b></p>	<p style="text-align: right;"><b>Page 60</b></p> <p>1 you've got a couple hundred million years to wait. You  2 know, it's feeding a lot of reservoirs up the hole, but,  3 you know, over the 20-year life of the well, it's not  4 doing us a lot of good. But we did prove that it was  5 source rock, that it was capable of generating  6 hydrocarbons, and those hydrocarbons could migrate to  7 other reservoirs. And we're in the process of  8 identifying those.</p> <p>9 You know, the other wells we drilled in  10 Rustler Breaks and down in Loving County all had these  11 risk profiles, particularly Rustler Breaks. Loving  12 County was not at the same level. There were 40 or 50  13 wells that had been drilled in the 3rd Bone Spring that  14 had dripped into and completed in the x-y sand, so we  15 had a better handle on that. So I would say that risk  16 profile was probably not as severe as this. But Rustler  17 Breaks --</p> <p>18 <b>Q. That's the Wolf area, right?</b></p> <p>19 A. That's the Wolf rea, right, in Loving County.</p> <p>20 Rustler Breaks, that was the first x-y well  21 we've drilled there. It was the first anybody had ever  22 drilled. But it was the same target that we had proved  23 down in Loving. We had drilled Loving County first. So  24 our geologist mapped those x-y sands up into the Rustler  25 Breaks area and then identified them, so that gave us</p>
<p style="text-align: right;"><b>Page 59</b></p> <p>1 <b>earlier that the percentage probability of success was</b>  2 <b>similar to industry standard and seemingly, I guess,</b>  3 <b>similar to the percentage bases Matador's experienced</b>  4 <b>elsewhere in this area. Can you give us some kind of</b>  5 <b>ballpark indicator what those might have been for, say,</b>  6 <b>the Pickard 2H or similar wells?</b></p> <p>7 A. So on the Pickard 2H, we had roughly about the  8 same risk profile, something around 10 percent. And, of  9 course, that well is not going to be economic, so that  10 risk profile was, you know, reasonable for that  11 particular prospect. I go back to what we learned from  12 that well. We've identified some zone uphole that look  13 very attractive to us and may be better landing targets.</p> <p>14 It is really important where you land  15 these -- these laterals in terms of finding enough  16 porosity and permeability to provide a good conduit for  17 all of the oil and gas that's feeding in from your  18 source rock. You need that conduit in order to get  19 enough productivity to produce the commercial  20 quantities.</p> <p>21 We drilled the Pickard in the source rock,  22 and the permeability of that source rock was much less  23 than -- we had some estimates of like ten nanodarcies in  24 the source rock, enough permeability for that oil to  25 migrate out over geologic time, great source rock if</p>	<p style="text-align: right;"><b>Page 61</b></p> <p>1 enough confidence to drill the Tiger, which is the first  2 x-y well, and it's a great well.</p> <p>3 <b>Q. Going back to the frac rate, as Chairman</b>  4 <b>Catanach touched on, what zone have you seen in the</b>  5 <b>350-foot propped radius in --</b></p> <p>6 A. Both the Wolfcamp, middle Wolfcamp B and the  7 upper Wolfcamp is the one where we're calculating what  8 the effective frac lengths are.</p> <p>9 <b>Q. Are you getting more down where you have more</b>  10 <b>forgiving reservoir characteristics, say, Wolf or</b>  11 <b>Rustler Breaks?</b></p> <p>12 A. I'm sorry. I didn't --</p> <p>13 <b>Q. Are you getting longer frac radiuses? Do you</b>  14 <b>have any idea if there are more forgiving plays, or are</b>  15 <b>you still shooting for that same radius, I guess, using</b>  16 <b>variances in treatment pressures?</b></p> <p>17 A. We're still shooting for that in our designs.  18 We think that's about the right propped fracture half  19 length for the reservoir properties we're seeing in  20 those areas.</p> <p>21 I had forgotten. We've drilled -- to  22 answer your earlier question, we've drilled several 2nd  23 Bone Spring wells in the Ranger area, which is where the  24 Airstrip well is, and we're seeing fracture half lengths  25 on the same order of magnitude, 300 feet. I think in</p>



<p style="text-align: right;"><b>Page 62</b></p> <p>1 one well we've seen up to 500 feet of propped fracture  2 half lengths. So we have some experience in the 2nd  3 Bone Spring in this area.</p> <p>4 But, of course, the Bone Spring is  5 completely different. It's bounded on two sides by good  6 strong limestone barriers, so you don't have as much  7 fracture or height growth, which is always an issue in  8 the Wolfcamp. We're seeing 300 to 400 feet of fracture  9 height growth in these wells, particularly from the  10 microseismic tests that we did down in Loving County.  11 And, of course, the taller that fracture is, the less  12 fracture length you get. So that's -- that's kind of  13 why we're seeing that 300 or so fracture half lengths.</p> <p>14 <b>Q. Does Matador design most of their frac</b>  15 <b>in-house or use third-party design groups?</b></p> <p>16 A. We design all our fracture treatments in-house.  17 We do depend and rely on the service companies'  18 expertise and experience, particularly in certain areas,  19 so we're constantly talking to them, having meetings  20 where we go over fracture treatment designs, looking at  21 what other people are doing in the area, and we try to  22 benefit from other people's experience.</p> <p>23 <b>Q. Thank you. That's all I have.</b>  24  25</p>	<p style="text-align: right;"><b>Page 64</b></p> <p>1 cost. Now, a month from now, something may be less.  2 And typically we'll tell our partners, if we have  3 partners in well, Hey, we just negotiated a lower  4 wireline cost for setting plugs and perforating, and  5 we're going to save, you know, \$5,000 per stage on this  6 well. That's great. We try to be as transparent as we  7 can. But, yeah, I mean, it's a continual process.</p> <p>8 <b>Q. So it's pretty safe to say that the May 2016</b>  9 <b>AFE, in Exhibit 8A, is probably not the final AFE?</b></p> <p>10 A. I'm betting we'll do better than that. But I  11 do agree with Mr. Byrd, that I think the 28 days is  12 probably a reasonable number.</p> <p>13 There's -- it hasn't been brought up. In  14 this area of the Basin, there is quite bit more chert  15 layers. We've encountered pretty nasty chert layers  16 that just eat our bits up. I mean, we've taken -- Aaron  17 will tell you that, you know, there have been some  18 layers that have eaten up two or three bits.</p> <p>19 So it's a tougher place to drill, no doubt  20 about it. But we're also -- we have a great drilling  21 department who are involved heavily in bit research, so  22 we're trying new bits. We're working with service  23 companies to design new bits that we think can handle  24 these tough chert and the real abrasive rocks that we  25 encounter.</p>
<p style="text-align: right;"><b>Page 63</b></p> <p>1 CROSS-EXAMINATION  2 BY COMMISSIONER BALCH:</p> <p>3 <b>Q. So now we're also looking at the record from</b>  4 <b>the previous hearing about a year ago. Has Matador, in</b>  5 <b>that interim time period, continued to study this</b>  6 <b>proposed well?</b></p> <p>7 A. Yes. Yes, we have.</p> <p>8 <b>Q. So we're safe to assume that if there is</b>  9 <b>discrepancy in answers between last year and this year,</b>  10 <b>I should give more weight to this year's answer from a</b>  11 <b>particular witness?</b></p> <p>12 A. I would, yes. Yeah. We definitely know more  13 today than we did a year ago.</p> <p>14 <b>Q. Similarly with the AFEs -- and Mr. Gallegos</b>  15 <b>touched on this in his questions -- is there a</b>  16 <b>modification process? When do you stop modifying AFEs</b>  17 <b>and go out and drill them?</b></p> <p>18 A. That's a great question. We talk about that  19 all the time. At some point you just have to say, Okay,  20 we're going to go with this AFE, and let's go out and  21 drill it, even if, in the interim period, you know,  22 we're constantly renegotiating or drilling contracts or  23 well completions, the fracture treatment contracts. And  24 so at some point -- we feel confident that as of the  25 date of the AFE, that that's our best estimate of the</p>	<p style="text-align: right;"><b>Page 65</b></p> <p>1 <b>Q. So the Pickard State #2H wildcat, lower</b>  2 <b>Wolfcamp, so you're talking about five miles away from</b>  3 <b>the Airstrip proposed site at that point. And you have</b>  4 <b>well problems, so you didn't get all the information you</b>  5 <b>would have liked. But was there any indication of</b>  6 <b>overpressure in the upper Wolfcamp?</b></p> <p>7 A. We didn't see any, no, only in the lower  8 Wolfcamp.</p> <p>9 <b>Q. In the Pickard?</b></p> <p>10 A. In the Pickard, yes.</p> <p>11 <b>Q. Okay. So that's why you have a high risk for</b>  12 <b>overpressure.</b></p> <p>13 A. Yes.</p> <p>14 <b>Q. Similarly, from the cuttings -- you would have</b>  15 <b>some fresh cuttings from the upper Wolfcamp over there?</b></p> <p>16 A. We would have, yes.</p> <p>17 <b>Q. Do you know if those were analyzed for thermal</b>  18 <b>maturity?</b></p> <p>19 A. I don't remember that we did. I feel pretty  20 confident that Ned and his group have looked at those  21 cuttings and have had those analyzed. I just can't give  22 you any results from that, and I don't remember  23 specific -- the wells after a while kind of start  24 running together.</p> <p>25 <b>Q. I think Dr. Frost's testimony was that thermal</b></p>

<p style="text-align: right;"><b>Page 66</b></p> <p>1 maturity was one of the higher-risk categories --</p> <p>2 A. Yes.</p> <p>3 <b>Q. -- for the Airstrip well?</b></p> <p>4 A. Yes.</p> <p>5 <b>Q. Five miles is a lot closer than 50 miles away,</b></p> <p>6 <b>those other analogs?</b></p> <p>7 A. It is. You're getting close to similar</p> <p>8 environment, deposition. So yeah, you certainly feel</p> <p>9 better about it as you get closer and closer.</p> <p>10 <b>Q. But you're pretty much upslope and into the</b></p> <p>11 <b>thicker Wolfcamp section at Pritchard -- sorry --</b></p> <p>12 <b>Pickard than you are at the Airstrip?</b></p> <p>13 A. Yes.</p> <p>14 <b>Q. So it still could be apples and apples?</b></p> <p>15 A. Still could be, yes.</p> <p>16 <b>Q. How about any natural fractures? Do you</b></p> <p>17 <b>encounter any natural fractures in your Wolfcamp wells?</b></p> <p>18 A. We have seen some in the lower part of the</p> <p>19 Wolfcamp. Again, we don't really have any good</p> <p>20 information on the upper Wolfcamp. I'm hoping we have</p> <p>21 some. And in some of our modeling -- we have modeled</p> <p>22 cases where, you know, you have -- you have natural</p> <p>23 fractures. And then in the case where you don't have</p> <p>24 natural fractures, obviously those are going to enhance</p> <p>25 the productivity of the well. But we haven't really</p>	<p style="text-align: right;"><b>Page 68</b></p> <p>1 lease shape than they are orientation of the stresses.</p> <p>2 <b>Q. So you're not trying to tackle natural</b></p> <p>3 <b>fractures?</b></p> <p>4 A. No.</p> <p>5 <b>Q. Thank you.</b></p> <p>6 A. Uh-huh.</p> <p>7 CHAIRMAN CATANACH: Anything further of</p> <p>8 this witness?</p> <p>9 MR. BRUCE: (Indicating.)</p> <p>10 CHAIRMAN CATANACH: This witness may be</p> <p>11 excused.</p> <p>12 Let's take a break.</p> <p>13 We'll let you set up.</p> <p>14 (Recess 10:09 a.m. to 10:24 a.m.)</p> <p>15 CHAIRMAN CATANACH: Call the hearing back</p> <p>16 to record.</p> <p>17 At this time I'll turn it over to</p> <p>18 Mr. Gallegos.</p> <p>19 MR. GALLEGOS: Thank you, Mr. Chairman. We</p> <p>20 call Harvey E. Yates, Jr.</p> <p>21 HARVEY E. YATES, JR.,</p> <p>22 after having been previously sworn under oath, was</p> <p>23 questioned and testified as follows:</p> <p>24</p> <p>25</p>
<p style="text-align: right;"><b>Page 67</b></p> <p>1 seen any in the upper, but that's, again, more a</p> <p>2 question of lack of data. We have seen some natural</p> <p>3 fractures in some of the more brittle members of the</p> <p>4 lower Wolfcamp.</p> <p>5 <b>Q. Do you have any sense of orientation on those?</b></p> <p>6 A. No. We didn't orient the core. And we do have</p> <p>7 one FMI from our Ranger 12 well, and I believe -- but</p> <p>8 that's right up against the shelf, so even though we got</p> <p>9 an indication of the orientation from that well, it</p> <p>10 being up next to the shelf, that could have altered the</p> <p>11 stress orientation where we don't want to rely heavily</p> <p>12 on that. But we did get an orientation from that one</p> <p>13 well. That's the farthest well, though.</p> <p>14 <b>Q. Okay. I was curious on your Exhibit 19. COG</b></p> <p>15 <b>and EOG and BOPCO are laying down their horizontals and</b></p> <p>16 <b>both of yours are stand-ups.</b></p> <p>17 A. We see that a lot, particularly in the Bone</p> <p>18 Spring and -- but the Wolfcamp down in Texas, we have,</p> <p>19 really, a very good handle on the orientation of the</p> <p>20 hydraulic fractures, and almost everybody is drilling</p> <p>21 the wells in the same orientation.</p> <p>22 If you go further west from here into what</p> <p>23 we call our Arrowhead area, you see as many wells</p> <p>24 north-south as there are east-west. I think they're</p> <p>25 drilled more based on the lease orientation and the</p>	<p style="text-align: right;"><b>Page 69</b></p> <p>1 DIRECT EXAMINATION</p> <p>2 BY MR. GALLEGOS:</p> <p>3 <b>Q. Mr. Yates, you've been sworn previously?</b></p> <p>4 A. Yes, sir.</p> <p>5 <b>Q. Would you state your name, please?</b></p> <p>6 A. Harvey E. Yates, Jr.</p> <p>7 <b>Q. Where do you live?</b></p> <p>8 A. Albuquerque, New Mexico.</p> <p>9 <b>Q. What is your occupation?</b></p> <p>10 A. I'm in the oil and gas exploration business,</p> <p>11 wildcatter in large part.</p> <p>12 <b>Q. How long have you been in that business?</b></p> <p>13 A. I've been in the oil and gas -- well, my dad</p> <p>14 put us on rigs when we were 14, each of his kids, and so</p> <p>15 I've been in the business one way or the other since</p> <p>16 that time.</p> <p>17 <b>Q. We've heard a mention of a company named HEYCO.</b></p> <p>18 <b>What is that company and what relationship, if any, does</b></p> <p>19 <b>that have to you?</b></p> <p>20 A. HEYCO -- my father used to own a quarter</p> <p>21 interest in a company known as Yates Petroleum. We sold</p> <p>22 our interest in Yates Petroleum and assembled his assets</p> <p>23 into a company called Harvey E. Yates Company, and</p> <p>24 that's where HEYCO comes from.</p> <p>25 <b>Q. What has been your general experience in the</b></p>

**oil and gas business in New Mexico?**

A. You mean what have I done in the business?

**Q. Yes. Yes.**

A. Yes. Well, I'm a small operator. I do -- I've done geology. I have done the engineering work, the land work, virtually all phases, all parts of it. I've done accounting work.

**Q. Do you have a college education?**

A. I do. I went, like many of these gentlemen here, to the University of Texas and graduated from there. I went to the University of Texas specifically because of the geology department. I took a large number of geology courses but decided I ultimately wanted to go to law school, and so in later years switched to a pre-law program, graduated with a history degree.

**Q. From the University of Texas or --**

A. Yes.

**Q. And what have you done in the business in other states?**

A. I have operated, over the years, in Texas, but I have participated in wells in Wyoming, Colorado, Texas, New Mexico.

**Q. And when you say you have participated, could you give the Commission some information on your**

Mound, in the Raton Basin, three in the Tularosa Basin, so forth. So that's my love, in a sense, to do that sort of exploration.

But much of what we do -- and we've explored in Chaves County, a lot wells -- San Andres wells' drilling. But we are also a nonoperator, as I stated before, in Texas and New Mexico, Delaware Basin.

**Q. In regard to this particular area where this Airstrip well is proposed, what is Jalapeno's acreage situation?**

A. It's very interesting. Actually, on the west half of the west half of Section 31, we hold no leaseholdings. We have a contractual interest because of an earlier operating agreement. In the whole area, they show us as having 2.9 -- I forget what it was -- 2.6. We actually have something like a 5 percent interest.

**Q. And is that -- that 5 percent, is that recognized in some of the communications with Matador?**

A. Melissa Randle stated the correct figure, from what we can tell, in her letter to me. I don't have an exhibit number but the letter of April 28th.

**Q. Let's see. I think that's -- look at the Matador exhibits.**

A. I don't have those here --

**participation where you were not the operator, but you agreed to participate in wells that were being proposed and drilled by other companies?**

A. I don't know how many wells I have participated in over the years, probably hundreds. But in terms of horizontal wells, I've participated in more than 75, about half of those in Texas and half in New Mexico.

**Q. And who have been the operators, generally, in those 75 or so wells?**

A. In Texas, EOG. In New Mexico, you name a major operator here and they have -- we've probably participated. We haven't with Matador, but they, more or less, just moved in. We have with Devon, Yates Petroleum, Mewbourne and so forth.

**Q. What is Jalapeno Corporation?**

A. Jalapeno Corporation is a company that was formed about 22 years ago, and it was -- into that, I put oil and gas working interests that I had.

**Q. And have you been developing those properties since that time?**

A. Yes. Yes. It is -- primarily, it is an operator. We have operated primarily shallow wells and rank wildcat exploration wells. And we, for instance, through Jalapeno and its predecessor, drilled a rank wildcat in Vaughn, New Mexico, a couple in -- near Wagon

**Q. It was on the --**

A. -- unless these are Matador (indicating).

**Q. No, no. The Matador exhibits.**

MR. GALLEGOS: Mr. Bruce, there was a set on the stand. Did you return it?

MR. BRUCE: I haven't touched it.

MR. GALLEGOS: What happened to the set that was on the witness stand?

MR. ROBINSON: There was a personal set that I had.

MR. GALLEGOS: We had a set with all the other witnesses.

**Q. (BY MR. GALLEGOS) All right. Do you have it now? And what I'm trying to call your attention to is Exhibit 5B in that book.**

A. Yes. That's the letter of March 24th, 2015.

**Q. Who is Melissa Randle?**

A. She was a land person for HEYCO, and once Matador merged with HEYCO's Delaware Basin assets, she became a Matador employee.

**Q. And with your attention to page 2, what information do you have there for the Commission regarding the Jalapeno interest?**

A. On the third paragraph, "As an alternative to participation, MRC Delaware hereby proposes the

<p style="text-align: right;"><b>Page 74</b></p> <p>1 following options covering your 5.097063 percent working 2 interest...."</p> <p>3 <b>Q. What information do you have regarding</b> 4 <b>Matador's acreage in this particular area? I asked that</b> 5 <b>in particular because of the testimony that their</b> 6 <b>acreage positions supported drilling a wildcat with a 10</b> 7 <b>percent chance of success.</b></p> <p>8 A. I'm looking at Jalapeno's exhibits. Matador -- 9 what page is this? Page 40.</p> <p>10 <b>Q. This is the Matador presentation?</b></p> <p>11 A. Yes. It's Matador's presentation.</p> <p>12 <b>Q. And that's Exhibit 18 of the Jalapeno exhibits?</b></p> <p>13 A. It's Exhibit 18, and it's page 40 on that.</p> <p>14 <b>Q. Okay. And what does that -- what information</b> 15 <b>does that provide concerning acreage position?</b></p> <p>16 A. Well, the red on this exhibit, as I understand 17 it, is Matador acreage.</p> <p>18 <b>Q. Can you point the Commission to the location of</b> 19 <b>the Airstrip well, if we're looking at this exhibit?</b></p> <p>20 A. Yes. If you look in the northeast part, the 21 upper and far to your right, the second township to the 22 left, you see Section 31 there.</p> <p>23 <b>Q. And there is a little red square?</b></p> <p>24 A. There is a red square showing the Airstrip 25 acreage.</p>	<p style="text-align: right;"><b>Page 76</b></p> <p>1 opinion expert witness in that category.</p> <p>2 MR. BRUCE: No objection.</p> <p>3 CHAIRMAN CATANACH: Mr. Yates is so 4 qualified.</p> <p>5 <b>Q. (BY MR. GALLEGOS) What do you understand</b> 6 <b>Matador's seeking to have approved in this proceeding?</b></p> <p>7 A. I understand that they seek to force pool the 8 west half of the west half of Section 31 and under 9 circumstances where they would receive the money back 10 for drilling plus a 200 percent penalty.</p> <p>11 <b>Q. Okay. Now, you stated just shortly previously</b> 12 <b>that you've participated in a number of wells to be</b> 13 <b>drilled by other companies. Is that a fact?</b></p> <p>14 A. Yes.</p> <p>15 <b>Q. Why have you declined to participate in this</b> 16 <b>well?</b></p> <p>17 A. Well, at that time, there were several reasons, 18 and I laid those out in my response to Melissa, in my 19 letter of April 28th. But to summarize, we felt the AFE 20 was very high. We had -- earlier, HEYCO had proposed a 21 Bone Spring well in the same location. We had signed 22 the AFE for that. We had consented to that. We did not 23 consent to HEYCO's proposed operating agreement for the 24 reason that it had 100-300 percent nonconsent 25 provisions.</p>
<p style="text-align: right;"><b>Page 75</b></p> <p>1 <b>Q. All right. And then what does this show you</b> 2 <b>concerning Matador's --</b></p> <p>3 A. Well, it's very interesting. They have talked 4 about this being a rank wildcat. I'm in the business of 5 drilling -- I've been in the business of drilling wells 6 that have 10 percent or less chance, like drilling in 7 the Tularosa Basin, like drilling at Vaughan and so 8 forth. And at least one of my requirements has been, if 9 I'm going to drill a well that has a 10 percent -- 5 10 percent, 10 percent chance, I've got to have a big lease 11 spread around it to justify it.</p> <p>12 And you see that actually their acreage -- 13 most of their acreage is off to the west of this, not 14 there. They have some acreage scattered around, but 15 they've also testified that a moving-away creates 16 another wildcat circumstance, another exploration 17 circumstance as opposed to development. So this -- 18 looking at the map causes me to look at their suggested 19 10 percent chance or 9. whatever with some skepticism.</p> <p>20 <b>Q. Mr. Yates, have you previously been qualified</b> 21 <b>to give testimony as an expert in oil and gas lease and</b> 22 <b>well operations before the Oil Conservation Division and</b> 23 <b>the Oil Conservation Commission?</b></p> <p>24 A. Yes, sir, I have.</p> <p>25 MR. GALLEGOS: And we offer Mr. Yates as an</p>	<p style="text-align: right;"><b>Page 77</b></p> <p>1 Matador added, if I remember correctly, it 2 was a 9 -- \$9.1 million AFE. The price went up. But in 3 the meantime, oil prices were dropping. And because we 4 deal with service companies, we knew the cost of 5 drilling was going down, and we knew these related 6 service costs were going down. So we thought Matador's 7 AFE was far too high, and we asked them to redo the AFE 8 with current figures.</p> <p>9 <b>Q. Now, if you turn to Exhibit 5C in the Matador</b> 10 <b>exhibit book, please --</b></p> <p>11 A. Yes, sir.</p> <p>12 <b>Q. -- is this a letter by you, of April 28th,</b> 13 <b>2015, to Melissa Randle?</b></p> <p>14 A. Yes, it is.</p> <p>15 <b>Q. And at that point, Mr. Yates, were you</b> 16 <b>negotiating to seek a voluntary agreement with Matador</b> 17 <b>concerning this Airstrip well?</b></p> <p>18 A. Yes.</p> <p>19 <b>Q. And did you express in this letter basically</b> 20 <b>the position that you've just stated, the problem with</b> 21 <b>the 100-300 nonconsent penalty and what you believed was</b> 22 <b>an overstated AFE?</b></p> <p>23 A. Yes. And I want to talk a little bit about our 24 reasoning.</p> <p>25 100-300 is essentially equivalent, except</p>

**20 (Pages 74 to 77)**

<p style="text-align: right;"><b>Page 78</b></p> <p>1 for the fact that 100-300 does not include the  2 equipment, an issue which I'm going to set aside right  3 here, or it doesn't -- it doesn't allow you to triple up  4 on the equipment charges. But we calculated that we  5 would have to come back in -- if we either nonconsented  6 under an operating agreement or were force pooled, that  7 the well would have to produce over a million barrels  8 for us to come back in. And there's the crux of the  9 problem.</p> <p>10 What's happened in the industry, as I  11 express in this letter, is that in 2003, this Commission  12 established the well-risk rule that has an automatic 200  13 percent, thrust the burden on the protestant, and then  14 came up with what I understand is the Stogner method.  15 That was done during the vertical well era.</p> <p>16 But by 2008, horizontal wells were being  17 drilled. And by the date of this letter, 2015, we had  18 participated in a number of them. We saw that a number  19 of those wells were paying out in a few months. We knew  20 that the risk had dramatically changed. What had  21 happened is the price, the cost of drilling, had gone  22 up. The risk had plummeted.</p> <p>23 When I drill a rank wildcat well, I not  24 only have to have 10,000 acres around it, I've got -- or  25 thereabouts, I've got to have -- in that 10 percent</p>	<p style="text-align: right;"><b>Page 80</b></p> <p>1 and 73 cents, depending on royalties, burdens and so  2 forth. That counts as severance. So say a well costs  3 9.1 million, in this case. If you take the present  4 price of oil, \$45 -- it wasn't that price at that point.  5 It's somewhat different. It had been down to 38 in the  6 interim. But let's take \$45. You divide the dollars.  7 For every barrel that comes in, you end up getting 31,  8 \$32, if it's \$45 oil, after all of this. So you take  9 that figure and divide it into the AFE cost, 9.1, and  10 multiply it by three, and you come up with something  11 like 8 million -- I'm sorry. You come up with something  12 like 800,000 barrels, but you do not have operating  13 costs in there. You plug in operating costs, too, and  14 that'll take you over the million dollar figure -- I  15 mean million barrel figure.</p> <p>16 <b>Q. Did you make similar calculations with a \$6.4</b>  17 <b>million well cost?</b></p> <p>18 A. Yes, we have. And some of that information's  19 going to be presented after us -- I mean after me.</p> <p>20 <b>Q. Let me draw your attention to Exhibit 5E in the</b>  21 <b>Matador book. Is that an August 26th, 2015 letter to</b>  22 <b>you from Van Singleton, Vice President of Land with</b>  23 <b>Matador?</b></p> <p>24 A. Yes, it is. Uh-huh.</p> <p>25 <b>Q. And in particular at that point, were you</b></p>
<p style="text-align: right;"><b>Page 79</b></p> <p>1 chance, if it does come in, I've got to feel that I have  2 the capacity to pay for ten more of those wells that has  3 the potential of creating the revenue to pay for ten  4 more like it, if it's a 10 percent chance.</p> <p>5 Well, what's happened here is the risk has  6 actually plummeted, and this 200 percent rule is -- does  7 not represent reality, does not represent actual risk.  8 It doesn't in these JOAs, and it doesn't here. Because  9 as I've said in this Matador case, you have to produce  10 so much to ever come back in because of the high cost of  11 drilling.</p> <p>12 And I can go through the figures with you.  13 I know you'll agree with me. We can just take a  14 calculator and go through, and you can see, just on a  15 rudimentary basis, how many dollars it would have to  16 produce in order for us to come back in, translate it to  17 barrels, and there you are.</p> <p>18 <b>Q. I was going to ask a question despite that,</b>  19 <b>which is how did you internally come to the conclusion</b>  20 <b>that the well would have to produce a million barrels of</b>  21 <b>oil in order for the nonconsent --</b></p> <p>22 A. I can pull out -- I can pull out a calculator,  23 but let me go through this.</p> <p>24 Every dollar produced from a well in the  25 field, the oil producer gets somewhere between 69 cents</p>	<p style="text-align: right;"><b>Page 81</b></p> <p>1 <b>concentrating, in your negotiations, on this 100-300</b>  2 <b>risk penalty provision? Was that a primary issue?</b></p> <p>3 A. That is the primary issue.</p> <p>4 <b>Q. All right. And in the last paragraph of the</b>  5 <b>letter on the first page, carrying over to the second</b>  6 <b>page, what did Mr. Singleton have to say on behalf of</b>  7 <b>Matador?</b></p> <p>8 A. "While we may not agree with such penalty,  9 based on our experience as an operator of horizontal  10 wells in the area, we disagree with your assertion that  11 a lower risk threshold is more appropriate for  12 horizontal wells. Accordingly, we are unable to  13 accommodate your request for a 100-150 percent penalty.</p> <p>14 <b>Q. Have you taken the position that there would be</b>  15 <b>no risk penalty that you would --</b></p> <p>16 A. No. No, I hadn't.</p> <p>17 And that statement, incidentally -- it had  18 been suggested earlier in testimony that we were just  19 talking about the spacing unit. If they had changed  20 that statement -- I made it very clear in my letter to  21 Mr. Singleton that if they had simply changed the  22 operating agreement to 100-150 rather than 100-300, that  23 it would have covered the entire section.</p> <p>24 <b>Q. And instead, was Matador's position we don't</b>  25 <b>give 1 percent on the 100-300?</b></p>

**21 (Pages 78 to 81)**

1 A. You mean -- I'm not --

2 **Q. Was it Matador's position that it was not**  
3 **willing to give --**

4 A. Yes. Matador's position, as I have understood  
5 it -- and I've talked to several people associated with  
6 Matador -- is that they're not going to give on the  
7 100-300.

8 **Q. And was the proposition to Jalapeno, from**  
9 **Matador, not only 100-300 for the first well, but it**  
10 **would be necessary for Jalapeno to sign a JOA that would**  
11 **have the same --**

12 A. Subsequent wells.

13 **Q. -- for subsequent wells?**

14 A. Consequently, in my estimation, if you're  
15 signing a JOA with that, under these circumstances, that  
16 what you might as well be doing is just giving them the  
17 title to that zone in your property.

18 And I'll say at this point that one of the  
19 things that we have done is examined the results of all  
20 horizontal wells in the four townships -- this is what  
21 we did in the Commission -- I mean in the  
22 Division -- horizontal results in the four townships  
23 surrounding the Airstrip: One dry hole, one well lost,  
24 all other producers. And the vast majority of the wells  
25 pay up. Risk has changed, and that is not recognized in

1 **JOA and it covers the entire section, and it continues**  
2 **with 100-300 --**

3 A. That's right? So you're essentially -- unless  
4 you're going to participate in those wells, you're  
5 essentially giving away that interest. Unless you  
6 feel -- now, at that point we had a \$9.1 million AFE.  
7 Unless you feel that those wells are going to produce  
8 more than a million barrels, you're essentially giving  
9 away your interest.

10 **Q. If Matador had said, All right, we're flexible,**  
11 **your 100-150 percent is an acceptable risk penalty,**  
12 **would you have participated, and we wouldn't be here?**

13 A. I don't know whether we would have  
14 participated. But what I say in my letters to them is,  
15 We will sign the operating agreement. We may or may not  
16 participate, depending on the price of oil at the time,  
17 but you'll be able to go on and drill. And we may --  
18 but that JOA would cover all horizons. It would cover  
19 the Bone Spring as well. And so the next time you might  
20 propose a Bone Spring, we might participate in it.

21 **Q. Why do you not believe that a 200 percent**  
22 **penalty, the so-called 100-300, is not appropriate for**  
23 **these horizontal Bone Spring and Wolfcamp wells in the**  
24 **Permian Basin.**

25 A. We've done analysis, which we did in

1 this 200 percent rule, nor in the antiquated 100-300  
2 percent JOA term.

3 **Q. In your opinion, is it appropriate to continue**  
4 **a 100-300 percent risk penalty for a second, third and**  
5 **fourth well in the same section?**

6 A. No, absolutely not.

7 I'm buying into the notion that proximity  
8 counts, so do not think I'm testifying otherwise. A  
9 mile -- a well 20 miles away -- proximity is a big  
10 issue. On the other hand, I can point out circumstance  
11 after circumstances, like in the last -- the OCD gave,  
12 in their filings here, a list of all the wells that have  
13 been force pooled in the last year, in 2016. You can go  
14 through those wells and see that a number of those wells  
15 were offset wells. So if proximity counts on the one  
16 hand in this Matador case where they're 20 miles away,  
17 why doesn't proximity count if you're drilling an offset  
18 to a producing well in the same zone? Why do you apply  
19 200 percent there?

20 Well, the flexibility in the JOA is not  
21 there, as they're laid out right now. They should be  
22 changed, in my opinion. The orientation of the  
23 regulations related to risk penalty ought to also be  
24 changed to take into account the actual risk.

25 **Q. But was it the position of Matador you sign the**

1 preparation for two things. First off, we do this kind  
2 of work -- this analysis work in order to determine  
3 whether or not we need to participate in wells. But as  
4 we approached the force pooling hearing at the  
5 Commission, we analyzed all the wells in the four  
6 townships surrounding, and here's what we found: That  
7 somewhere between 1 percent of the time and 9 percent of  
8 the time, depending on prices -- prices and depending on  
9 AFE costs, costs of operation, so forth, but only in  
10 that number of percentage of times will the person who  
11 has been force pooled under circumstances of 200 percent  
12 come back in.

13 And so most of the time, these people who  
14 have agreed to that are unaware of what they're doing,  
15 and they're giving away their acreage -- their acreage.  
16 It is absolutely unfair.

17 While that is going on, you see that most  
18 wells pay out. We came up with -- and, again, it  
19 depends on the prices you're talking about, but we came  
20 up with something like 31 percent of the wells paying  
21 out -- I mean -- pardon me -- 71 percent of the wells  
22 paying out, in our analysis. That has changed based on  
23 prices and cost and so forth. And so what you find is  
24 that payout happens and then the operator starts putting  
25 money in his bank account, but you almost never reach

<p style="text-align: right;"><b>Page 86</b></p> <p>1 the point where the 200 percent penalty pays out.</p> <p>2 And I point out that since we were at the</p> <p>3 Commission -- when we were at the Commission, I believe</p> <p>4 84 wells had been drilled -- horizontal wells in those</p> <p>5 townships. Since then, there have been additional</p> <p>6 wells, and now it's 104, I believe, wells drilled in the</p> <p>7 township. Prices have been low. Operators are</p> <p>8 continuing to drill. And why are they doing that?</p> <p>9 Because they're making money.</p> <p>10 In the rank wildcat era circumstance,</p> <p>11 vertical well era, we had to have six times -- we had to</p> <p>12 think that we were going to have six times or more money</p> <p>13 coming out of a well than we put in.</p> <p>14 In this era, that's not the circumstance</p> <p>15 because the risk has dropped. It's much closer to a</p> <p>16 manufacturing operation.</p> <p>17 Now, that said, I appreciate the fact that</p> <p>18 this well is 20 miles from the nearest producer. But I</p> <p>19 do not think, however, that Matador would be drilling</p> <p>20 this well with the paucity of leases around if the 10</p> <p>21 percent actually represented what they feel in terms of</p> <p>22 risk.</p> <p>23 <b>Q. And did you hear testimony today by Mr. Frost,</b></p> <p>24 <b>the geologist, that would indicate a different</b></p> <p>25 <b>percentage than the --</b></p>	<p style="text-align: right;"><b>Page 88</b></p> <p>1 what I heard was correct, and so we asked for the</p> <p>2 production of a rough draft of the testimony. That's</p> <p>3 what this is about.</p> <p>4 But essentially the testimony was that, as</p> <p>5 I understand it, as I read the material, that you have a</p> <p>6 75 percent chance of having a well that will break</p> <p>7 event, pay out.</p> <p>8 <b>Q. (BY MR. GALLEGOS) Do you have an opinion about</b></p> <p>9 <b>the quantity of risk that would be associated?</b></p> <p>10 A. Well, very interestingly, that is more or less</p> <p>11 what we came up with throughout the four townships,</p> <p>12 examining all the wells. We came up with perhaps --</p> <p>13 that would mean 75 percent of the wells are going to pay</p> <p>14 out. 25 percent would not. Those 25 percent, a number</p> <p>15 of them would come close to pay out, but you wouldn't</p> <p>16 quite get there. And we came up with a little more, in</p> <p>17 this surrounding area, in those four townships, maybe a</p> <p>18 30 percent chance that the wells wouldn't pay out that</p> <p>19 we examined. So it's very close.</p> <p>20 <b>Q. And you are -- you are doing business in Texas?</b></p> <p>21 A. Yes.</p> <p>22 <b>Q. And are you participating in wells in Loving</b></p> <p>23 <b>County, Texas just across the state line?</b></p> <p>24 A. No, I'm not. Our wells of participation is in</p> <p>25 the -- with EOG and Eagle Ford.</p>
<p style="text-align: right;"><b>Page 87</b></p> <p>1 A. No. In fact -- his testimony yesterday, right?</p> <p>2 Commissioner Balch was talking to</p> <p>3 Mr. Frost, the geologist. And I think many people</p> <p>4 didn't hear that, but it's absolutely maybe the most</p> <p>5 significant part of the testimony that I have heard in</p> <p>6 these two days. And it was a discussion related to what</p> <p>7 the chances of getting payout are, and the answer was 75</p> <p>8 percent -- 75 percent of getting payout.</p> <p>9 Well, I want to discuss a little bit later</p> <p>10 this issue of risk because I have searched, tried to</p> <p>11 figure out what the rules and regulations and law is in</p> <p>12 the state of New Mexico related to risk. What does it</p> <p>13 mean? And I can go into that later.</p> <p>14 But on this testimony here (indicating), do</p> <p>15 you have any --</p> <p>16 <b>Q. Yeah. That's what I was asking about. And you</b></p> <p>17 <b>have the --</b></p> <p>18 A. Do you want me to read this?</p> <p>19 <b>Q. Yeah. I'd like for you to read that.</b></p> <p>20 A. This is a question by Mr. Balch.</p> <p>21 (The court reporter interrupted the</p> <p>22 proceedings concerning the witness reading</p> <p>23 from a rough draft of testimony.)</p> <p>24 THE WITNESS: There is a rough draft, but</p> <p>25 because I heard this yesterday, I wanted to be sure that</p>	<p style="text-align: right;"><b>Page 89</b></p> <p>1 <b>Q. Eagle Ford.</b></p> <p>2 <b>What -- what -- what is the situation</b></p> <p>3 <b>regarding force pooling and risk penalties when you do</b></p> <p>4 <b>business in that state.</b></p> <p>5 A. Well, in 2009, there was a case, a Barnett</p> <p>6 shale case, where the Commission was asked to force</p> <p>7 pool.</p> <p>8 <b>Q. Are you talking about the Railroad Commission?</b></p> <p>9 A. Railroad Commission.</p> <p>10 And in that case, they awarded the cost of</p> <p>11 the well but no risk penalty. However, in many, many</p> <p>12 cases, they have awarded --</p> <p>13 MR. BRUCE: Again, I would object to Texas</p> <p>14 Railroad Commission proceedings. They're totally</p> <p>15 inapplicable and not relatable to New Mexico statutes</p> <p>16 and regulations.</p> <p>17 MR. GALLEGOS: Well, we're talking about</p> <p>18 the risk, about how it's evaluated, and it's important</p> <p>19 information to know when we're drilling. Just because</p> <p>20 of a state line doesn't make a difference.</p> <p>21 THE WITNESS: Well, the other part is</p> <p>22 Mr. -- Senor, you suggested in your opening statement</p> <p>23 that if the 200 percent risk penalty were eliminated,</p> <p>24 that you would see far less horizontal drilling. So why</p> <p>25 isn't it relevant to look in a state that has -- the</p>

**23 (Pages 86 to 89)**

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<p style="text-align: right;"><b>Page 90</b></p> <p>1 largest producing state and see what they do there? Has 2 drilling diminished over there?</p> <p>3 Also, there's been testimony that we need 4 to look and see what is customary. Well, why isn't what 5 Texas does part of the balance in terms of what is 6 customary?</p> <p>7 CHAIRMAN CATANACH: Hang on a second. 8 (Consultation off the record.)</p> <p>9 CHAIRMAN CATANACH: I think we'll let him 10 proceed on this line.</p> <p>11 THE WITNESS: If I could?</p> <p>12 <b>Q. (BY MR. GALLEGOS) Yes. Yes, just do that.</b> 13 <b>Complete this testimony regarding the Texas situation.</b></p> <p>14 A. When I went to look at Texas, I was attempting 15 to ascertain an answer to this question: What is risk? 16 What's the risk?</p> <p>17 If you look at the law in the state of New 18 Mexico, this is what is said related to imposition of 19 penalty. At 70-2-17 -- and I won't read the whole 20 paragraph unless you want me to, but you're very 21 familiar with it, no doubt. "But which shall 22 include" -- this is penalizing someone -- this is what 23 happens to someone who doesn't participate in a well: 24 "But which shall include the reasonable charge for 25 supervision and may include a charge" -- "and may</p>	<p style="text-align: right;"><b>Page 92</b></p> <p>1 half the wells did. So the Texas Railroad Commission 2 awarded a 50 percent -- not a 200 percent but a 50 3 percent penalty. And so the operator would get back the 4 cost of drilling. And this is 75 percent leases, I 5 believe, not 80 percent. But the operator would get 6 back cost of drilling, plus 50 percent, and then the 7 party would come back in.</p> <p>8 In other words, they did not go through a 9 convoluted -- I'm going to go into the Stogner approach 10 here. But what they did was have -- they looked at it 11 as economic risk. Do you have a payout? Do you not 12 have payout? And that's why when I heard Mr. Frost's 13 testimony, it was so significant. Because as I 14 understand it, he testified that they had a 75 percent 15 chance of payout in this well, and thus a 25 percent 16 chance of not -- of not having payout in the well.</p> <p>17 Well, let me talk a little bit --</p> <p>18 <b>Q. Mr. Yates, let me ask you a question. We've</b> 19 <b>had a presentation here by Matador in which they've</b> 20 <b>addressed support for the risk penalty, speaking to</b> 21 <b>geologic risk, reservoir risk, operational risk, those</b> 22 <b>three factors. Let me ask, first of all, do you know of</b> 23 <b>anything in the rules of the Commission or the Division</b> 24 <b>that say that's the standard, that's the measure that --</b> 25 <b>for arriving at risk penalty?</b></p>
<p style="text-align: right;"><b>Page 91</b></p> <p>1 include a charge for risk involved in the drilling of 2 such well which charge shall not exceed 200 percent of 3 the nonconsenting owner," and so forth. "Owner share of 4 the cost of the drilling and completing the well." 5 Well, if you look at this closely, "may include a charge 6 for the risk of drilling such well." Does that mean 7 that the question is, in the statute, drilling the well 8 down and that's it, that you do not take into account 9 economic risk? Do you get the well down or not? Is 10 that the risk they're talking about? Well, you know and 11 I know that that's not the approach the Commission has 12 taken.</p> <p>13 So I went to look to see what Texas did 14 because they have much the same issue. And in Texas, 15 they -- as I started to say a minute ago, in 2009, they 16 were asked to force pool. They gave -- they awarded the 17 cost of drilling the well. In other words, the operator 18 could get that back. And then you can find cases where 19 they -- in addition, they awarded 10 percent.</p> <p>20 But in 2014, they changed. What they did, 21 they were presented with a Barnett shale circumstance, 22 where an operator wanted to force pool the people 23 around. They came in with the economic data for a 24 five-mile radius. And what they showed is that 25 approximately half the wells never reached payout and</p>	<p style="text-align: right;"><b>Page 93</b></p> <p>1 A. No. Except that in 2003, a number of major 2 operators in the state -- Mr. Bruce represented three of 3 them -- two of them at that point, in the 2003 hearing. 4 Mr. Stogner was on the stand, and he testified about 5 what the Commission had been doing, and he broke risk 6 down into three parts.</p> <p>7 Now, Matador suggested that we weren't 8 doing risk analysis correctly because we're not 9 multiplying. What we did was follow Stogner because 10 that's the only thing that we could find from the 11 Commission -- and I'd be pleased if you'd point out some 12 alternative that deals with risk. I do not think that 13 the Stogner method is particularly rationale for a 14 variety of reasons, but it is what we had.</p> <p>15 So when we went to the Division, we 16 followed the Stogner method. The Stogner method 17 categorized geology. They separated geology from 18 reservoir, which has been convoluted in Matador's 19 approach here. And I know why, because often we said -- 20 we talk about, in the oil industry, Well, what's the 21 geologic risk? And we mix them. But Stogner separated 22 them out. In Stogner's approach, the only question for 23 geologic risk was is the horizon there?</p> <p>24 So in the Division, we showed that the 25 Wolfcamp had been penetrated in the four townships 300</p>

**24 (Pages 90 to 93)**



<p style="text-align: right;"><b>Page 94</b></p> <p>1 times. So there is no question that the Wolfcamp's  2 there. So zero possibility -- zero risk on whether the  3 Wolfcamp is there in this -- in this area. And that's  4 why the Commission reduced the penalty in their award,  5 by the portion that Stogner had allocated to each of the  6 three parties, 66 percent. That's why -- that's why  7 they reduced it.</p> <p>8 Now, in reservoir risk, he threw in all of  9 the stuff having to do with will the rock produce. Do  10 you have porosity there, thermal maturity? All those  11 things were in that next 66 percent.</p> <p>12 I particularly enjoyed Mr. Frost's  13 testimony. I learned from it. I appreciate that there  14 are questions there because of the lack of proximity.  15 But there's not a geologic risk based on the way Stogner  16 analyzed it, which is the only guidance that I have seen  17 from the Commission. I may be wrong. I'd appreciate it  18 if you'd point it out to me.</p> <p>19 Then there is operational risk. Now, we  20 presented those four townships and showed that among  21 all 84 wells, that there had been one dry hole, and it  22 was a Delaware well drilled -- because we looked at all  23 horizontal wells -- one Delaware well produced on the  24 edge of the four townships, dry hole, only horizontal  25 dry hole, and that there had been one well lost. It</p>	<p style="text-align: right;"><b>Page 96</b></p> <p>1 and they have lost circulation -- lost circulation, the  2 company experiences that, in the next AFE, they're going  3 to up the AFE to cover those contingencies. What I'm  4 not sure everyone heard in Mr. Byrd's response was that  5 in this AFE they had raised it because it was -- it was  6 a way -- it wasn't in an area where they had drilled.  7 They raised the contingency. Well, why did they do  8 that? To cover some of these risks.</p> <p>9 But in any case, all this discussion about  10 operational risk, I mean, yes, Stogner put it in there,  11 but really nobody's arguing. They should get all their  12 money back from whatever -- from our proportional of the  13 shared production for whatever cost to drill the well  14 and complete it.</p> <p>15 <b>Q. Let me ask you, Mr. Yates, to go to our Exhibit</b>  16 <b>8. Would you identify that?</b>  17 A. Yes. I believe this is what we presented  18 before the Division; is that correct?  19 <b>Q. No. No.</b>  20 A. Revised -- oh, 6.5.  21 <b>Q. No. This is -- this is your analysis of</b>  22 <b>Matador's analysis and the factors that they gave their</b>  23 <b>25 percent --</b>  24 A. I'm not on the right page here. You say it's  25 Exhibit 8?</p>
<p style="text-align: right;"><b>Page 95</b></p> <p>1 happens to have been drilled by Matador. One well lost.  2 Now, there's been a lot of discussion. And  3 in the Division, what I suggest is that the operational  4 risk should be 184ths just based on that fact. Matador  5 attacked me, saying, Well, aren't there all of these  6 other risks? And you have heard about all these  7 other -- all these other risks. Well, keep in mind that  8 nobody here is suggesting that Matador should not  9 receive back proportional from our interest whatever it  10 costs to drill the well, even if it's a million dollars  11 higher. Nobody's arguing about that. The whole  12 argument is 200 percent.</p> <p>13 Also please note that -- and I'm not sure  14 that everyone heard this yesterday. A Commissioner was  15 asking the drilling engineer, Aaron Byrd, I think was  16 his name, about the AFE, the current AFE. And the  17 Commissioner pointed out, Well, your -- let me find that  18 AFE here.</p> <p>19 Exhibit 16A, I think --  20 <b>Q. Yeah.</b>  21 A. -- pointed out that there is a contingency of  22 439,000. Well, in their earlier AFE, the 9.1, I had  23 pointed out that those contingency fees are meant to  24 take care of a variety of problems.  25 If the drilling engineers go into a company</p>	<p style="text-align: right;"><b>Page 97</b></p> <p>1 <b>Q. Exhibit 8 in the Jalapeno exhibits.</b>  2 MR. BRUCE: Mr. Gallegos, I don't think he  3 has the revised exhibit.  4 MR. GALLEGOS: Oh, thank you.  5 THE WITNESS: Thank you.  6 <b>Q. (BY MR. GALLEGOS) Did you need a minute?</b>  7 <b>Did you prepare that, Mr. Yates?</b>  8 A. Yes. Yes, I did.  9 <b>Q. Before we get into the contents of it, what was</b>  10 <b>the source of information you were using?</b>  11 A. These are all Matador's figures just compiled a  12 different way. They were Matador's figures put into a  13 Stogner system.  14 <b>Q. So what does that show?</b>  15 A. Well, they suggested that there is a 25 percent  16 geologic risk. And, again, the problem here is they're  17 not following Stogner method, because the only issue in  18 Stogner is whether -- for geologic, is whether the zone  19 is there or not. And I know where he came up with that,  20 because lots of times in exploration, we will say, Drill  21 on the nose. Or you'll be drilling for the  22 Mississippian or the Fusselman or something, and you'll  23 drill down, and lo and behold, the zone isn't there.  24 It's not there. So I'm sure that's where he came up  25 with that notion is the horizon there.</p>

**25 (Pages 94 to 97)**

<p style="text-align: right;"><b>Page 98</b></p> <p>1       <b>Q. What is the P, the capital P? Like you've got</b>  2       <b>P-G --</b>  3       A. Probability of success. These are probability  4       of success.  5       <b>Q. And was that 25 percent --</b>  6       A. 25 percent.  7       <b>Q. -- the number that Matador placed on it?</b>  8       A. Right.  9       So I multiplied that. Now, Stogner broke  10      200 percent down into three parts, 66 percent each. And  11      so what I'm doing is taking probability of success times  12      what he allocated for it, 66 percent, and ending up with  13      1.65. I've done the same with reservoir based on what  14      they said. There's 50 percent of the reservoir, so you  15      end up with .33.  16      <b>Q. When you say "they said," just for the record,</b>  17      <b>Matador's presentation before the Commission?</b>  18      A. Matador, yes. And they say there is a 75  19      percent chance of success in the reservoir -- I mean --  20      pardon me -- in operational. And I multiply that times  21      66. So they're saying, in earlier testimony, We don't  22      know what we're doing because you should multiply  23      figures together and so forth and risk and so forth. I  24      grant that ordinarily when we do risk analysis, we  25      don't -- I don't agree with the figures they've</p>	<p style="text-align: right;"><b>Page 100</b></p> <p>1      talking about? I mean, you could talk about several  2      things.  3      For instance, under the statute, if you  4      look at the statute, it could be risk of getting the  5      well down or not. Does it produce? That's irrelevant.  6      Risk of getting the well down. Or you could jump way  7      ahead and say, Well, what we're going to do is -- the  8      real risk is does the operator get 12 percent or 15  9      percent return on investment? That's the risk we're  10     talking about. I don't think so.  11     Texas method is: Do you get your money  12     back or not? If you put -- your risk, in putting money  13     down on the table, is are you going to get it back? And  14     that's what the Texas method is.  15     <b>Q. Mr. Yates, are you familiar with the concept of</b>  16     <b>correlative rights?</b>  17     A. Yes.  18     <b>Q. What do you -- what do you -- what is your</b>  19     <b>understanding of that phrase in this oil and gas</b>  20     <b>business?</b>  21     A. Well, correlative rights essentially means  22     that -- Mr. Bruce asked this. You're jumping ahead of  23     Mr. Bruce. He loves to ask this question. It means the  24     opportunity afforded, so far as it's practical to do so,  25     to each owner in a pool to produce without waste his</p>
<p style="text-align: right;"><b>Page 99</b></p> <p>1      allocated, but our job has been -- because this is the  2      guidance we have to impose them in this Stogner method.  3      Well, in that case, you end up with .99 chance of  4      success, so you deduct that from 200 percent. And what  5      are you left with? You're left with 101 percent  6      chance -- 101 percent risk penalty in that circumstance.  7      Now, the correct method, I think, is to  8      take -- what I had below, and you have 25 percent  9      geologic risk based on what they've said --  10     <b>Q. You're using 100 instead of the 200?</b>  11     A. That's right.  12     And then you -- so you end up with .835,  13     and then you have reservoir risk or 50 percent times --  14     and on. So it's essentially the same. But you end up  15     with .49, about a 50 percent chance of failure under  16     those -- using the Stogner method, rather than 10  17     percent.  18     And I want to -- though I analyzed it this  19     way, I did it because that is what I understand the  20     Commission has been doing, following the Stogner method,  21     and the Division. I do not think that the Stogner  22     method is necessarily the most rationale system, that  23     there is -- I think the Texas system, where you're  24     looking at a simple question: Are you going to pay out  25     or not -- when you talk about risk, what are you really</p>	<p style="text-align: right;"><b>Page 101</b></p> <p>1      just and equitable share of oil and gas or both in the  2      pool.  3      <b>Q. From your -- from your -- from your addressing</b>  4      <b>this entire risk situation, what is your opinion for the</b>  5      <b>Commission as to the impact in correlative rights of a</b>  6      <b>200 percent risk penalty versus, let's say, a 50 percent</b>  7      <b>risk penalty?</b>  8      A. Well, first off, correlative rights are taken  9      because the wells aren't going to pay out and the  10     operator gets -- gets it all. They should have --  11     <b>Q. Is that with reference to a 200 percent risk</b>  12     <b>penalty?</b>  13     A. 200 percent risk penalty.  14     I think that the people against whom the  15     Commission has imposed, in this horizontal drilling era,  16     a 200 percent risk penalty have lost their correlative  17     rights, and they're, for the most part, going to get  18     nothing back.  19     <b>Q. Let me -- let me turn to a bit of a different</b>  20     <b>subject here. Is -- in the industry, is an accepted</b>  21     <b>meaning given to the word "drilling"?</b>  22     A. I'm going to go drill a well? Yup.  23     <b>Q. Because our statute that you referred to,</b>  24     <b>70-2-17, is speaking to the risk penalty, and it refers</b>  25     <b>to drilling.</b></p>

**26 (Pages 98 to 101)**

- 1 A. Yes.
- 2 **Q. What does that mean?**
- 3 A. It means to get a rig out there, prepare the
- 4 location and drill the well to the total depth you hope
- 5 to reach.
- 6 **Q. Would you say that's the accepted meaning given**
- 7 **to that term?**
- 8 A. Yes, I think so. I mean, it involves also such
- 9 things as running surface casing and running whatever
- 10 pipe needs to be run in order to get down to total
- 11 depth. But it generally does not mean production --
- 12 running production casing.
- 13 **Q. Is there an industry-accepted meaning for**
- 14 **completion?**
- 15 A. Yes. Once you do that, what I've talked about,
- 16 you would analyze the hole or take the information you
- 17 get from the rock, from the electric logs and so forth
- 18 and from what you see, in some cases, coming out the
- 19 borehole, whether you get oil or gas coming out, and
- 20 make a decision to complete, and you run pipe in,
- 21 perforate the pipe and stimulate it, and that's
- 22 completion.
- 23 **Q. Okay. Stimulate means by hydraulic fracturing**
- 24 **and --**
- 25 A. Or acidizing.

- 1 **Q. Now, is there a third phase?**
- 2 A. Equipping. Equipping the well. Putting
- 3 equipment on it.
- 4 **Q. All right.**
- 5 A. I'd like to point something else out because of
- 6 the testimony related to the fact that horizontal
- 7 drilling has changed. Actually, the Commission -- the
- 8 Commission imposed what we called the Pit Rule several
- 9 years ago and then altered the Pit Rule. But the long
- 10 and short of it is that -- I drilled several vertical
- 11 successful wells. And in this era, because you can't
- 12 let a well blow out and you really can't put much oil in
- 13 the pit, what we do is move equipment on right away and
- 14 before we start flowing the well back or pumping --
- 15 pumping the well. And that equipment is fungible.
- 16 The reason there is less risk there in the
- 17 JOA -- it's 100 and you don't get the penalty -- is you
- 18 can take that and use it on the next location. You can
- 19 take it and sell it. You don't have -- you don't have a
- 20 risk there. You cannot go recover that cemented pipe
- 21 out of the hole. Therefore, the penalty is greater
- 22 there.
- 23 **Q. Okay. And you touched on the JOA, but I just**
- 24 **wanted to call this back to the Commission's attention.**
- 25 **If you look at Exhibit 7 in the Matador book, that's a**

- 1 **JOA?**
- 2 A. Yes, it is. Uh-huh.
- 3 **Q. And at the bottom of page 5, does the agreement**
- 4 **speak to where 100 percent, not the 300 percent, would**
- 5 **be applicable?**
- 6 A. Yes. Do you want me to read that or --
- 7 **Q. Yes. I think that would be helpful for the**
- 8 **record.**
- 9 A. And this has to do with a nonconsent penalty.
- 10 "100 percent of each Non-Consenting Party's share of the
- 11 cost of any newly acquired surface equipment beyond the
- 12 wellhead connections (including, but not limited to,
- 13 stock tanks, separators, treaters, pumping equipment and
- 14 piping) plus 100 percent of each Non-Consenting Party's
- 15 share of the cost of operation of the well commencing
- 16 with first production and continuing until each such
- 17 Non-Consenting Party's relinquished share shall revert
- 18 to it under the provisions of this Article, it being
- 19 agreed that each Non-Consenting Party's shares of costs
- 20 and equipment will be that interest which would have
- 21 been chargeable to each Non-Consenting Party had it
- 22 participated in the well from the beginning of the
- 23 operation."
- 24 **Q. Now, it was pointed out, Mr. Yates, that in the**
- 25 **300 percent penalty, there is reference to -- and it**

- 1 **appears on page 6 of this document -- reference to the**
- 2 **wellhead connection. Can you help as to what that is**
- 3 **referred to in the industry?**
- 4 A. Well, wellhead connection is a connection to
- 5 the pipe down the hole, tubing and casing and so forth,
- 6 and tying it into the --
- 7 **Q. On this point, please refer to Exhibit 16A in**
- 8 **the Matador exhibit book. It should be the AFE.**
- 9 A. It is. Yeah.
- 10 **Q. Okay. Do you -- do you place any significance**
- 11 **on the fact that the AFE, when it comes to intangible**
- 12 **costs, it has a contingency amount in this case of about**
- 13 **\$439,000, but for tangible costs such as surface casing**
- 14 **and so forth, there is no contingency?**
- 15 A. That's right, because the cost is known. The
- 16 operator often will have bought it ahead of time to use
- 17 in this well or that, and so the cost is known.
- 18 **Q. And as you've testified, if it turns out that**
- 19 **there is a risk and the well's not successful, equipment**
- 20 **goes to another well or --**
- 21 A. Generally. And I will say that sometimes
- 22 you'll see a contingency charge in this area, the
- 23 equipment, where the prices are moving up and down,
- 24 where the price of steel -- they're afraid steel prices
- 25 are going up, so they will sometimes put a contingency.

<p style="text-align: right;"><b>Page 106</b></p> <p>1       <b>Q. Is there any justification for placing a 300</b>  2       <b>percent penalty on surface equipment?</b>  3       A. Not in my opinion.  4       <b>Q. I think, other than our Exhibit 8, every</b>  5       <b>exhibit I refer to has already been admitted, so I --</b>  6       <b>yes.</b>  7               MR. GALLEGOS: I move the admission of  8       Exhibit 8 and pass the witness.  9               CHAIRMAN CATANACH: Exhibit 8 will be  10       admitted.  11               (Jalapeno Corp. Exhibit Number 8, revised,  12               is offered and admitted into evidence.)  13               CROSS-EXAMINATION  14       BY MR. BRUCE:  15       <b>Q. Now, Mr. Yates, you mentioned Dr. Frost's 75</b>  16       <b>percent comment. Isn't that really a 75 percent chance</b>  17       <b>the well would make some oil?</b>  18       A. No. No. It was -- my memory it was 75 percent  19       of payout -- chance of payout.  20               THE WITNESS: And if you'll move to allow  21       the admission of the document here that she (indicating)  22       says ought not to be admitted, we can examine that in  23       detail.  24               MR. BRUCE: I would simply caution the  25       Commissioners to look at the transcript, because I</p>	<p style="text-align: right;"><b>Page 108</b></p> <p>1               THE WITNESS: Pages 12 and 13.  2               MR. BRUCE: Also page 11.  3       <b>Q. (BY MR. BRUCE) Now, first I want to ask you,</b>  4       <b>you mentioned the Texas Railroad Commission. Do you</b>  5       <b>have any order numbers or any type of reference to those</b>  6       <b>cases?</b>  7       A. If you'll look at Oil and Gas Docket Number  8       09 -- I'll be glad to give you a copy of this if you  9       would like.  10       <b>Q. Thank you.</b>  11       A. 09-0284751, which is a final order, and it's  12       application of Vantage Fort Worth Energy, LLC pursuant  13       to the Mineral Interest Pooling Act for the formation of  14       a pooled unit for the Rosedale North 7H MIPA unit, Well  15       Number 7H Newark East Barnett Shale Field, Tarrant  16       County, Texas. That's one.  17               Also look at Railroad Commission of Texas  18       Hearing Division, Oil and Gas Docket Number 09-288329,  19       which covers the same matter. And on page 7, it  20       addresses risk penalty, and I'll be glad to go into that  21       with you.  22       <b>Q. I just wanted references.</b>  23               Let's go to your exhibits. Just go to your  24       <b>Exhibit 1 for a second. Mr. Gallegos said all of these</b>  25       <b>documents are part of the record.</b></p>
<p style="text-align: right;"><b>Page 107</b></p> <p>1       looked at that, too, and I think there is a big  2       difference between what Mr. Yates recalls and what I  3       recall.  4               THE WITNESS: Can we read it?  5               MR. BRUCE: No. I'll let the Commissioners  6       read it.  7               MR. GALLEGOS: But maybe we should make an  8       exhibit because I think it is appropriate for the --  9               MR. BRUCE: No. I would rather not. I  10       object. Like she said, it's not certified.  11               MR. GALLEGOS: All right. Well, then once  12       it's in final and certified, can that be made an  13       exhibit?  14               CHAIRMAN CATANACH: It's part of the  15       record.  16               MR. GALLEGOS: Yeah. It'll be part of the  17       record anyway.  18               CHAIRMAN CATANACH: Do you know -- does it  19       have a page number?  20               MR. BRUCE: That may not be a page number,  21       but it's Dr. Balch's cross exam about -- it looks to be  22       about ten pages into his examination of Dr. Frost.  23               MS. ARNOLD: Page 11, line 10.  24               MR. BRUCE: Yeah. It'll have a different  25       page number in the final record.</p>	<p style="text-align: right;"><b>Page 109</b></p> <p>1       A. That is a letter from Harvey E. Yates Company.  2       <b>Q. Correct. Yeah, their original well proposal.</b>  3       <b>This was a Bone Spring proposal?</b>  4       A. Correct. Uh-huh.  5       <b>Q. And they also proposed a section-wide JOA; did</b>  6       <b>they not?</b>  7       A. They did. Uh-huh.  8       <b>Q. And their AFE for a Bone Spring well --</b>  9       A. 7.3 million.  10       <b>Q. So now Matador is proposing a deeper well, a</b>  11       <b>more complicated well, and it's a lower AFE?</b>  12       A. Yeah, because prices come down. I congratulate  13       them for doing that. I wish they had presented that  14       during the Division hearing.  15       <b>Q. And in looking at -- and this goes into the</b>  16       <b>risk involved, you testified what the Railroad</b>  17       <b>Commission did in those cases is look at all wells in</b>  18       <b>the Barnett shale.</b>  19       A. Within a five-mile radius, and these were gas  20       wells. And what they look to see is what portion of  21       those wells would pay out and what portion wouldn't, and  22       that was the key issue.  23       <b>Q. And how many upper Wolfcamp wells are there</b>  24       <b>within five miles -- completed horizontal Wolfcamp</b>  25       <b>producers within five miles of Section 31?</b></p>

**28 (Pages 106 to 109)**

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- 1 A. There are none.  
 2 Matador -- I'll supplement that. Matador,  
 3 in its statements to us, suggested the Wolfcamp would be  
 4 better than the Bone Spring, and so we looked at all the  
 5 Bone Spring wells to analyze them.  
 6 **Q. And there are differences between Bone Spring**  
 7 **and Wolfcamp wells?**  
 8 A. Yes, sir.  
 9 **Q. There's depth, deeper formation?**  
 10 A. Slightly deeper.  
 11 **Q. Usually higher pressures?**  
 12 A. Usually higher pressure. I have some  
 13 experience with the Wolfcamp.  
 14 **Q. And oftentimes the need for extra casing**  
 15 **string?**  
 16 A. Yes.  
 17 **Q. Looking at Matador Exhibit 5C, which is your --**  
 18 **I believe it's your letter -- or Jalapeno's letter. I**  
 19 **don't mean to --**  
 20 A. To Melissa, right?  
 21 **Q. And then maybe I'm on the wrong -- excuse me.**  
 22 **5D. 5D, as in dog. I'm sorry.**  
 23 A. My letter to Van Singleton.  
 24 **Q. That is correct, dated August 17, 2015.**  
 25 A. Uh-huh.

- 1 **Q. And you had been in discussions with them for**  
 2 **quite some time?**  
 3 A. With Van?  
 4 **Q. With both HEYCO and then Matador?**  
 5 A. Yes. Yes, with Matador, generically [sic].  
 6 **Q. Correct. Correct.**  
 7 **And the first bullet point there, you ask**  
 8 **for a 100/150 percent penalty, but you still said you**  
 9 **were nonconsent in the drilling of the well?**  
 10 A. That's correct.  
 11 **Q. Why?**  
 12 A. Well, because of oil -- lower oil prices at  
 13 that point and because we have other alternatives for  
 14 putting our money. We're a small company. We have  
 15 other alternatives that we thought were --  
 16 **Q. Less risky?**  
 17 A. -- which are more likely to produce more money.  
 18 **Q. Less risky?**  
 19 A. That's your word (laughter). What does risk  
 20 mean, Mr. Bruce?  
 21 **Q. Fortunately, I don't have to answer questions.**  
 22 **(Laughter.)**  
 23 A. I'm looking for the answer to that question.  
 24 **Q. Assuming Matador drills this well, is there a**  
 25 **chance it won't receive all of its money back on the**

- 1 **well?**  
 2 A. Yes. I think there is a chance. There is a  
 3 chance of losing it, and it's about 1 out of 104 that it  
 4 won't get down, based on what I've seen. And there is a  
 5 chance -- there is a chance it won't pay out. And based  
 6 on the earlier testimony I've heard, it is about 25  
 7 percent, meaning it would get much of its money back but  
 8 not all of it. And I would grant to you that that  
 9 figure, 25 percent, is -- it could be 30 percent chance  
 10 it won't get its money back.  
 11 **Q. And you said, Well, why is anybody drilling**  
 12 **currently? But you do have such things as lease**  
 13 **expiration dates?**  
 14 A. That's right. But do you spend \$6.5 million  
 15 for that purpose, or do you solve that problem some  
 16 other way?  
 17 **Q. Well, what if you have to spend \$6.4 million to**  
 18 **re-acquire the leases down the road?**  
 19 A. Well, that's an issue. Is there a lease  
 20 expiration problem here?  
 21 **Q. I think Mr. Singleton -- not lease**  
 22 **expiration -- well, I think Mr. Singleton testified that**  
 23 **there -- not in this well unit, but there were also term**  
 24 **assignments. Term assignments are generally short term,**  
 25 **aren't they?**

- 1 A. Matador reached a deal with Yates Energy, who  
 2 was in this litigation --  
 3 **Q. Correct.**  
 4 A. -- related to getting a term assignment. I'm  
 5 not sure -- if we're going to talk about it, I would ask  
 6 that Matador produce that term assignment so we can take  
 7 a look at it. But it may run out. I would urge my  
 8 brother to extend it if necessary.  
 9 **Q. But the aim of a well isn't simply to reach**  
 10 **payout, is it? Your company and Matador and everyone**  
 11 **else wants to make money.**  
 12 A. No. But what is risk? That's the issue. The  
 13 aim -- when I go drill a well that has a 10 percent  
 14 chance, it is to -- it is make six times the cost of  
 15 that well or ten times. That's the aim.  
 16 **Q. And -- but each company is different?**  
 17 A. Yup.  
 18 **Q. Your original Exhibit 8 in the booklet urges a**  
 19 **risk charge of 30 percent?**  
 20 A. Because that's -- your Exhibit 8 here?  
 21 **Q. Your -- your original Exhibit 8.**  
 22 A. Yes, we got that. Zero geologic -- now, all of  
 23 this is based on Stogner's method. Zero geologic  
 24 because the horizon is there. No question about that.  
 25 Operational risk, 1 percent, because you're looking at

1 one well lost out of 84. And reservoir risk -- what we  
2 did to analyze reservoir in the division below was look  
3 at all the horizontal wells drilled and the chance that  
4 those wells would not pay out, and we came up with about  
5 29 percent, which is very close to Mr. Frost's figure.

6 **Q. Would you participate at a 30 percent risk  
7 charge?**

8 A. I'm sorry. I'm not understanding.

9 **Q. If the risk charge was 30 percent, would  
10 Jalapeno participate in the well?**

11 A. The chance -- the risk charge up and down is  
12 not going to determine whether we participate in the  
13 well. We're going to look at our other -- where we put  
14 other assets and what we think this is as compared --  
15 the ultimate results of this as compared to our other  
16 drilling.

17 **Q. In any event, the current AFE for the Wolfcamp  
18 well is less than the original Bone Spring AFE?**

19 A. Yeah. It's a remarkable reduction. It's about  
20 \$2-and-a-half million less than Matador's original AFE,  
21 which was 9.1, which under a 200 percent risk penalty  
22 means you have to recapture \$7 million-something less.  
23 So it's a remarkable difference.

24 **Q. And that's a good thing?**

25 A. It's good thing. It's a great thing.

1 **Q. Okay. Well, I will represent to you to just  
2 assume that the pooling order covers the entire  
3 Wolfcamp.**

4 A. Okay.

5 **Q. Do you know that under the regulations, the  
6 operator can then propose additional wells in the  
7 Wolfcamp or whatever formation is force pooled, but that  
8 you get an election each time? So you're not losing  
9 your interest. You're losing your revenue interest in  
10 the first well if you go nonconsent, correct?**

11 A. Uh-huh. Yes, in that horizon. I'm not --  
12 frankly, I'm not sure whether the way the orders are  
13 written cover the whole -- that you've lost everything  
14 within the Wolfcamp or only within the area. And I  
15 don't know if they know what they're going to frac and  
16 what they're not going to frac, you know. I don't know.

17 **Q. As I said, just assume -- you're qualified as  
18 an expert.**

19 A. Okay.

20 **Q. Assume the pooling order covers the entire  
21 Wolfcamp --**

22 A. Okay.

23 **Q. -- and I will represent to you that the  
24 regulations of the OCD provide for additional wells to  
25 be proposed by the operator.**

1 **Q. And if you did participate in this well, then  
2 there would be no risk charge, no nonconsent penalty?**

3 A. That's right. But what I offered -- what I  
4 said to Melissa is, If we participate, we're not going  
5 to sign this operating agreement. Signing an operating  
6 agreement that has 100-300 percent, in this horizontal  
7 era, is tantamount to giving those zones away if you're  
8 not going to participate.

9 **Q. And you still have a well-by-well election.  
10 The other witnesses -- Matador's witnesses testified  
11 that there are multiple Bone Spring -- I mean Wolfcamp  
12 zone?**

13 A. Uh-huh. You mean multiple pay potential up and  
14 down the Bone Spring.

15 **Q. Well, multiple zones within the Wolfcamp.**

16 A. The Wolfcamp, right. Uh-huh.

17 **Q. And if they propose another well, you would  
18 have an opportunity to come in risk free in that well.  
19 Let's say they propose -- and they drill this one and  
20 they propose a lower Wolfcamp well. You'd able to  
21 participate --**

22 A. I'll not sure about that, Mr. Bruce, because  
23 I'm not sure whether a Commission's forced pooling order  
24 would cover the entire Wolfcamp or only that part. So I  
25 really, from a -- I don't know.

1 A. Under the pooling order?

2 **Q. Under the pooling order and under the  
3 regulations.**

4 A. Okay.

5 **Q. You would have an opportunity to participate in  
6 those additional wells in the Wolfcamp within this well  
7 unit; would you not?**

8 A. Is that a statement or --

9 **Q. Would you not, or do you not know?**

10 A. Based on what you tell me, yes.

11 **Q. So you could come in risk -- risk free -- not  
12 risk free, risk charge free in subsequent wells?**

13 A. What I don't know, Mr. Bruce, is whether  
14 earlier costs -- costs of the earlier well would be  
15 counted against the subsequent well. She's (indicating)  
16 shaking her head no.

17 **Q. And in this well, Matador has made deals with  
18 most of the parties in here, so there's only a small  
19 interest -- three interest owners left, essentially,  
20 correct?**

21 A. Well, you're telling me that. I mean --

22 **Q. So they've negotiated with other parties?**

23 A. They have.

24 **Q. And certain other parties are participating in  
25 the well?**

- 1 A. Okay. Good.
- 2 **Q. Well, you've looked at their exhibits. You've**
- 3 **heard the testimony here, haven't you?**
- 4 A. That other parties are participating?
- 5 **Q. Yes.**
- 6 A. I've heard there are some parties they
- 7 haven't -- haven't been able to reach and some parties
- 8 are participating and some aren't and that they have got
- 9 term assignments from some.
- 10 **Q. I'm just looking at this. Matador shows you as**
- 11 **owning 2.75 percent, plus or minus, interest in this**
- 12 **proposed well unit. What would be your cost to**
- 13 **participate in the drilling of the well?**
- 14 A. Well, that particular figure is in error. We
- 15 have about a 5 percent -- I've given to Matador here
- 16 where the problems are, and so we have about 5 percent.
- 17 So multiply 5 percent times 6.5 million.
- 18 **Q. Okay. But whatever the number is, there will**
- 19 **have to be a Division order title opinion for payment?**
- 20 A. Sure. Right.
- 21 **Q. And I believe Mr. Singleton testified that they**
- 22 **do have title opinions on interest?**
- 23 A. I know they've been working on title opinion,
- 24 and I know that it's a difficult title area.
- 25 **Q. In Exhibit -- your Exhibit 2, when you're**

- 1 talking about -- you're discussing with -- this is what,
- 2 shortly after HEYCO became part of Matador, I believe?
- 3 A. Correct. Uh-huh.
- 4 **Q. And you're talking about the well costs.**
- 5 **Aren't all the wells contained in this comparison Bone**
- 6 **Spring wells?**
- 7 A. Yes. Uh-huh.
- 8 But, Mr. Bruce, our point that we made
- 9 related to the AFE problem were proven by the lower AFE
- 10 that Matador came up with, \$2-and-a-half million less.
- 11 I don't know where you're going, but --
- 12 **Q. And there were a number of options that were**
- 13 **discussed by you and by Matador regarding participation**
- 14 **in this well?**
- 15 A. Yes.
- 16 **Q. And wasn't -- one of them was, you know, sell**
- 17 **down your interest slightly and participate with a**
- 18 **smaller interest?**
- 19 A. I don't remember -- I don't remember that. We
- 20 talked about their trading property in Chaves County --
- 21 **Q. Sure.**
- 22 A. -- to us for our interest under the well site
- 23 here.
- 24 **Q. And was there a term assignment discussion?**
- 25 A. Yes. I believe there was a term assignment

- 1 discussion.
- 2 **Q. And under a term assignment, you would not be**
- 3 **responsible for any well costs?**
- 4 A. That's correct.
- 5 Do you want me to tell you the hang-up on
- 6 the term assignment? The only condition I had that
- 7 caused a hang-up was if the acreage comes out of the
- 8 term assignment -- in other words, Matador doesn't earn
- 9 it -- I don't want it to be subject to a 100-300 percent
- 10 provision.
- 11 **Q. Okay. I've come to understand you don't like**
- 12 **the 100 percent/300 percent?**
- 13 A. It's a taking. Have you ever heard that word?
- 14 **Q. Well, it's provided by statute, isn't it? It's**
- 15 **allowed by statute, a valid New Mexico statute.**
- 16 A. The Commission may impose that penalty, but if
- 17 you look at the constitution and you have a question as
- 18 to whether that amounts to a taking in current
- 19 circumstances.
- 20 **Q. And this pooling is strictly limited to the**
- 21 **west half-west half of Section 31?**
- 22 A. That's my understanding.
- 23 **Q. So it doesn't affect your other interests in**
- 24 **the -- I think your interests are in the south half**
- 25 **through a JOA; is that correct?**

- 1 A. We have interests in both the north half and --
- 2 contractual. That's what was missed.
- 3 **Q. Contractual. Yeah. That's what I mean.**
- 4 A. In the south half as well.
- 5 **Q. Okay. And so your interests -- other interests**
- 6 **are unaffected by this pooling?**
- 7 A. That's correct.
- 8 **Q. And in the rest of the section?**
- 9 A. That's correct.
- 10 **Q. And this pooling is limited only to the**
- 11 **Wolfcamp, so a Bone Spring well is proposed, or wells,**
- 12 **you have the right to participate in those?**
- 13 A. That's correct.
- 14 **Q. And this pooling is totally -- does not affect**
- 15 **the Bone Spring Formation?**
- 16 A. That's my understanding. There was a question
- 17 about that initially in Matador's initial application,
- 18 but my understanding is it will not affect it.
- 19 **Q. And you have the right to -- as an interest**
- 20 **owner, to propose the drilling of wells in this section?**
- 21 A. Yes. Well, under an operating agreement. And
- 22 there is an operating -- you have the right to propose
- 23 wells, and under the rules of the Commission where there
- 24 is not an operating agreement, we could go stake a well.
- 25 So if that's what you're asking --

<p style="text-align: right;"><b>Page 122</b></p> <p>1       <b>Q. Sure. And if you think you can produce your</b>  2       <b>fair share of oil and gas, you can do that?</b>  3       A. Uh-huh.  4       <b>Q. Have you drilled and operated any horizontal</b>  5       <b>wells?</b>  6       A. No. We've participated in more than 75 percent  7       of them.  8       MR. GALLEGOS: Did you mean percent or  9       wells?  10       THE WITNESS: Wells. I'm sorry. I'm hung  11       up on 75 percent success -- risk success.  12       <b>Q. (BY MR. BRUCE) Mr. Yates, is another witness</b>  13       <b>going to discuss Exhibits 5, 6, 7, et cetera, or are</b>  14       <b>these yours?</b>  15       A. I think there are witnesses that are going to  16       discuss all of those.  17       <b>Q. In particular, 5 and 6?</b>  18       MR. GALLEGOS: Yes. 5 and 6 will be  19       Mr. Gaddis.  20       <b>Q. (BY MR. BRUCE) Going to Matador Exhibit 5A,</b>  21       <b>just looking at the HEYCO AFE, Mr. Yates --</b>  22       A. Okay. I'm sorry. I had the wrong book. 5A?  23       <b>Q. Yes. And the AFE submitted by HEYCO --</b>  24       A. All right.  25       <b>Q. -- to Jalapeno. First of all, there are 10</b></p>	<p style="text-align: right;"><b>Page 124</b></p> <p>1       <b>costs, correct?</b>  2       A. Oh, I see. Would you point --  3       <b>Q. Look down lower, right-hand corner of the first</b>  4       <b>page on the AFE, tanks, pipeline, electricity, pumping</b>  5       <b>units.</b>  6       A. Are you looking on the far, right-hand side?  7       Where are you looking?  8       Those tangible lease and battery equipment  9       go into the total -- total completion cost of the well,  10       as I see it now. Are you pointing out something else?  11       <b>Q. Yeah. It's part of the completed cost of the</b>  12       <b>well?</b>  13       A. Sure. Of course.  14       <b>Q. Okay.</b>  15       MR. BRUCE: Mr. Gallegos, were you going to  16       introduce Jalapeno Exhibit 3?  17       MR. GALLEGOS: Let me see what that is.  18       Probably not. If we do, it would be with  19       MJ, not Mr. Yates. Mr. Yates was not present at that  20       meeting -- or Harvey Yates was not.  21       MR. BRUCE: Just a second, Mr. Yates. I  22       believe I'm almost through.  23       <b>Q. (BY MR. BRUCE) Do you at this point or has</b>  24       <b>Jalapeno thought about proposing drilling wells in</b>  25       <b>Section 31?</b></p>
<p style="text-align: right;"><b>Page 123</b></p> <p>1       <b>percent contingency costs on separate items; are there</b>  2       <b>not?</b>  3       A. I bet there are.  4       <b>Q. So that amounts to a substantial amount of</b>  5       <b>money?</b>  6       A. Uh-huh.  7       <b>Q. Just like on Matador's AFE?</b>  8       A. I think the price of the equipment was influx,  9       as I testified before, during that period of time.  10       <b>Q. But the battery, et cetera still comes up to</b>  11       <b>about 321,000 in this AFE?</b>  12       A. Okay.  13       <b>Q. And you agreed to that?</b>  14       A. Uh-huh.  15       <b>Q. You were going to participate in that well?</b>  16       A. Right. I wasn't going to pay a risk penalty on  17       that. Are you suggesting that we've ever --  18       <b>Q. Well, if you're participating in the well by --</b>  19       <b>it's a simple fact that you're not paying any risk</b>  20       <b>penalty on anything.</b>  21       A. Well, that's right. But I'm not sure what  22       you're asking me in pointing out that we signed an AFE  23       that has equipment charges in it. They always have  24       equipment charges. So I'm not sure what your point is.  25       <b>Q. Well, it's included as part of the initial well</b></p>	<p style="text-align: right;"><b>Page 125</b></p> <p>1       A. No. No, we haven't. Our forte is shallower  2       zones in terms of operator, and if we found a shallow  3       zone that would save -- save a lease, if they have that,  4       we would be glad to talk about that.  5       <b>Q. You said -- one final question. You said you</b>  6       <b>participated in 70 or 75 horizontal wells?</b>  7       A. What I said was more than 75 wells, about half  8       of them in Texas and half in New Mexico.  9       <b>Q. Have you signed JOAs with 300 percent</b>  10       <b>nonconsent penalties?</b>  11       A. You mean ever?  12       <b>Q. (Indicating.)</b>  13       A. Of course, I have, in the vertical well era.  14       And what's happening is all these AFEs that were signed  15       in the vertical well era, the world has changed. The  16       world changed starting, in New Mexico, in 2008. So  17       we're confronting -- confronted -- I have also, I  18       believe, as explained in these documents, likely signed  19       an AFE for a spacing unit with those risks where we were  20       going to participate in the well.  21       <b>Q. Have you signed a JOA for a horizontal well</b>  22       <b>unit?</b>  23       A. Yeah, in that circumstance I just explained.  24       <b>Q. Okay. There's been --</b>  25       A. Limited to that. Other operators have received</p>



<p style="text-align: right;"><b>Page 126</b></p> <p>1 the same stuff from me that Matador has. The risk has  2 changed. We're not going to sign an operating agreement  3 covering a zillion acres, but we may in this spacing  4 unit if it's limited to the spacing unit and we're going  5 to participate. Best of my memory, that's --  6 <b>Q. And you wouldn't budge off the 50 percent</b>  7 <b>penalty?</b>  8 A. I might, yeah. I mean, I was surprised. I  9 thought the Division would likely come back -- because  10 of the risk and things, come back with a 66 percent  11 penalty rather than 133 percent. And I could understand  12 that in regard to the remoteness of the well.  13 <b>Q. Now, there's been a lot of questions,</b>  14 <b>especially from Mr. Gallegos, about doing a pilot hole</b>  15 <b>in this well.</b>  16 A. Uh-huh.  17 <b>Q. But if that was done, since you're not going to</b>  18 <b>participate, you wouldn't share in the cost of drilling</b>  19 <b>that?</b>  20 A. It depends on how they propose it.  21 <b>Q. And that would substantiate --</b>  22 A. Do not assume that. It depends. If they go  23 back and say, We want to drill a pilot hole in order to  24 confirm this and so forth, we might. It depends. Are  25 they willing to do it under an operating agreement that</p>	<p style="text-align: right;"><b>Page 128</b></p> <p>1 <b>Q. I'm going to use the ballpark numbers 2.9 and 5</b>  2 <b>percent regarding Jalapeno's interest.</b>  3 A. Oh, okay.  4 <b>Q. Some of the testimony yesterday -- and this may</b>  5 <b>be a question for a later Jalapeno witness. My</b>  6 <b>understanding was that 5 percent was Jalapeno's in the</b>  7 <b>section at large, and the 2.9 related to this particular</b>  8 <b>well. Would that be --</b>  9 A. No. That's not -- that's not my understanding.  10 My understanding is we would have 5 percent interest and  11 that -- what I think happened is that there are  12 assignments that are blanket assignments covering  13 thousands of acres that we have received, and we haven't  14 received -- say it's an assignment of a federal lease.  15 We haven't, in many cases, received assignment of  16 specific federal leases under that blanket assignment.  17 Some of those leases we haven't received are now  18 Matador's responsibility. They were, earlier, HEYCO's  19 responsibility. And I think one of those has been  20 overlooked, is, I think, the discrepancy. I may be in  21 error. I mean, our land department is pretty certain  22 it's 5 percent interest.  23 <b>Q. Okay. Slow-downs with the BLM of those federal</b>  24 <b>leases.</b>  25 A. Pardon me?</p>
<p style="text-align: right;"><b>Page 127</b></p> <p>1 has reasonable nonconsent provisions? We might  2 participate in that pilot hole.  3 <b>Q. Might?</b>  4 A. Yes. How could --  5 <b>Q. And that would substantially add to the cost of</b>  6 <b>the well?</b>  7 A. Might save you a lot of money, too. That's the  8 question.  9 <b>Q. But there are a lot of costs upfront?</b>  10 A. There are costs upfront.  11 <b>Q. Okay. And for a year and a half now, you have</b>  12 <b>been unhappy with the well costs. Is that a fair thing</b>  13 <b>to say?</b>  14 A. I am a great deal happier with the current AFE.  15 It seems to be what we requested in the first place and,  16 as far as I can tell, reasonable.  17 MR. BRUCE: That's all I have,  18 Mr. Chairman.  19 COMMISSIONER PADILLA: Just a few  20 questions.  21 CROSS-EXAMINATION  22 BY COMMISSIONER PADILLA:  23 <b>Q. Mr. Yates, going back to -- I'm going to use</b>  24 <b>the ballpark numbers of 2.9 and 5 percent.</b>  25 A. I'm sorry?</p>	<p style="text-align: right;"><b>Page 129</b></p> <p>1 <b>Q. Slow-downs at the BLM of those federal leases.</b>  2 <b>You talked quite a bit about the economics</b>  3 <b>of payout under 200 percent on the wells.</b>  4 A. Right.  5 <b>Q. Given your history in the business in</b>  6 <b>New Mexico, can you talk a little bit about the</b>  7 <b>economics of that 200 percent and the payout under</b>  8 <b>vertical scenario?</b>  9 A. Yes. Under a vertical scenario, you can have  10 much lower cost of wells, say a million-dollar well,  11 800,000. I've been drilling San Andres wells for a  12 quarter of a million dollars, for instance. And those  13 were figures -- today, those are, say, 400,000. But you  14 can get -- you can find a well like that that will  15 produce, say, 130,000 barrels, which is -- so at a 200  16 percent or a Fusselman [phonetic] well where you might  17 get a million barrels, you can reach that 200 percent  18 payout. You have a greater risk, but you can get to the  19 300 -- your money back plus 200 percent penalty.  20 On this -- these horizontal wells, because  21 the cost has gone up so high of drilling the wells, you  22 have a very difficult time. We'll have testimony about  23 that because we've asked an engineering firm to come in  24 and analyze that, the chances of getting payback, but a  25 very remote chance because of the elevated cost of</p>

**33 (Pages 126 to 129)**

<p style="text-align: right;"><b>Page 130</b></p> <p>1 these.</p> <p>2 But on the other hand, you have a lower</p> <p>3 risk -- I mean, the Commission -- this 200 percent rule</p> <p>4 is -- would make it appear that there are dead bodies</p> <p>5 all over those four townships. There is one dry hole</p> <p>6 and one well lost among the horizontal wells. We're not</p> <p>7 talking about the vertical wells. Vertical wells, there</p> <p>8 are a number of dry holes.</p> <p>9 But the 200 percent risk was created in the</p> <p>10 vertical well era, 2003, and things changed, and the</p> <p>11 rules need to change to take that into account.</p> <p>12 What's happening is the operator gets 200</p> <p>13 percent penalty. The forced pooling never comes back</p> <p>14 in, but the operator, after he gets his risk back -- he</p> <p>15 has about a 25, 30 percent chance of reaching payout,</p> <p>16 from what I've seen -- then manufactures money. And by</p> <p>17 the time it gets to the 200 percent, there is nothing</p> <p>18 left. Are you understanding what I'm --</p> <p>19 <b>Q. So in your opinion, for horizontal development,</b></p> <p>20 <b>what would be an appropriate risk penalty?</b></p> <p>21 A. I'm sorry?</p> <p>22 <b>Q. In your opinion, for a horizontal development,</b></p> <p>23 <b>what's an appropriate risk penalty?</b></p> <p>24 A. Well, when we analyze the Bone Spring, they</p> <p>25 said -- this isn't a Bone Spring, obviously. But Bone</p>	<p style="text-align: right;"><b>Page 132</b></p> <p>1 property, and I would advocate for the burden -- you</p> <p>2 know how much you've learned today from Matador's</p> <p>3 magnificent representatives here who -- who -- and I'm</p> <p>4 not being cynical. Mr. Frost did a great job. They're</p> <p>5 having to put on the burden of proof. They're having</p> <p>6 to -- it's very educational for the Commissioners, in my</p> <p>7 estimation. And I think that's what out to happen. I</p> <p>8 think you can make a more rationale decision that way.</p> <p>9 But you have to answer one question first.</p> <p>10 When you say risk, what are you talking about? Are you</p> <p>11 talking about getting the hole down, or are you talking</p> <p>12 about getting them back 12 percent on their money, or</p> <p>13 are you talking about breaking even? And that's -- or</p> <p>14 are you talking about a Stogner method, which in my view</p> <p>15 is irrational, where you're separating it into the</p> <p>16 various -- various parts. And I can go through that</p> <p>17 with you.</p> <p>18 But we came in here using the Stogner</p> <p>19 method because we understand that to be the Commission</p> <p>20 approach because in the 2003 well rule -- or risk rule,</p> <p>21 Stogner testified and laid out his approach, and it</p> <p>22 seemed to be the one accepted by the Commission. I</p> <p>23 understand no one here on the Commission here today was</p> <p>24 on that Commission then.</p> <p>25 <b>Q. Thank you.</b></p>
<p style="text-align: right;"><b>Page 131</b></p> <p>1 Spring, it looked to us like a risk penalty of 29 or 30</p> <p>2 percent that you had about that chance of not getting</p> <p>3 payout. Now, they said this is -- this is not in that</p> <p>4 zone. It's a Wolfcamp zone. I understand that. And</p> <p>5 it's remote, so the risk penalty ought to be higher.</p> <p>6 But they also said that it's going to be better than the</p> <p>7 Bone Spring.</p> <p>8 That's why we went in and analyzed, for the</p> <p>9 Division, all the Bone Spring wells in the four</p> <p>10 townships, and we've had an engineer go analyze, run</p> <p>11 EURs on all those wells.</p> <p>12 Now, you and I both know that there are</p> <p>13 variables. We used Matador's new AFE recently to</p> <p>14 analyze them. Earlier, we were using an AFE cost based</p> <p>15 on what we had participated in, and the number AFEs --</p> <p>16 we assumed that the AFE on the number of wells that we</p> <p>17 had participated was what other people were paying, so</p> <p>18 we used that. And we used current prices then, and we</p> <p>19 used the operating cost that we were familiar with.</p> <p>20 Whether you can spread that, you know, throughout the</p> <p>21 Basin, I don't know. But those are the things that we</p> <p>22 did.</p> <p>23 <b>Q. So would you advocate for the case-by-case</b></p> <p>24 <b>approach?</b></p> <p>25 A. Yes. I think that otherwise you're taking</p>	<p style="text-align: right;"><b>Page 133</b></p> <p>1 COMMISSIONER BALCH: I actually have no</p> <p>2 questions for you today. Thank you.</p> <p>3 THE WITNESS: Thank you.</p> <p>4 CROSS-EXAMINATION</p> <p>5 BY CHAIRMAN CATANACH:</p> <p>6 <b>Q. I just want to go over the analysis you did on</b></p> <p>7 <b>the Bone Spring and the four-township area. I just want</b></p> <p>8 <b>to get those results again. You said there are how many</b></p> <p>9 <b>wells?</b></p> <p>10 A. In the Division -- in the Division hearing,</p> <p>11 there were, I believe, 84 wells, one of which was a dry</p> <p>12 hole and one of which was a well that was lost. Now, we</p> <p>13 took every horizontal well in those four townships, and</p> <p>14 so you've had a few Delaware wells, very, very few,</p> <p>15 mostly Bone Spring wells. I think there was perhaps one</p> <p>16 Wolfcamp that wasn't in this particular horizon.</p> <p>17 Since that time, there have been additional</p> <p>18 wells drilled, and now I believe there are 104 wells in</p> <p>19 those four townships. And so those wells have been</p> <p>20 drilled in the last two years, the additional -- and I</p> <p>21 pointed out that those wells have been drilled in a</p> <p>22 fairly low price -- low-oil-price environment.</p> <p>23 <b>Q. So I just want to make sure I understand. Did</b></p> <p>24 <b>you analyze all 104 wells in this township area?</b></p> <p>25 A. Uh-huh.</p>

1 **Q. And some of these were different horizons,**  
2 **either Bone Spring or Delaware?**

3 A. Right.

4 **Q. But they're all horizontal wells?**

5 A. Right.

6 **Q. And you did a -- you determined that how many**  
7 **had reached payout? Is that what you were trying to**  
8 **figure out?**

9 A. Yes. Yeah. We were -- we were attempting  
10 to -- and, in fact, in the Division, we suggested that  
11 the Division needs to be doing this in order to really  
12 determine what the risk is in areas. But all of the  
13 information that we got came from the Division, Division  
14 records.

15 So we would take production -- we had to  
16 assume some things. For instance, the AFE cost, we had  
17 to assume. Well, where do we get that? We got that  
18 from our experience drilling with Devon, COG, et cetera,  
19 et cetera, what the AFEs were. We had to assume a price  
20 of oil. And so in that -- in that attempt to understand  
21 what was going on, we used the Base [phonetic] case from  
22 Bank of Oklahoma for determining pricing out. And we  
23 took the -- what decline curves did we use? Well, we  
24 took the 20 oldest wells in those four townships and  
25 applied those to -- and so we came up with an average

1 decline curve and applied it to all of those 100- --  
2 those 82 producing wells, because two are producing, and  
3 then subsequently applied that -- updated it and applied  
4 it to the 102 producing wells.

5 Later, we asked an engineering firm to come  
6 in and do -- run the EURs on all of those wells, and  
7 you'll hear that this afternoon. But the variables are  
8 the things I mention. Operating cost is something I  
9 didn't mention, but it's a big deal. What kind of  
10 operating cost do you have?

11 But our results in the early period were  
12 that, based on this stuff, you had about 29 percent of  
13 the wells that were not reaching payout. That didn't  
14 mean we didn't make a lot of oil, but they didn't reach  
15 payout, and the rest would pay out. And so that  
16 comported with our own experience in investing in these  
17 wells as opposed to investing in vertical wells, that  
18 the risk had dropped. The cost had gone up; the risk  
19 would drop.

20 **Q. So you have signed JOAs with companies for**  
21 **horizontal wells? You've participated in the drilling**  
22 **of those wells?**

23 A. Sure.

24 **Q. And you have signed JOAs with 100-300 percent?**

25 A. I have refused to sign where they want to cover

1 a vast area. I have refused to sign JOAs in this  
2 horizontal well era that cover a vast area. And I have  
3 often -- they send a JOA. I'll send a letter back  
4 saying, Your nonconsent penalties do not reflect today's  
5 risk in this drilling. So we'll sign the AFE but not  
6 sign the JOA and go on and participate in the well. I  
7 think I've done that with Yates Petroleum, Matador,  
8 maybe Devon. I don't know whether I've done it with  
9 COG. In other cases, we have said, We'll sign an AFE  
10 with those nonconsent provisions, but it has to cover  
11 only the spacing unit, and we're going to participate in  
12 that.

13 As I said, my view is that if you sign that  
14 JOA and you think you're not going to be able to  
15 participate, then what you're doing is signing title  
16 over to them.

17 **Q. Mr. Yates, what's been your experience with**  
18 **trying to negotiate with other companies to get that**  
19 **penalty reduced?**

20 A. It's been very, very difficult. First off,  
21 most of them have a very great stake in that --  
22 consider -- consider this: That in order to be able to  
23 drill, a company like Matador or COG or whoever has to  
24 go buy leases. And some of those leases are very, very  
25 expensive. But if they can send a lawyer in here and

1 get an automatic 200 percent, that's the cheapest lease  
2 they've bought. Depending on the size -- on the  
3 lawyer's cost and the size, cheapest lease they've  
4 bought. They go drill it, they take everything out of  
5 it, and there will be nothing left at 200 percent. And  
6 that is one of the reasons, I believe, that lease prices  
7 in Texas have buoyed up.

8 You have operators coming out of Texas into  
9 New Mexico because of the lease prices over there where  
10 you do not have the penalty that we've talked about, but  
11 they can come in here and drill their way into leases  
12 they can go buy.

13 **Q. So, I guess, have you had any success with any**  
14 **operators to reducing the risk penalty?**

15 A. I've had -- I've had success in them agreeing  
16 to go out and drill where we just -- or agreeing to  
17 reduce the size -- the area covered by the operating  
18 agreement. And yes, I have. I think -- I think in one  
19 case I got a 100 and 150.

20 But they're moving. I mean, these  
21 customary things in the industry -- I'm old enough to  
22 remember a circumstance where gas was selling, for 20  
23 years, at 14 cents an mcf, and I remember saying, We're  
24 going to stop doing that. And the push-back that we got  
25 because that was customary in the industry, we're at a

1 period like that now, where the risk has dropped, things  
2 have changed.

3 One of the things going on here, if you --  
4 they look at what this Commission is doing. And they  
5 look at that, and if you don't sign this joint operating  
6 agreement, we're going to go force pool you and you'll  
7 end up in the same place because of the 200 percent.  
8 Touchdown negotiated.

9 **Q. Just one more question. There's been a lot of**  
10 **talk about the Stogner method, the Stogner hearing.**  
11 **What was that hearing in context? Was that a rule**  
12 **change?**

13 A. It was in context -- I can give you copies of  
14 it, if you want, here. But in regard to the 2003 risk  
15 charge, where the Commission decided to automatically do  
16 a 200 percent where people -- and reduce it from that.  
17 It's the 200 -- this is where we ended up in this 2- --  
18 this automated [sic] -- automatic pilot, 200 percent.  
19 It was his testimony --

20 MR. GALLEGOS: Mr. Chairman, if you'd like,  
21 if I can -- that was the proceeding in which there was  
22 an industry group, and the basic message was, Oh, it  
23 cost us extra money every hearing, and it's quicker and  
24 more convenient if we don't have to bring a witness on  
25 the risk penalty, and so forth. And that was where

1 had been laid out, where you're taking an automatic --  
2 one problem with Stogner method is he took 200 percent  
3 and reduced it from that. It wasn't taking -- figuring  
4 out what risk is and starting at zero and building up to  
5 the point where you actually had risk. It was take 200  
6 percent and reduce it. That was part of his method.  
7 That has been used all the time by the Division and, as  
8 far as I can tell, by the Commission.

9 We looked at all the wells that  
10 Mr. Brooks -- Mr. Brooks gave -- one of the exhibits  
11 from the Division was a list of wells that had been  
12 force pooled in 2016. His purpose in putting that into  
13 the record was to show that there was precedent for  
14 pooling.

15 The other thing it showed is the Commission  
16 always applies 200 percent, and it also showed that --  
17 and there was only one cases where it didn't apply that  
18 rule, and the Commission in that case denied the forced  
19 pooling because they were drilling into a federal unit,  
20 but every other time, whether it was an offsetting well  
21 to a producer or whether it was miles away. So that's  
22 the Stogner method as I understand it.

23 **Q. Okay.**  
24  
25

1 Mr. Stogner testified -- and it was in the Fruitland --  
2 I always use 165, I think, he said, or something he had  
3 come to. That was that proceeding, and it came out --  
4 I've always called it Rule 35, which is not the  
5 New Mexico administrative rule, but it's the one where  
6 they said 200 percent is to be awarded in well costs.  
7 And it defines well costs to include surface agreement.  
8 That was that proceeding.

9 THE WITNESS: In that same proceeding,  
10 Stogner talked about the Fruitland coal era -- area in  
11 the northwest, and he said -- this was an example he  
12 gave for his -- the geologic -- what he meant by  
13 geologic. There have been people in here and they  
14 testified that the Fruitland coal is there every time.  
15 So he reduced from 200 percent to 156 percent risk  
16 penalty or something like that as a consequence.

17 **Q. (BY CHAIRMAN CATANACH) Right. I remember it**  
18 **was 156 percent of the Fruitland coal, and to some**  
19 **extent, I was involved in that, also.**

20 Do you know that if the Stogner method has  
21 been applied in any subsequent compulsory pooling cases?  
22 I mean, that didn't establish a precedent of any kind,  
23 did it?

24 A. Well, we approached it in the Division here  
25 because that's the only method that we could find which

#### CROSS-EXAMINATION

1 BY MR. BRANCARD:

2 **Q. This is all fine, but at the end of the day,**  
3 **the Commission has to make a decision. Okay? And if**  
4 **the Commission agrees to pooling this unit, it's going**  
5 **to have to assign a risk charge. What is Jalapeno's**  
6 **proposal for a risk charge in this unit?**

7 A. Well, our proposal -- what I think is, if you  
8 look at the Bone Spring area, the risk, and analyze  
9 that, it's about 30 percent.

10 On the other hand, this is not a Bone  
11 Spring. And they have come in and testified this is --  
12 it is something in the nature of a wildcat well, using  
13 Stogner's method for the -- Stogner's method, I think,  
14 you would come up with something like a 66 percent. And  
15 to me, because of the remoteness of it, it seems to  
16 be -- that would seem to be fair.

17 **Q. 66 percent risk charge?**

18 A. Right.

19 **Q. Okay. Are you going to have another witness**  
20 **who is going to go into detail how you got to that**  
21 **number, or is this it?**

22 MR. GALLEGOS: No.

23 **Q. (BY MR. BRANCARD) Okay. So you're**  
24 **extrapolating from the Bone Spring number. And is that**  
25

1 your original Exhibit 8?

2 A. Yes, the Bone Spring. I think that a -- that a  
3 fair charge for drilling in an area where you have  
4 offsetting wells -- like around in that four township,  
5 if we were drilling a Bone Spring well, that is what I  
6 think a fair risk charge would be.

7 MR. BRANCARD: Just to clarify, Mr.  
8 Gallegos, you submitted a revised Exhibit 8, but did you  
9 want to keep the original Exhibit 8?

10 MR. GALLEGOS: No. It was supposed to  
11 replace the Exhibit 8 -- the prior Exhibit 8.

12 THE WITNESS: I don't know what that's  
13 prior.

14 MR. BRANCARD: That's the 30 percent.

15 THE WITNESS: Yeah.

16 So what I'm saying is let's assume  
17 Matador -- what Matador said is not right, that --  
18 originally, they said that Bone Spring -- Wolfcamp would  
19 be better than Bone Spring. They're guessing about that  
20 to some extent. This is remote. I give them that. So  
21 I would impose a risk penalty greater than I would for  
22 this to be a Bone Spring

23 Q. (BY MR. BRANCARD) I know you want to talk about  
24 risk, so let's talk about risk. You're talking about --  
25 when you're talking about risk, as I understand it,

1 Q. Okay. So you have focused on the risk of a  
2 failure to pay out when an operator drills a well. Let  
3 me just talk about what I'm seeing as another kind of  
4 risk that's going on here.

5 We can look at your Exhibit 1, the  
6 attachment of this, just for the numbers here. This  
7 represents a \$7.3 million well charge. Jalapeno has  
8 about 5 percent, 372,000. They're asking for you to  
9 participate. Okay?

10 A. Uh-huh.

11 Q. If you say, We're not going to participate,  
12 right, that means that the operator, whoever it is, now  
13 has to come up with that \$372,000 that you're not  
14 paying, right?

15 A. Uh-huh.

16 Q. So now they're adding -- they're increasing  
17 their risk by putting up money that you should have been  
18 putting out to produce your oil?

19 A. Well, they're getting back that cost, the  
20 300-and-some-odd-thousand.

21 Q. If the well pays out?

22 A. If the well pays out, that's right.

23 Q. If the well doesn't pay out, you haven't lost a  
24 penny?

25 A. That's correct.

1 you're talking about the risk of a failure to pay out at  
2 a well?

3 A. That's right. That is what I think.

4 Q. And that is the sole basis for determining a  
5 risk charge under the statute?

6 A. In my -- no. No. I'm not sure of that. The  
7 Commission hasn't applied that. The Commission has  
8 applied the Stogner rule. And my view is that that  
9 approach is the rationale basis because it allows you to  
10 take into account the cost, the price of oil and gas and  
11 so forth.

12 Let me find the Stogner deal. Just a  
13 minute here.

14 Q. And I understand, based on, I believe, one of  
15 the orders referenced in the motion hearing, the Stogner  
16 testimony was part of the rulemaking procedure that  
17 replaced the Stogner method with the 200 percent  
18 default; is that correct?

19 A. Well, my understanding is not that. It's that  
20 Stogner was applying 200 percent and reducing from that,  
21 which is essentially what the Commission has done since  
22 then. It's hung on the 200 percent. The producers came  
23 up and said, We're always in here having to prove why it  
24 ought not to be 200 percent, and we don't like to come  
25 in here.

1 Q. You've taken on zero risk?

2 A. That's correct.

3 Q. You've allocated all your risk to the operator?

4 A. That's correct.

5 Q. So, essentially, you're a free rider in that  
6 case?

7 MR. GALLEGOS: As soon as the well is  
8 producing --

9 MR. BRANCARD: I'm sorry. I'm asking the  
10 witness a question.

11 MR. GALLEGOS: -- the revenue from that 5  
12 percent goes to --

13 MR. BRANCARD: Mr. Gallegos, I'm not  
14 questioning you. Okay? I'm questioning the witness.

15 Q. (BY MR. BRANCARD) So you're taking zero risk if  
16 you have nonconsent?

17 A. The 30 percent in that circumstance is  
18 representative of the chances of not paying out. So in  
19 that circumstance, you have -- and you would bear -- the  
20 nonparticipant would bear that penalty, the 30 percent  
21 penalty. And so the operator would get back all of his  
22 money for what he put out to drill that proportionate  
23 part, the 300-some-odd-thousand. On top of that, he  
24 would be awarded for the risk he took, which was 30  
25 percent risk, by getting 30 percent more. So he is

<p style="text-align: right;"><b>Page 146</b></p> <p>1 rewarded for that.</p> <p>2 <b>Q. But only if it pays out?</b></p> <p>3 A. Well, that's right.</p> <p>4 <b>Q. In the meanwhile, like you said, you may have a</b></p> <p>5 <b>better use for your money?</b></p> <p>6 A. Well, that's correct. That's always the case.</p> <p>7 I've drilled wells in the rank wildcat</p> <p>8 basins, as I've said, where we might force pool 40</p> <p>9 acres, and if we're successful, then the guy who</p> <p>10 nonconsented owns part of the 10,000 acres around here</p> <p>11 and he's benefited from that. You can't solve every</p> <p>12 problem by this force pooling. And that's an example</p> <p>13 where you would need a unitization force pooling, so to</p> <p>14 speak, and we don't have that. There are problems.</p> <p>15 But this circumstances where he would be</p> <p>16 rewarded for the 30 percent, which is likely to pay out,</p> <p>17 gives him a reward for having taken the risk.</p> <p>18 <b>Q. Thank you.</b></p> <p>19 MR. GALLEGOS: Mr. Chairman, I know we're</p> <p>20 trying to get out of here, but apropos Commissioner</p> <p>21 Padilla's question about the interest, I just want --</p> <p>22 <b>REDIRECT EXAMINATION</b></p> <p>23 BY MR. GALLEGOS:</p> <p>24 <b>Q. Just quickly, if you look at Exhibit 5A in the</b></p> <p>25 <b>Matador book, was this a proposal for the Airstrip</b></p>	<p style="text-align: right;"><b>Page 148</b></p> <p><b>RECROSS EXAMINATION</b></p> <p>1 BY MR. BRUCE:</p> <p>2 <b>Q. Quickly, maybe this will answer the question.</b></p> <p>3 <b>But we've talked about this study. Is someone else</b></p> <p>4 <b>going to talk about that study other than you?</b></p> <p>5 A. Yes.</p> <p>6 <b>Q. Okay. Well, then I think --</b></p> <p>7 A. You mean the study that we've done?</p> <p>8 <b>Q. Yes.</b></p> <p>9 A. Yes.</p> <p>10 MR. BRUCE: If that's the case, I don't</p> <p>11 need to ask anymore.</p> <p>12 <b>RECROSS EXAMINATION</b></p> <p>13 BY CHAIRMAN CATANACH:</p> <p>14 <b>Q. Just one comment. On the Stogner case, I</b></p> <p>15 <b>believe that after that case was presented, that the</b></p> <p>16 <b>Fruitland coal well started to be charged a 200 percent</b></p> <p>17 <b>risk penalty. That's my recollection on it, and I think</b></p> <p>18 <b>that's correct.</b></p> <p>19 A. I don't operate up in that area. I don't know.</p> <p>20 I'm just looking at the record.</p> <p>21 <b>Q. So if that's the case, I'm not sure that</b></p> <p>22 <b>Stogner's method can be used as a precedent -- a</b></p> <p>23 <b>precedent-setting nature if his method was then thrown</b></p> <p>24 <b>out by that case.</b></p> <p>25</p>
<p style="text-align: right;"><b>Page 147</b></p> <p>1 <b>project area for the well being the 1504.22 acres, west</b></p> <p>2 <b>half-west half, in Section 31?</b></p> <p>3 A. For the Bone Spring, yes.</p> <p>4 <b>Q. Yes. But just talking about that, that was</b></p> <p>5 <b>the -- that's the land area involved, the west half?</b></p> <p>6 A. Right.</p> <p>7 <b>Q. Okay. If you turn the page over, is there an</b></p> <p>8 <b>attachment to it?</b></p> <p>9 A. Yes. Uh-huh.</p> <p>10 <b>Q. And does the attachment show the working</b></p> <p>11 <b>interests of the various parties?</b></p> <p>12 A. I see the parties listed. I don't see the</p> <p>13 working interests specifically.</p> <p>14 <b>Q. Turn to the very last page, Mr. Yates.</b></p> <p>15 A. Okay. Okay.</p> <p>16 <b>Q. It's this (indicating).</b></p> <p>17 A. Yes, I do see it.</p> <p>18 <b>Q. It's the schedule.</b></p> <p>19 A. Right. I see the schedule.</p> <p>20 <b>Q. Okay. What does it show for Jalapeno's</b></p> <p>21 <b>interest?</b></p> <p>22 A. It's 5 percent, 5.097063.</p> <p>23 <b>Q. That's all I was just trying to --</b></p> <p>24 A. At a cost of 372,000.</p> <p>25 <b>Q. Thank you.</b></p>	<p style="text-align: right;"><b>Page 149</b></p> <p>1 A. If there is a method other than just the</p> <p>2 automatic imposition of 200 percent, I mean, a</p> <p>3 definition of risk, what we're talking about, I would</p> <p>4 appreciate being guided to that. I haven't found it.</p> <p>5 <b>Q. And having been here 25 years prior to my</b></p> <p>6 <b>latest term, I don't recall it ever being an issue</b></p> <p>7 <b>except in the Basin Fruitland coal. That's the only</b></p> <p>8 <b>time I recall there was any kind of detailed examination</b></p> <p>9 <b>of the risk penalty.</b></p> <p>10 A. Uh-huh.</p> <p>11 MR. BRUCE: Mr. Chairman, I believe you're</p> <p>12 right. It did go up to 200 percent, and the basis was</p> <p>13 even though the Fruitland coal was there, it might not</p> <p>14 necessarily pan out every time. So, therefore, the</p> <p>15 penalty was increased back up.</p> <p>16 CHAIRMAN CATANACH: Okay.</p> <p>17 COMMISSIONER PADILLA: I have one point</p> <p>18 just for the Commissioners with regard to what</p> <p>19 Mr. Gallegos just said. Those working interests</p> <p>20 percentages do relate to the entire 634 acres, which is</p> <p>21 on the first page of that.</p> <p>22 MR. GALLEGOS: Well --</p> <p>23 COMMISSIONER PADILLA: So it's the entire</p> <p>24 JOA proposal, not just that well.</p> <p>25 MR. GALLEGOS: Apparently, yeah.</p>

<p style="text-align: right;"><b>Page 150</b></p> <p>1 CHAIRMAN CATANACH: Anything further of 2 this witness? 3 MR. BRUCE: No. 4 Mr. Gallegos -- I haven't consulted with 5 him, but it's 12:30, and I presume the Commissioners are 6 going to take lunch. Just the timing, it doesn't look 7 like we're going to get done today. 8 CHAIRMAN CATANACH: Doesn't look like it, 9 no. 10 MR. BRUCE: And probably, with the next two 11 witnesses -- we're not going to get through the next two 12 witnesses. 13 (Discussion off the record.) 14 MR. BRUCE: Well, I mean, if there is a 15 hearing next week -- I think Matador is available next 16 week or within the next couple of weeks for just a 17 continuance of this hearing. 18 CHAIRMAN CATANACH: I am not here next week 19 at all. 20 MR. GALLEGOS: I'm out of town almost all 21 of next week so maybe the following week. 22 MR. BRUCE: Maybe Friday or earlier next 23 week -- this Friday or the week after. 24 COMMISSIONER BALCH: This Friday, all the 25 Commissioners are available or can be.</p>	<p style="text-align: right;"><b>Page 152</b></p> <p>1 COMMISSIONER PADILLA: What about the 13th, 2 14th of September? 3 MS. ARNOLD: No. You're not available on 4 Friday. 5 MR. GALLEGOS: I'm not. I'm out of town. 6 CHAIRMAN CATANACH: Friday. 7 MR. GALLEGOS: In fact, I'm leaving 8 tomorrow. 9 What about the week of September 19th? 10 COMMISSIONER PADILLA: I'm open the 20th, 11 21st and 22nd-ish. 12 COMMISSIONER BALCH: I'm not really 13 available that week. 14 (Discussion off the record.) 15 CHAIRMAN CATANACH: At the moment, for the 16 17th -- and this is if you can't get out of that, we'll 17 change it back to the 6th -- I'm sorry -- So the 15th 18 and 17th -- 19 (Discussion off the record regarding 20 scheduling.) 21 CHAIRMAN CATANACH: All right. I guess 22 with that, we stand in recess until we resume this 23 hearing. 24 (Recess 12:49 p.m.) 25</p>
<p style="text-align: right;"><b>Page 151</b></p> <p>1 COMMISSIONER PADILLA: Friday, the 9th, 2 yeah. 3 MR. BRUCE: Are available? 4 COMMISSIONER PADILLA: Yes, Friday morning. 5 What about your afternoon? 6 (Consultation off the record.) 7 COMMISSIONER BALCH: Two of us have 8 prior -- 9 CHAIRMAN CATANACH: Did you file a 10 de novo? 11 MR. BRUCE: Yeah (laughter). 12 CHAIRMAN CATANACH: A bad one? 13 MR. BRUCE: Yes. And Mr. Singleton can 14 confirm this, but there are expiring term assignments, 15 et cetera that need to be dealt with, so we can't wait a 16 couple of months to recongregate or even, I suppose -- 17 You know, I would guess we would need 18 another half day, Mr. Gallegos? 19 MR. GALLEGOS: I think so. I think 20 Mr. Gaddis is probably -- direct will be an hour. 21 MR. BRUCE: And I did file a de novo, 22 although perhaps I could get that continued. 23 CHAIRMAN CATANACH: Which case is that? 24 MR. BRUCE: It's the Caza Petroleum, Legacy 25 forced pooling horizontal well unit. Imagine that.</p>	<p style="text-align: right;"><b>Page 153</b></p> <p>1 STATE OF NEW MEXICO 2 COUNTY OF BERNALILLO 3 4 CERTIFICATE OF COURT REPORTER 5 I, MARY C. HANKINS, Certified Court 6 Reporter, New Mexico Certified Court Reporter No. 20, 7 and Registered Professional Reporter, do hereby certify 8 that I reported the foregoing proceedings in 9 stenographic shorthand and that the foregoing pages are 10 a true and correct transcript of those proceedings that 11 were reduced to printed form by me to the best of my 12 ability. 13 I FURTHER CERTIFY that the Reporter's 14 Record of the proceedings truly and accurately reflects 15 the exhibits, if any, offered by the respective parties. 16 I FURTHER CERTIFY that I am neither 17 employed by nor related to any of the parties or 18 attorneys in this case and that I have no interest in 19 the final disposition of this case. 20 21 22 MARY C. HANKINS, CCR, RPR 23 Certified Court Reporter 24 New Mexico CCR No. 20 25 Date of CCR Expiration: 12/31/2016 Paul Baca Professional Court Reporters</p>