STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:	)	CASE NO. 12,698
APPLICATION OF MEWBOURNE OIL COMPANY FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO	)	ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

COMMISSION HEARING

BEFORE: LORI WROTENBERY, CHAIRMAN
JAMI BAILEY, COMMISSIONER
ROBERT LEE, COMMISSIONER

October 12th, 2001

Santa Fe, New Mexico

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This matter came on for hearing before the Oil Conservation Commission, LORI WROTENBERY, Chairman, on Friday, October 12th, 2001, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

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I N D E X

October 12th, 2001
Commission Hearing
CASE NO. 12,698

(Continued...)

YATES/JALAPENO WITNESS:

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By: MICHAEL H. FELDEWERT

* * *

WHEREUPON, the following proceedings were had at 10:12 a.m.:

CHAIRMAN WROTENBERY: Now we get to Case Number 12,698, that's the Application of Mewbourne Oil Company for compulsory pooling in Eddy County. This case is being heard *de novo* before the Commission upon the Application of Harvey E. Yates Company and Jalapeno Corporation.

We did have prehearing statements filed by the parties to this particular case. And Commissioners, I believe you got copies of that before the hearing.

And we are ready, I believe, to call for appearances at this point.

MR. BRUCE: May it please the Commission, my name is Jim Bruce from Santa Fe. I'm representing Mewbourne Oil Company, and I have three witnesses.

MR. FELDEWERT: Madame Chairperson, members of the Commission, my name is Michael Feldewert. I'm with the law firm of Holland and Hart and Campbell and Carr here in Santa Fe. I'm here representing Harvey E. Yates Company and Jalapeno Corporation. I have an opening statement and then I have one witness here today.

You should have received our -- like we said, our prehearing statement. And then I've also submitted to you a set of exhibits, the first of which is a type log.

CHAIRMAN WROTENBERY: Okay, we might first ask

that all of the witnesses who will be testifying here today stand and be sworn.

(Thereupon, the witnesses were sworn.)

CHAIRMAN WROTENBERY: Mr. Bruce, do you have an opening statement as well?

MR. BRUCE: I really don't have an opening statement. If Mr. Feldewert would give his, I'd just reserve maybe 30 seconds to respond.

CHAIRMAN WROTENBERY: Mr. Feldewert?

MR. FELDEWERT: I'm going to stick this up here so everybody won't have to pull out their type log.

Mewbourne has -- They've filed an Application in this case seeking to pool properties for a Morrow well. They have not proposed to produce gas from any other formation, they have not proposed to produce gas from any shallower zones. Indeed, what we attached as Attachment 1 to our prehearing statement was their request for an unorthodox well location, which was approved. And that request was limited to production from the Burton Flat-Morrow Pool, and that is indeed what the Division granted, authority for their unorthodox well location to produce from the Burton Flat-Morrow Pool.

Heyco does not object to Mewbourne's request to pool what is necessary to allow Mewbourne the opportunity to produce from the Burton Flat-Morrow Pool, which we

contend is the ability to pool from what we call the base of the Wolfcamp formation, which is depicted on our type log in yellow, down to the base of the Morrow formation. That, we believe, is what they need to have an opportunity to produce from the target area for their well.

What we do have a concern about, and a problem with their request, is that it goes beyond what is necessary for Mewbourne to have their opportunity to effectuate their correlative rights. They've asked the Commission now, at the outset of this project, to pool everything, to pool multiple zones from the base of the Yates all the way down to the base of the Morrow. In other words -- the type log doesn't go quite up that far, but it's basically from the base of the Yates all the way down to the base of the Morrow, rather than just from the base of the Wolfcamp down to the base of the Morrow.

The problem with that approach is that what it does is, it effectively prevents Heyco, it effectively prevents Jalapeno, it effectively prevents all the other working interest owners in the southeast quarter of Section 15, which is where this well is going to be located, from proceeding with their plans and their right to develop these shallower oil and gas reserves under the property. And I'm talking about the reserves above that yellow line, reserves in the Wolfcamp, the reserves in the Delaware, the

other shallower reserves that our witness is going to testify about here today.

I submit to you that their effort here to, in essence, tie up these shallower zones, this shallower acreage for their Morrow well is really an improper, unnecessary use of our compulsory pooling proceedings, because compulsory pooling really exists to provide each working interest owner out there, no matter how big or how small, the opportunity -- it provides a vehicle to them to exercise their correlative rights.

And indeed, if you look at the statute -- and if I may approach, for the convenience of the Commissioners I've made copies of what I'm going to refer to -- if you look at our compulsory pooling statute, the first thing you see in Section A is that it basically repeats the definition of correlative rights, and I think that's important to keep in mind here.

The actual definition of correlative rights is found in the statute on the fourth page of what I've given you, in Section 70-2-33.H, which is on the last page of what I've just handed you. And you'll see by that definition that it is really a limited property right. It's nothing more than a reasonable opportunity to produce your fair share of the reserves in a pool

The statute says that correlative rights means

the opportunity afforded, so far as it is practical to do so, to the owner of each property in a pool to produce without waste his just and equitable share of the oil or gas or both in the pool. That is the correlative right, the opportunity to produce your fair share of the reserves from a pool.

And our -- I should have handed this out when I was up there, I apologize. If I may approach again, our Supreme Court looked at this definition in the Continental case and really reiterated or explained what this property right is.

And on page 818 of this Continental Oil Case, *373 P. 2nd 809* at page 818, they point out that the Legislature however has stated definitively the elements contained in this -- in such right. They're talking about this property right. It is not absolute or unconditional. Summarizing it, it consists merely of an opportunity to produce, only insofar as it is practical to do so, without waste, a proportion insofar as it can practically be determined and obtained without waste of the gas in the pool.

So Mewbourne certainly has a right to produce gas from the Burton Flat-Morrow Pool, and they have the vehicle to do that with our compulsory pooling statute.

And the Commission has authorized the use of police powers of this State to pool -- or take, really --

the property rights of the other working interest owners in this pool, those of Heyco, Jalapeno, et cetera, pool them and allow Mewbourne to pursue their endeavor, but, I submit to you, only to the extent based on what the law says necessary to provide Mewbourne with what they are entitled to, the opportunity to produce their fair share of the reserves, as the statute says, in a pool, which in this case is the Burton Flats-Morrow Pool. That is the designated target of their well, that what they told the Commission in their unorthodox well location, that is what they've gotten approval for.

But at the same time, while the Commission is accommodating the desire, the rights of Mewbourne to pursue the oil or gas in this pool, it has to keep in mind the correlative rights of the other working interest owners in the southeast quarter of Section 15.

When you are exercising this regulatory takings process, Mewbourne's desire to develop this pool cannot go out and trump the rights of the working interest owners out there to develop these shallower reserves, to develop the reserves above and outside of the designated target for Mewbourne's well. They have just the same right as Mewbourne has to go out and explore the reserves in the oil and gas pools in the formations, in these shallow -- in what I would call the shallower formations, and what we are

talking about here is those above the base of the Wolfcamp.

So I think you have to -- in each case you get a compulsory pooling application, I think you have to ensure, one, that it only goes so far as is necessary to provide the applicant with the opportunity to pursue their drilling project, but at the same time look at the other side and make sure that it does not impair unreasonably the correlative rights of the other working interest owners to pursue other projects.

The other thing that's important, and the reason I went through this compulsory pooling explanation, this correlative rights definition, is because the compulsory pooling statute does not sit there as a mechanism for ensuring or shoring up the economics of a project. That's not its purpose. The economics of a project are dictated or decided by the working interest owner who desires to explore a certain pool. And all the compulsory pooling statute does is give them the vehicle to do that. It does not sit there to shore up the economics or improve the economics of their project.

It is something that just -- It sits out there to afford Mewbourne, in this case, and other working interest owners, the opportunity to pursue what they believe to be or what may be an economical project. The compulsory pooling statute is not there to do anything more than that.

Now, the evidence that we're going to show you here today -- I'm going to call Mr. Reyes to the stand -- he's a geologist -- and he's going to testify that pooling from the base of the Wolfcamp down to the base of the Morrow is all that is needed to provide Mewbourne with their opportunity, their correlative right, to proceed with their desire to explore the Burton Flat-Morrow Pool.

Pooling all formations from the base of the Yates all the way down to the base of the Morrow is not necessary to protect their correlative right, and indeed I submit to you it impairs the correlative rights of the other working interest owners out there.

We're also going to demonstrate that not only does Mewbourne have the opportunity with a more limited pooling order to explore the Burton Flats Pool, but it ends up they also have even a bailout zone in the Strawn, if you pool from the base of the Wolfcamp to the base of the Morrow, roughly here. There's going to be testimony on that today.

And finally, we will provide testimony that a pooling order from the base of the Yates to the base of the Morrow, as Mewbourne has requested here, will indefinitely delay Heyco's plans to develop the shallower zones and thereby impair the correlative rights of Heyco, the correlative rights of Jalapeno, and the correlative rights

of all the other working interest owners in the southeast quarter of Section 15.

That's all I have.

CHAIRMAN WROTENBERY: Thank you, Mr. Feldewert.

Mr. Bruce?

MR. BRUCE: Madame Chair, I'll probably be longer than I intended to be, because of what Mr. Feldewert said.

If I can approach, I've handed you a case which I'll get to in a minute. I'd simply like to say that in this case Mewbourne does seek to force pool zones from the shallow depths down to the base of the Morrow. It has made a good-faith effort to obtain the voluntary joinder of Heyco, Jalapeno and two other corporations, both before and after the Division hearing on this matter, and it believes pooling is proper.

Now, this proposed well is a reasonable prospect, otherwise we wouldn't be here. Mewbourne wants to drill the well, they think they can make money doing it, which is why these oil companies drill these wells.

However, in wells, especially in a lot of these older producing areas, which has become a target of drilling ever since the Commission approved the infill drilling, you need multiple zones to make the well economic. We have an engineer here who will testify to that.

We will also testify that although we are seeking two force-pool zones down to the base of the Morrow, the uphole zones other than the Morrow are marginal. Now, they do help make the well economic, but we need those zones. Period, end of story.

As to pooling only certain limited zones, I don't dispute that the Commission has the authority to do that. The case I just handed you, *Viking Petroleum versus the Commission*, went up to the Supreme Court. In that case, the positions were flipped. Heyco in that case was seeking to pool everything from the surface, I believe, to the base of the Ordovician.

And Viking said, No, no, no, you can't impose a penalty or you shouldn't pool the zones above the base of the Abo, you should only force pool the deep zones.

The Supreme Court in this case said that the Commission has the discretion to do it either way, but since I've been here for 20 years and ever since this case, it has been Division policy to -- and Commission policy, to force pool all the zones requested by the Applicant. And the reason for that I will get to in a minute, some of the practical reasons.

I highlighted a couple of things on this case, in particular on page 2 where Viking contended the penalty should only apply to the drilling and completion cost being

carried on behalf of Viking below the base of the Abo formation.

And then if you turn to page 5 of this case, the reason for that was -- or the reason the Commission force pooled all zones is because it wasn't a justifiable economic risk to drill a well at the proposed location depending only upon Abo production.

That's what we have today. What Heyco is saying is, You shouldn't force pool the Wolfcamp, because we want to go to the Wolfcamp at some future uncertain date.

A couple of things about that: Heyco has owned its interest in this half section of land for 30 years. It has -- Since 1975 there has been no deep test drilled on this half-section of land. Mewbourne comes forward with a proposal, and Heyco seeks to impair or impede drilling a deeper well.

Secondly, what we will be doing when drilling this Morrow well -- and the Morrow is clearly the main pay in this area -- is, we will be going through the Wolfcamp. We think it's not proper if we're going through the Wolfcamp not to force pool that zone, because what Heyco is seeking, in effect, will be to drill a second well on this quarter section. We don't think that's proper until we drill this well and see what the Wolfcamp looks like in this zone. Why twin the wells when you don't need to? Why

have two wells go to the Wolfcamp when one may do?

Now, the reasons for force pooling all zones, I think there's several of them. As I've just mentioned, you need to stack the zones to make the well economic, first and foremost.

Second, if the Division or the Commission only pools one or two zones at a time, we're going to be back here on the same well time after time after time, force pooling new zones. What will happen if that's done? Well, as you well know, the pooling process generally takes 90 to 120 days. Every time somebody drills a well and seeks to force pool an uphole zone, you're going to have to wait for that 90- or 120-day period to recomplete, because you're going to seek to force pool the same interest owners in a well that you've already drilled. We think that's a waste of time and money.

And finally, we think there's a -- just a practical aspect to this. It gives the parties who do not desire to participate in a deep test a free look at all uphole zones. They don't want to spend any money, but they want a free look at the logs and all the uphole zones. We don't think that's proper.

We think a change in the Division or the Commission policy will have an adverse effect on drilling, and it will penalize the interest owners who are willing to

risk their funds for drilling a well.

The one final matter I would state is that the pooling statute -- it's not a taking of property. Whether before or after pooling, Jalapeno and Heyco will own their leasehold interests. What happens is, if they choose not to join in the well, they have a penalty on production.

In a case -- Now, this involved a joint operating agreement, not force pooling, but it was Nearburg Exploration Company versus Yates Petroleum Corporation. In interpreting the penalty provision in a joint operating agreement, which is similar to the penalty in a force-pooling statute, they said this is -- the nonconsent penalty provision is not an unenforceable penalty, it's not a taking of property. It's simply the arrangement by which risk is attributed to the working interest owners who desire to pay for the well.

As I said, we have three witnesses. We will show evidence that we need to force pool all zones. If Heyco doesn't want to join in the well, they don't have to. But our position is, it's a good risk, we're not taking anything from them, they will get eventually well data that might cause them to drill later on. They haven't for 25 years, but maybe in the future they will.

As far as developing shallower zones, they can go ahead and develop most of the shallower zones. Oil zones

are only spaced on 40 acres. They can propose a number of oil wells in this area. We're not forbidding them from doing that. But we need all zones to make this well economic, it's as simple as that.

Thank you.

CHAIRMAN WROTENBERY: Thank you, Mr. Bruce.

Would you like to call your first witness?

MR. BRUCE: Call Mr. Haden to the stand.

Madame Chair, Mr. Haden is the landman for Mewbourne. Heyco in its prehearing statement said they're not contesting the good faith negotiations among the parties, and I propose to make Mr. Haden's testimony fairly summary in nature if it's okay with the Commission, and Mr. Feldewert and I have talked about incorporating the record from the prior Examiner hearing into this matter.

MR. FELDEWERT: Yeah, I have no objection. I don't think there's a lot of land issues in this matter, so I have no objection to incorporating the prior record, and if Mr. Bruce thinks we need some testimony from his land person that's fine, but...

CHAIRMAN WROTENBERY: Okay.

(Off the record)

CHAIRMAN WROTENBERY: Okay. We will, then -- Since both parties are in agreement, then it will help speed this hearing along. We will take administrative

notice of the record in the hearing on this matter at the Division level.

MR. BRUCE: Before I begin, just one thing. If you will look at Mewbourne's Exhibit Number 1, Commissioners, I'll just briefly state what we're seeking. Exhibit 1 shows the east half of Section 15.

CHAIRMAN WROTENBERY: Okay, give us a moment here. You're referring to the exhibits that you've --

MR. BRUCE: Yes.

CHAIRMAN WROTENBERY: -- prefiled with the --

MR. BRUCE: Yes.

CHAIRMAN WROTENBERY: -- Commissioners?

MR. BRUCE: Yes.

CHAIRMAN WROTENBERY: I think we're caught up with you now.

MR. BRUCE: Okay. Outlined on that is the east half of Section 15, with the well location spotted on there. What Mewbourne seeks is to drill a well at the location in the northwest quarter of the southeast quarter of Section 15. It seeks to pool oil zones from the base of the Yates formation to the base of the Bone Spring formation, which are spaced on 40 acres. It seeks to force pool the southeast quarter of that section for any zone spaced on 160 acres, and there is a Bone Spring gas pool here which could be spaced on 160 acres. And then it seeks

to force pool the east half for the deep gas zones, which are from the top of the Wolfcamp to the base of the Morrow.

D. PAUL HADEN,

the witness herein, after having been first duly sworn upon his oath, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. BRUCE:

Q. Mr. Haden, would you please state your name and city of residence?

A. My name is Paul Haden. I live in Midland, Texas.

Q. And who do you work for and in what capacity?

A. Mewbourne Oil Company as a petroleum landman.

Q. Have you previously testified before the Division or the Commission as a petroleum landman?

A. Yes, I have.

Q. And were your credentials as an expert accepted as a matter of record?

A. Yes, they were.

Q. And are you familiar with land matters involved in this case?

A. Yes, I am.

MR. BRUCE: Madame Chair, I tender Mr. Haden as an expert petroleum landman.

CHAIRMAN WROTENBERY: We accept his qualifications.

Q. (By Mr. Bruce) Referring to Exhibit 1, Mr. Haden, there's some ownership information attached to the land plat. Who exactly does Mewbourne seek to pool in this matter?

A. Mewbourne Oil Company seeks to pool Harvey E. Yates Company, Cibola Energy Corporation, Yates Energy Corporation and Jalapeno Corporation.

Q. Okay. Now, very briefly, what are Exhibits 2A, 2B and 2C?

A. Exhibits 2A, 2B and 2C are a copy of all my communications regarding our negotiations with all of these parties. Also gives a summary of communications on the front of each exhibit.

Q. Okay. Now briefly, what have been the sticking points in the negotiations?

A. First of all, the other parties wanted to give us only zones below the base of the Wolfcamp formation. They also wanted a very high back-in after payout, which we would only agree to a quarter back-in, which we thought was reasonable. We also could not agree on their farmout language, nor their form of agreement.

Q. Okay. Now, the back-in, Heyco, et al., had wanted a one-third back-in after payout, correct?

A. That's correct.

Q. And Mewbourne was willing to give a one-fourth

back-in?

A. That's also correct.

Q. Will the engineer, our engineer, discuss economics about this later on?

A. Yes, he will.

Q. Okay. And in your opinion has Mewbourne made a good-faith effort to obtain the voluntary joinder of the interest owners in the well?

A. Yes, I believe we have.

Q. Regarding communications, just one final matter. After the Division's order was issued, did Mewbourne mail an AFE and a copy of the order to the parties being pooled?

A. Yes, we mailed and faxed a copy of the order along with the AFE August 13th, 2001.

Q. Okay, did you ever receive a response to the election letters that you sent out?

A. No, we did not.

Q. Okay. What is Exhibit 2D?

A. 2D is a copy of our drilling opinion of title for the east half of Section 15, which describes the ownership. It's dated March 28th, 2001.

Q. When does it show Heyco or its predecessor first acquiring an interest in this half-section of land?

A. Apparently Harvey E. Yates first acquired an interest back in 1964.

Q. Okay. Has Mewbourne received any well proposal from Heyco or the other parties being pooled?

A. No, we have not.

Q. Okay. What is the well's footage location?

A. The location of the well is 2232 feet from the south line and 1980 feet from the east line, in Section 15 of Township 21 South, Range 27 East, in Eddy County, New Mexico.

Q. And that location in the Morrow was approved administratively?

A. Yes, it was.

Q. Did Mewbourne want an unorthodox location?

A. No, Mewbourne Oil Company did not desire to have an unorthodox location.

Q. Okay, now -- And the geologist can get into this, but the location you wanted was in what, the west half of the southeast?

A. West half of the southeast quarter, that's correct.

Q. Why did you need this unorthodox location?

A. We needed this unorthodox location due to archeological restrictions and also the existence of some surface restrictions, being pipelines.

Q. Okay. Is it very difficult to find a surface location in the west half, southeast quarter of the

section?

A. Absolutely. In fact, the only location that we could find that was drillable is the location in which we've proposed. It is between two pipelines. This is the only location in the west half of the southeast quarter that can be drilled.

Q. Okay. Now, the next exhibit is an AFE. Will Mewbourne's engineer discuss that AFE?

A. Yes, he will.

Q. And regarding overhead rates, do you request the rates that were adopted by the Division's order be incorporated in the Commission's order?

A. Yes, we do.

Q. And the parties being pooled originally notified of the Examiner hearing?

A. Yes, I have.

Q. And were Exhibits 1 through 4, except Exhibit 3, prepared by you or under your supervision or compiled by company --

A. That's correct.

Q. -- or from company business records?

A. Yes, that's correct.

Q. And in your opinion, is the granting of Mewbourne's Application in the interests of conservation and the prevention of waste?

A. That's correct.

MR. BRUCE: Madame Chair, I move the admission of Mewbourne Exhibits 1 through 2D and 4.

CHAIRMAN WROTENBERY: Mr. Feldewert?

MR. FELDEWERT: Madame Chairperson, I think they've been -- Have all those been admitted at the Division hearing?

MR. BRUCE: There was correspondence after the Division hearing, which is attached to Exhibits 2A through 2C.

MR. FELDEWERT: Okay, I have no objection.

CHAIRMAN WROTENBERY: Exhibits 1, 2A through 2 -- B?

MR. BRUCE: 2D.

CHAIRMAN WROTENBERY: -- and 3 are -- or 4, I'm sorry, not 3, 4 -- are admitted.

Mr. Feldewert?

CROSS-EXAMINATION

BY MR. FELDEWERT:

Q. Mr. Haden --

A. Yes, sir.

Q. -- in looking at Exhibit 2A --

A. Right.

Q. -- there's a letter there -- the last entry there is a letter you sent October 2nd to Heyco; is that right?

A. Actually, we received a letter from Heyco on October 9th to which we responded, and I had some conversations with Melissa that same date, and we responded October 10th with a letter.

Q. Just --

A. I also have a copy of that letter, if you would like to --

Q. Well, let me ask you more quickly here -- and it's out of order, I apologize, but Heyco Exhibit Number 8, is that the October 9th letter from Harvey E. Yates company that you were referencing that was missing from your exhibit?

A. Yes, it is.

Q. Okay. I just wanted to have that to make the record complete.

Now, have you seen Heyco's prehearing statement, Mr. Haden?

A. Yes, I have.

Q. Okay, have you looked at the attachments to that prehearing statement?

A. I don't believe I have, I do not have a copy of that --

Q. Well, let me --

A. -- prehearing statement.

Q. -- give you a copy, because I want to refer to

Attachment 1 to that prehearing statement.

Mr. Haden, I'm going to represent to you that attachment to that prehearing statement is the file from the Division's records for your request for your unorthodox well location, and we're talking about -- your proposed well is the Esperanza 15 State Com Well Number 1; is that correct?

A. That's correct.

Q. All right. And in connection with seeking an approval of your unorthodox well location, you sent a June 26th, 2001, letter to Mr. Stogner; is that correct? It should be probably four or five pages into the attachment.

A. Mr. Bruce did on our behalf.

Q. Okay. And the second paragraph of this letter says that the well will be drilled to test the Morrow formation in the Burton Flat-Morrow Gas Pool; is that right?

A. That's what it says.

Q. Okay. And then the third paragraph of that letter, about halfway down, indicates there are two primary zones, the middle Morrow blue and the lower Morrow orange; is that correct?

A. Those are -- Yes, that's correct, those are both within the Morrow.

Q. Are those both potential pay zones for your well?

A. I would like to refer that question to our geologist.

Q. Okay. In your submissions to the Division for your unorthodox well location -- and Mr. Haden, you only identified the Burton Flat-Morrow Gas Pool as a target; is that correct?

A. As far as the unorthodox location request is concerned.

Q. Okay, and you didn't identify and intend to produce gas from any other pool or formation in this request to the Division; is that correct?

A. No, we did not. However, it's normal practice to only request your main target zone for unorthodox location.

Q. And the geologic evidence that you submitted to the Division were for the two primary zones, or what you call the two primary zones for the Morrow, the middle Morrow and the lower Morrow; is that correct?

A. That's what we submitted, yes, that's correct.

Q. Now, this well that we're talking about encroaches to the -- I guess it would be the northeast quarter of Section 15. It's too close; isn't that correct?

A. That's correct, that's moving toward ourself.

Q. Okay, the setback requirements are 660?

A. 660, that's correct.

Q. Now, the second page of this letter, Mr. Bruce to

the Division, indicates that because you were encroaching on the interior of your 320-acre spacing unit, you didn't identify the offset operators -- or, I'm sorry, you didn't notify the offset operators of your request for an unorthodox well location?

A. We didn't think that was necessary because we are encroaching upon ourself and nobody else.

Q. I understand. And the Division approved your request for an unorthodox well location for the Burton Flat-Morrow Gas Pool; is that right?

A. That's correct.

Q. Okay. Now, Mr. Bruce has identified and I believe your Application talks about the East Avalon-Bone Spring Gas Pool as a potential producing gas zone in this area; is that right?

A. That's correct, of which our geologist will testify about.

Q. What is the spacing for an Avalon-Bone Spring gas pool in this area, do you know?

A. As far as I know, but I'm not absolutely certain, I believe it's 160 acres.

Q. Okay, and you're the landman for Mewbourne, correct?

A. Yes, sir, I am.

Q. What is the setback requirement for a gas well

that has produced or that has drilled to the Avalon-Bone Spring Gas Pool?

A. I believe it's 660.

Q. So am I correct that your Esperanza well would be unorthodox at this location for this pool? It would, wouldn't it?

A. Yes, it's closer than 660.

Q. And you don't have approval from the Division at this point to produce from an unorthodox well location for this pool, do you?

A. No, sir, but we would seek approval upon recompletion of that Bone Spring zone as the other zones that are currently unorthodox.

Q. So if you were -- if you ever got around to moving uphole to this particular gas pool, you would have to file an Application with the Division to approve your unorthodox well location?

A. Absolutely.

Q. And for that 160 spacing unit, because you're encroaching on the northeast quarter, you'd have to notify the operators of that northeast quarter of your request; isn't that correct?

A. We are the operator for the northeast quarter.

Q. And if there were other operators up in the northeast quarter you'd have to notify them as well, would

you not?

A. Yes, if there were.

Q. Okay. And if any of those operators objected, you're aware that then there would have to be a hearing before the Division on your unorthodox well location; isn't that correct?

A. Yes, we're aware of that.

Q. All right. So if Mewbourne ever decides to test this pool with your Esperanza well, you're going to have to come back to the Division, you're going to have to file an application and maybe even have a hearing; isn't that right?

A. That could happen if the owners do not wish us to recomplete that zone, that could very well happen.

MR. FELDEWERT: Okay, that's all I have. Thank you.

CHAIRMAN WROTENBERY: Commissioners, any questions?

EXAMINATION

BY COMMISSIONER BAILEY:

Q. When did Mewbourne obtain the rights in this section?

A. We first started negotiating trades with various parties in the year 2000. We first obtained an interest in January of 2001.

Q. Can you tell me about rig availability right now?

A. Rig availability right now seems to be a lot better than it was a few months ago. However, we have scheduled our drilling program. I've told the poolees all along that we'd like to drill this well September 1st. However, we're restrained from doing that because of these hearings. We would like to drill the well just as soon as we can get this matter resolved.

Q. Do you have a rig under contract?

A. We currently have a rig under contract, it's drilling the well for us right now in Eddy County.

Q. You said that this location was chosen because of archaeology and pipeline constraints?

A. That's correct.

Q. Was there any seismic or geologic reasons for --

A. Yeah, obviously we'd like to drill in the west half of the southeast quarter, based on geologic reasons, which our geologist will point out the reasons why. But there were some surface restrictions.

We tried to initially locate our well in the southwest southeast quarter, however there's some archaeological problems at a legal location there. We tried numerous times to get a location in the southwest southeast quarter. There is some shallow production which has some environmental concerns.

Also in the northwest southeast quarter there's some problems with pipelines. We have located our well in between two pipelines. One pipeline is to the north of our location and one is to the south. However, the location of those pipelines as to our location is sufficient.

Q. Would you please run that by me again? You made a comment concerning production, they had environmental concerns?

A. Southwest southeast quarter, there's some shallow oil wells, at least one of them is producing. There appears to be possible spills.

Q. Okay, those are the types of --

A. Yes, that's the environmental concerns that we've seen on the surface.

COMMISSIONER BAILEY: Those are all the questions I have of this witness.

CHAIRMAN WROTENBERY: Questions?

COMMISSIONER LEE: (Shakes head)

EXAMINATION

BY CHAIRMAN WROTENBERY:

Q. Mr. Haden, the Application of Mewbourne also asked to form a standard 40-acre oil spacing and proration unit for the formation or pools spaced on 40 acres, and there are several existing pools that are covered by Mewbourne's Application.

Is the proposed Esperanza 15 State Com Well Number 1 standard in the 40-acre unit, proposed 40-acre unit?

A. Those would be standard 40-acre units.

CHAIRMAN WROTENBERY: Mr. Bruce, did you have any follow-up?

FURTHER EXAMINATION

BY MR. BRUCE:

Q. Really just one, Mr. Haden, regarding the question on the Bone Spring unorthodox location. You know, referring to your Exhibit 1, the land plat there --

A. Right.

Q. -- go to page 2 of that Exhibit 1.

A. Yes.

Q. People who -- although there is somewhat different ownership, the immediate offsets to that Bone Spring unorthodox location are the same people who own an interest in the -- it appears there's three tracts where the leasehold ownership is basically the same; is that correct?

A. That's correct.

Q. So the immediate encroachment would be -- there would be no difference in ownership?

A. That's right.

MR. BRUCE: That's all I have.

CHAIRMAN WROTENBERY: Anything else, Mr. Feldewert?

FURTHER EXAMINATION

BY MR. FELDEWERT:

Q. Do you know if there's a difference in royalty interest?

A. As far as the State's royalty?

Q. No, in terms of royalty owners between the northeast quarter and the southeast quarter. Have you looked at that?

A. No, I have not researched that.

MR. FELDEWERT: Okay, that's all I have.

CHAIRMAN WROTENBERY: Thank you, Mr. Haden.

THE WITNESS: Thank you.

MIKE BURKE,

the witness herein, after having been first duly sworn upon his oath, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. BRUCE:

Q. Would you please state your name and city of residence?

A. My name is Mike Burke, I'm from Midland, Texas.

Q. Who do you work for?

A. I'm a petroleum geologist with Mewbourne Oil Company.

Q. And have you previously testified before the Division or the Commission as a petroleum geologist?

A. Yes, sir, I have.

Q. And were your credentials as an expert accepted as a matter of record?

A. Yes, sir, they were.

Q. And are you familiar with the geology involved in this Application?

A. Yes, sir.

MR. BRUCE: Madame Chair, I tender Mr. Burke as an expert petroleum geologist.

MR. FELDEWERT: No objection.

CHAIRMAN WROTENBERY: We find him qualified to testify as an expert.

Q. (By Mr. Bruce) Mr. Burke, could you identify Mewbourne Exhibit 5 and discuss the primary zone of interest for your proposed well and other production in this area?

A. I certainly will. What I've prepared here is a map that shows all of the producing formations. This is Exhibit Number 1.

CHAIRMAN WROTENBERY: Exhibit Number --

MR. BRUCE: -- 5.

CHAIRMAN WROTENBERY: -- 5.

THE WITNESS: Excuse me.

Q. (By Mr. Bruce) It's got a lot of colors on it, Mr. Burke, so please go through it slowly to identify what is what.

A. This map is 1 to 1000 scale and encompasses the nine sections, and including Section 15 adjacent to it, that I have summarized the production on.

If you look in the lower left-hand corner of the map, you see a legend, and you'll see here that I have color-coordinated these colors around these wellbores on the map based on the producing formation. You'll see some wells on the map that have only one color and some that have up to four colors, so you can see some of these wells are single-zone wells, some of them were drilled and subsequently recompleted or dually completed through time.

Also, those formations -- there in the legend the Yates at the top is the shallowest formation, and then as you move down through that legend area, the Delaware, Bone Springs, all the way down to the Morrow, you're moving down in depth. So that's just something for your reference.

And bear with me, because I'm going to spend a good bit of time on this map, because it's very important.

If you look at the key there next to the legend, I've posted some information that I feel is important around the wells. You'll see that the actual well symbol there, if it contains a slash or a strike through it, that

well is currently plugged and abandoned. In other words, it's no longer producing.

Posted around the well is some important information. Just below the wellbore will be the total depth in feet, and then just below that -- and these are in black -- is the original completion date of the well. Now, the well may have been subsequently, and I have some information on that, but it gives you an idea when the well was originally drilled, whether it was in the 1950s, the 1960s, the 1970s, the 1980s.

On this particular map I have highlighted above the well subsea elevation. It's not posted on this well, but it will be on some other maps I'll present to you later.

And then if the well is currently active, above the well symbol will be the name of the current operator. Now, if you don't see an operator name above the well symbol, it means -- you can look, of course, it will have a slash through it as plugged and abandoned. I didn't post that data.

Now then, if you'll look next to the well -- and it could be posted to the left or to the right but it's color-coordinated -- I have the production from each particular zone that the well has produced from.

And just a good for example, it's posted in

thousands of barrels of oil and billion cubic feet of gas. If you'll look at the very bottom of the map, in about the center bottom of the map you see an OXY well there. It's made .178 billion cubic feet of gas, and it's made .129 thousand barrels of oil or 129 barrels of oil.

And then if that well is active, also posted below that is the original completion date of the zone it's currently in. So it's a red dot, so it's in the Morrow formation, you can see what the production is. It was completed in that zone in 8 of the year 00.

And that's kind of how the information is laid out on this. It's a very busy map. And I'm going to talk about each of these zones here in just a moment, but I would like to point out our proposed location, which is in the very center of the map in Section 15. There's a pink dot on it and there's a line running down to it showing where we propose to drill.

Now, I'm going to begin talking about the shallow formations first, and then I'm going to work my way down through the deeper formations. And I will primarily talk about production at this time, production volumes and production averages, and I will go into some more specific geology of certain formations in some later exhibits. But for the moment I'd like to give you an understanding of what is productive in the area and what kind of production

volumes, you know, an operator can expect when they drill a well out here.

The shallow, the Yates formation, that's the pink dots. You see a good many of them in the middle of the map there in Section 15. It's a very shallow formation. The average completion depth is 352 feet. These original wells were drilled in the 1950s.

Most all -- As a matter of fact, all of these wells are plugged but one, and the wells have averaged -- of those dots that were completed in there, they've averaged about 3000 barrels of oil per well and, oh, 749,000 cubic feet, which you know, at that shallow a depth may or may not be commercial. That zone we have not even asked for pooling, but I'm going to talk about all the zones.

There's been 30 wells out here that have penetrated that zone, and of those 30 wells only seven were completed.

The next formation I'm going to talk about is the Delaware formation, and those are the brown dots you see in the northeast and the northwest parts of the map. In this nine-section area there have been 30 penetrations through the Delaware formation, there have been 11 completions. The average well in this -- And the average completion depth, excuse me, is 4414 feet. The average well has

produced 30,392 barrels and 98 million cubic feet of gas.

The next zone I would like to talk about going down are the orange dots, it's the Bone Spring formation. There have been 23 penetrations through this formation, five of which have made completions. The average depth of completion is 6530 feet. The average production per well is 2321 barrels of oil and 21 million cubic feet of gas.

And I'm reading from a statistical summary I have here that I did not make as an exhibit. If you'd like, I have some extra copies of it. I know I'm reciting a lot of numbers, but what I'm trying to get to by reciting these numbers is that most of these zones have proven to be noneconomic as a stand-alone drilling contractor. They don't produce enough oil and gas by themselves in this area, typically, to make a well commercial to drill for these shallower zones.

So I'm going to go ahead and talk about the rest of them, but if -- I know I'm getting you bogged down, I have extra copies of what I'm reading from, if you'd like to have those. You would?

CHAIRMAN WROTENBERY: It would be helpful to have those marked.

THE WITNESS: And I'll go ahead and talk about the next zone. The Wolfcamp --

MR. BRUCE: Just a minute.

THE WITNESS: Okay.

MR. BRUCE: Madame Chair, I've marked Mewbourne Exhibit 5A, which is just the statistical summary that Mr. Burke was talking about.

Q. (By Mr. Bruce) Mention the Wolfcamp and then stop, Mr. Burke.

A. Okay. The Wolfcamp formation in this area, average completion depth -- and it's in the middle of this page you were just handed, and you'll see I say Wolfcamp/Penn, because in this particular area there's been some mixing of the nomenclature Wolfcamp/Penn in the area, and I'll talk about that in a few minutes.

But the average completion depth is 9416 feet. There have been a total of 22 wells penetrate this zone, of which seven have been completed. The average production is 10,325 barrels of oil and 229,000 MCF of gas.

Q. Now, just looking at the statistical summary, Mr. Burke, and the figures, the average figures per well, even if you drilled from the top of the Yates down to the base of the Wolfcamp and you got the statistical average production for each zone in that well, would it still look marginal to you?

A. Yes, it would, and that's assuming that you had production from each of the zones.

Q. That's what I'm assuming --

A. Right --

Q. -- that each zone produced its average amount in this statistical area.

A. Right.

Q. Okay. Move on to the deeper zones.

A. Okay, and I will talk about the deeper zones now.

The Strawn formation, 10,376 feet is the average depth. It has pretty good production, 781 million cubic feet of gas and 11,000 barrels of oil.

Q. And will you discuss the Strawn --

A. And I will discuss --

Q. -- a little bit more later?

A. -- the Strawn in more detail, the trapping and nature of it.

The Atoka is a lot like many of the shallower formations. It's a multiple lenticular zone. Its depth is 10,782 feet. Four completions out of 22 wells penetrating it.

And then we get to our primary objective, and it's the zone that we are primarily drilling a well for, the Morrow formation, and this includes the upper, middle and the lower Morrow in these production numbers. It's an average completion depth of 11,460 feet, average production is 2.3 BCF and nearly 1000 barrels of oil. And there have been 17 completions of 22 wells attempting to go through

that formation, so...

Q. Now, before we move on to the primary Morrow maps, what about the Morrow production in this area? We've already discussed, either through questioning of Mr. Feldewert of Mr. Haden, two primary Morrow zones. What are they, just briefly?

A. Right, the Morrow in this area we subdivide into a middle Morrow sand sequence and a lower Morrow sand sequence, and within each of those sequences -- and you'll see that on the cross-section -- are multiple sands within those that are and are not productive, depending on where you encounter them.

Q. Now, is one zone more permeable than the other?

A. And generally speaking, the lower Morrow gives you the higher production volumes and the higher cumulative production, has better permeability and porosity, however, is structurally controlled, whereas the upper Morrow has lower permeability and porosity and generally is not as structurally controlled, is more stratigraphically controlled in its production, and I'll have exhibits to demonstrate that for you also.

Q. Now, has a lot of production in the past from the older Morrow wells been lower Morrow production?

A. That's correct, a lot of it has been lower Morrow production. And that probably skews the Morrow production

number higher, because a lot of the high-production wells are in the lower Morrow.

Q. Okay. Do you have anything further on this map, Mr. Burke?

A. No, if you have any questions we may refer back to this map, you might keep it handy.

Q. Maybe just one final thing. There are a number of well sites for this shallow Yates zone in the southeast quarter, correct?

A. Yes.

Q. And that impaired the ability to find a well location, did it not?

A. It was my understanding that it did.

Q. Okay. And now maybe if I could direct the Commission to take the next few exhibits together, they all involve the Morrow, Exhibits 6 through 8, which are structure and isopach maps and a Morrow cross-section. Mr. Burke, If you could let the Commissioners get those in front of them and then go through these exhibits as you see fit and describe the Morrow -- the primary zone of interest in Mewbourne's proposed well.

A. Okay. Are you ready? Exhibit Number 6, 7A and 7B are all maps. They're at a 1-to-2000 scale. I prepared these maps. And Exhibit 6 is a structure map at the top of the lower Morrow formation, and I will demonstrate that to

you on the cross-section, but it is a consistent stratigraphic marker that we map structure on this area.

The wells with the red dots and circles around them are wells that have completed and produced from the Morrow formation here. Some are active, some are active. This does not have near the detail as Exhibit Number 5 that shows all of the wells, and you can see I've only posted wells with total depths deeper than 11,000 feet. So you're really only looking at wells on this map that penetrated the Morrow formation, and I'm not going to testify about the shallow formations off of this map.

Q. Now, one thing before you go on: This map has production data on it also, does it not?

A. It sure does, and --

Q. And what -- Go ahead.

A. It is the cumulative production of the wells at the time I first presented these maps at the first hearing, in millions of cubic feet equivalent. So I've converted the oil on a six-to-one ratio to gas and added it to the gas to kind of normalize things and let you see what kind of production volumes you have from these wells.

Q. In just looking at the production data, there's really -- if you're going to the east or the southeast, you're really on the fringe of decent production, are you not?

A. That is correct. If you look at the map what you will see structurally is, from the north center part of the map trending down to the southwest is a plunging anticline or a high. And running along that high what you will see are the better cumulative production. Two of the wells in Section 10 on the north end up there, one has made 3733 MMCFE, which is 3.7 billion cubic of gas. The one just south of it -- it's inactive now -- has made 9336 MMCFE or 9.3 BCF. And there are other good wells along that structural anticline.

Now, next to each well you'll see in bold red print I have MM and LM. If it says MM it means it was perforated in the middle Morrow, and LM means it was perforated in the lower Morrow. These two zones in these sands have been perforated and produced together as a matter of common practice out here for years. It's usually up to the operator to determine the productive zones and complete those.

But what you see in general here is a trend that as you move to the east you're moving in a downdip direction, and as you move to the east you'll see that the cumulative production overall becomes poor until you've reached the very eastern part of the map, southeastern especially, and you see that there is no Morrow production at all down there, even though there have been penetrations

down there.

And what happens is, the lower Morrow sands become wet as you move offstructure and the middle Morrow sands are tighter, and many of the operators that drilled some of these wells 20 years ago did not even attempt completions in them. They didn't feel like the had sufficient porosity and permeability to make a completion. However, we've had some success in these middle Morrow zones, and our well here will be an attempt to complete in it.

That is really all I have on that exhibit. Do you have any questions?

Q. Just go on.

A. Okay. Now, included here are two isopach maps, and I'll point these zones of isopach to you out on the cross-section, which is the next exhibit, but these are net pay isopach maps. What I've mapped on here is, I've correlated the individual sands on Exhibit 7A and 7B and constructed isopach maps of potential pay based on a porosity cutoff of approximately 9-percent density, with a clean gamma-ray reading.

And what you have here on Exhibit 7A is a net pay map. The wells in red with the red circles around them have perforated this particular zone. So you can see from the net isopach map, Exhibit 7A, the lower Morrow orange,

that many of the wells in here have produced from the lower Morrow orange, and it's just reasonable at our location for us to expect that we'll encounter some pay at that location.

Exhibit 7B is the same type of map of what we call the middle Morrow blue, constructed the same way with the same porosity cutoffs and criteria, what we call pay. And again, what I'm really trying to demonstrate here is, you can see the wells that produce just from this zone or were perforate in this zone there. They're highlighted in red. And what I'm trying to demonstrate here, again, that it's reasonable that we will encounter this zone and that production is around us from this zone.

And that's really all the testimony I have on those Morrow exhibits.

Q. Okay. But the Morrow, based on your study, is clearly the primary objective in this well?

A. Yes, it is.

Q. Okay. Let's move on, maybe take your final three exhibits together, Mr. Burke, Exhibit 9 --

A. Oh, I need to talk about 8 just a second.

Q. Oh, okay, go ahead.

A. That's the cross-section. And what you see here, quickly, you see on the cross-section I have lower Morrow, a bold line across there. That's what I've mapped the

structure on. It's a recognized and consistent stratigraphic marker in the area for structural mapping purposes.

And then you see a line at the top of the middle Morrow, and all of the sand between the middle Morrow and the lower Morrow marker, you can see there are about four primary sands. The one in about the middle is the blue sand, that's one of our primary objectives. These are the zones that I spoke of earlier that are primarily stratigraphically trapped and produce in the area but don't typically produce the high volumes that the lower Morrow sands below produce.

If you look below the line for the lower Morrow, you'll see three primary sands, a yellow, an orange and a brown sand. All of these sands are productive in the area, especially at the tops of the structures. They've contributed a tremendous amount of the gas on the high cumulative wells, high on the structure. They're highly depleted at the present time.

And so one thing I'd like to stress is that when we drill our well, first of all, we're not going to be at our location at an optimum structural position for the lower Morrow, plus we're going to have incurred some pretty significant depletion from offsetting wells. So the average that we looked at earlier of 2.3 BCF for this nine-

section area for the Morrow is probably not what we're going to get.

We're going to get something less than that, because we're including in the averages wells that have never suffered any depletion, and we're at the tops of the structure, and we're not in that instance in either case.

So we'll testify here, our engineer will testify, the kind of reserves we think we're going to encounter in the Morrow. It will be less than the averages because of those geologic and production reasons.

Q. But once you're down to the middle Morrow it makes sense to go to the lower?

A. Of course. Yes, of course, because the incremental drilling cost of that other 600 or 700 feet is insignificant.

Q. Okay. Now like I said, let's take your last three exhibits together, Exhibits 9, 10 and 11, and there's been some discussion about secondary zones here, Mr. Burke. In particular there's already been some mention of the Wolfcamp and the Strawn. If you could first get your Exhibit 9 which is, I believe, a Wolfcamp structure map, could you discuss the prospects in that zone?

A. Sure. This map is, from an areal standpoint, almost identical to the map that you looked at as Exhibit 5 that had all the production on it. But what I've done on

this particular map -- and I have all of the wells on this map that have been drilled out here -- is, I've highlighted in green or in a grayish color the wells that have produced from the Wolfcamp or the Penn formation, which I'll show you in a moment have been used interchangeably out here.

But what you see is, there are some -- one, two, three, four, five, six, seven wells, you know, within a mile or a little over a mile from out well that have produced from the Wolfcamp or the Penn formation. And of those wells, the average that we spoke of earlier, that, you know, .2 of a BCF of gas and 20,000 barrels of oil, more or less -- no, 10,000 barrels of oil, more or less, is the average for this area.

So there's been a pretty good sampling of attempts to complete in this zone around us, and we -- you know, we have -- for the reserve calculations that we do, we look at all of the wells around us and try to attempt to come up with a reasonable number of what we can expect from this formation based on offset wells.

Q. Looking at production, it looks like it goes from almost nothing, just a few MCF, up to what, maybe a little more than a half a BCF?

A. That's right, the well that is just to the east of our proposed location, that's one of the better wells in this map area. It's made 23,122 barrels of oil from the

Wolfcamp-Penn and nearly a half a billion cubic feet of gas. Most of the wells that you see on here, if you'll look at the production numbers, are poorer than that.

This is a structure map of the formation. As you can see, updip is to the left or to the northwest, downdip is to the right, which is the southeast. And our location is both updip and downdip to production from these intervals, so we feel like we have a reasonable chance, based on offset production and our structural position, of encountering production in the Wolfcamp formation here.

Q. Okay, now, let's move on to Exhibit 10, which is your Strawn map, and discuss the potential for production from the Strawn in the east half of Section 15.

A. The Strawn is a carbonate formation, and I'll show it to you on the cross-section in a moment that goes with these exhibits, but it's located between the Wolfcamp and the Morrow. In this particular area, the Strawn is primarily a structurally controlled target.

If you'll look down the center of the map, you'll see this structure is at Strawn level, but you also see the structural anticline that you saw at Morrow level on the Morrow maps running down through here. And what you see along that structural anticline are these better cumulative wells, especially the ones up in Section 10, you have some 2- and 3-BCF, billions of cubic feet wells, very good

wells, with 50,000, 30,000 barrels of oil.

As you move offstructure you can see the cumulative productions go down very rapidly, both left of the structure downdip and right of the structure downdip.

Q. Looking in the west half of Section 15, there's a well that has produced a fair amount from the Strawn, is there not?

A. Yes, it has.

Q. But you are significantly off that structure?

A. Right, we're some 50-plus feet downdip to that, and I'll demonstrate to you on the cross-section that the Strawn has been tested in this area at a similar structural position to where we're planning to drill, and there just has not been any commercial or good production here because of the high water cut and your being off the structure.

Q. Okay.

A. There may be some initial tests that look real good, but there's just no sustained production due to that high water cut.

Q. And that's kind of exhibited by that well in the northeast quarter of Section 15?

A. That's correct, that's correct.

Q. It's a little higher than your well, but it produced very little from the Strawn?

A. That's correct.

Q. Okay, let's finish with your Exhibit 11.

A. Exhibit 11 is a cross-section. This cross-section, B-B', was depicted on the other map that I showed you, but there's also an index for it on the right-hand side.

What I'm showing you here, at the very top you see a Wolfcamp detrital marker. That's a fairly consistent stratigraphic marker in the area that I have mapped structure on for the Wolfcamp map that I presented earlier.

As you move down you'll see colored in green on the logs near the top the Wolfcamp zone, which has been used interchangeably -- the name Penn has been used, but for the most part, most of the completions in this area call this Wolfcamp.

Moving further down you'll see a Strawn, top-of-the-Strawn marker. That's what I mapped my Strawn zone on. The porosity zone in the Strawn that is productive in this area is colored in blue. For the large part within this area, this is the zone that produces from the Strawn. It's been productive at the top of the structure, but it's a pretty continuous porosity formation in this area, as you can see from the cross-section, and as you move downdip you encounter water.

Further down, colored in yellow, there's an Atoka marker, and this is the zone that typically produces in

this area from the Atoka. Very lenticular, very limited, no huge production numbers.

And then you see a top-of-the-Morrow marker and then several Morrow marker sands down here colored in red. These are all these Morrow sands that are productive in this area. We've mapped these individually, and as they are multiple sands with -- at some locations one sand will be good, at other locations other sands will be good.

What makes the Morrow a good objective out here is simply that there are so many sands, you know. There are multiple opportunities to make wells in this Morrow where in the Atoka and in the Strawn and in the Wolfcamp you primarily have one zone that you're going after and are limited in your opportunities up there. That's why the Strawn has the higher production figures in the area, just due to the number of reservoirs, as opposed to the other formations.

Q. Why the Morrow has been?

A. Yes, why the Morrow is the primary objective out in this area.

Q. Okay. And just looking at this, again just from a geologic standpoint, does this also reinforce the need to stack the zones you are seeking to hit in a particular well?

A. Certainly. As you can see from the multiple

nature of these formations from the Morrow all the way p to the Yates, there are many, many formations. All can be mapped by a geologist as myself. And every geologist is going to have a different opinion. And probably when it's all said and done, we're all wrong, you know, the truth is something else out there, which you usually don't find out what that is until you drill a well. You have many zones that you're going after.

But for this particular area, by and large, our approach, from a business standpoint is, we try to drill wells to the Morrow, which has proven to be the most commercial formation out here. We do some limited mapping on the shallow zones, trying to encounter pay in those. But generally speaking, we drill our wells based on a Morrow objective at that location, and the shallower zones, we get what we get when we drill the well, basically.

Q. Now, in your opinion is a cost-plus-200-percent penalty fair and reasonable in this well?

A. Certainly, I believe it is, due to the multiple lenticular reservoirs, the depletion risk in this area, yes.

Q. And were Exhibits 5 through 11 prepared by you or under your supervision?

A. Yes, I prepared all of these exhibits.

Q. And in your opinion is the granting of

Mewbourne's Application in the interests of conservation and the prevention of waste?

A. Yes, sir, it is.

MR. BRUCE: Madame Chair, I move the admission of Mewbourne Exhibits 5 through 11.

CHAIRMAN WROTENBERY: Any objection?

MR. FELDEWERT: No objection.

CHAIRMAN WROTENBERY: Exhibits 5 through 11 are admitted in the record.

Mr. Feldewert?

CROSS-EXAMINATION

BY MR. FELDEWERT:

Q. Mr. Burke, if I just heard you correctly, you were asking the Division to give you a 200-percent penalty for your risk in going down to the Morrow; is that correct?

A. Yes.

Q. Okay. And reason you're asking that is to try to offset some of the economic risk that you feel that you have in going all the way down to the Morrow formation; is that right? That's the purpose of the risk penalty?

A. Yes, sir.

Q. Okay. Now, I think you also testified, if I understood you correctly, that when you looked at this area everybody has a different opinion, and I think you said everybody could be wrong, right?

A. That's right.

Q. Okay. But your desire is to go down and go ahead and incur the cost and take the risk of taking a look at the Morrow and producing from the Burton Flat-Morrow Pool; is that right?

A. That's the primary intent, but you know, Mewbourne and all operators out here, you know, reserve the right -- if you encounter some zones on the way down that have a chance of adding significantly to the economics of the well, we may choose to dual the well or even drill a twin well, you know, if we see something like that on the way, if it makes economic sense to us and our partners.

We evaluate all the formations very thoroughly with an extensive set of electrical logs and downhole testing and try not to leave any zone, that has the potential of generating revenue for ourselves and all the parties, unevaluated.

Q. That's something you would want to look at in the future, after you had the opportunity to go down and test the Morrow, and if you're successful produce from the Morrow, right?

A. By and large, that's what we anticipate here. But you know, we put mud loggers on these wells, you know, at the very shallow depths, and we're registering and reporting hydrocarbon readings all the way up and down

these wells and trying to evaluate the entire well at a significant cost to us.

Q. I understand, I understand. And that's why you're asking for a 200-percent risk penalty?

A. Right.

Q. But when you decided to take a look at this project, you actually focused your location of your well to give you the best shot at producing from the Morrow; isn't that correct?

A. That's correct.

Q. And that's what you told the Division in your letter to the Division; is that right?

A. That's correct.

Q. Okay, you asked for your unorthodox location so that you would have the best possibility of producing from the Morrow sand that you've identified here today?

A. That's correct.

Q. And your Exhibit Number 8, as I understand it, identifies seven potential pay sands. Am I reading that correctly?

A. That's correct.

Q. All right. And I think you testified that generally the highest volumes of sands are in the lower Morrow; is that right?

A. That's correct.

Q. Which is where you're going?

A. That's correct.

Q. Would you agree with that if you look at this map -- I'll try to hold it up here -- your proposed well location is here?

A. Yes, sir.

Q. And these are you mapping wells that you used?

A. Yes, sir.

Q. It looks like at least from a geologic standpoint you don't have much risk in encountering the sands, do you?

A. Encountering the sandbodies, whether they have enough porosity and permeability and pressure remaining in them to produce commercially is where the significant question --

Q. I understand, but you're going to hit these sands, right? You feel pretty good you're going to hit these sands?

A. I feel pretty good we will, yes.

Q. The only question you've got is how much gas is left down there?

A. That's right.

Q. All right. And you decided as a company that you'd go ahead and take the risk and ask for a 200-percent risk penalty and go down there and produce what you can out of the Morrow?

A. Yes, sir.

Q. Let me ask you, if you're successful in the Morrow, how long do these Morrow wells typically produce?

A. Many of these wells -- and if you really want some real detailed analysis of that, I'd --

Q. I just need your --

A. -- refer you to our reservoir --

Q. I know --

A. -- engineer, he --

Q. -- what's your knowledge of that?

A. I would think that a 20-year life is probably not -- 10- to 20-year life is not uncommon, but I defer to our engineer on specifics.

Q. Okay, but you could go down, and if you're successful in drilling to these Morrow sands, your Esperanza well could produce -- what did you say, 10 to 20 years?

A. Yes, sir.

Q. Okay. Now, in your opinion how long will a well that's completed in the Strawn formation -- how long typically could that well produce?

A. Again, for the real detail of that I'd like to refer to our engineers. Usually that's much more short-lived because there's a lot of water there, and the water tends to kill the wells earlier, as it does a lot in the

lower Morrow. So if I were guessing I would say a typical life would be in the five-year range.

Q. Okay. So if I understand it, if you're successful and if everything goes well and you hit the sands, you could produce from the Morrow from 10 to 20 years; is that right?

A. Yes.

Q. And then you could move uphole and produce in the Strawn for maybe five years?

A. That's possible.

Q. All right. And as a prudent operator you would not abandon the Morrow sands and move uphole until you had depleted those sands; is that right?

A. I'd like to refer that question to the engineering also, because what depletion is, is an economic --

Q. You're right, that's an economic term, but --

A. Yeah.

Q. -- as a prudent operator, I mean, your goal here as a company, if you're going down to the Morrow you're going to produce out of the Morrow as long as it's economic for you to do so, right? I mean, that's what everybody does?

A. Well, certainly -- and I'm going to refer to the engineering, but it's a business decision. Many times it's

frugal and prudent for the operator, if they have a high production zone up the hole, to abandon a low producing zone down below, go produce the higher production zone above because of the time value of money, and then at a later time when the upper zone is depleted and down to a low rate, go back to the lower zone or perhaps get a permit to commingle both the zones.

Q. Okay.

A. It depends well by well, and the economics depend on the specific well, what you encounter and the economics at that particular point in time.

Q. But at this time you're drilling your well to just produce from the Morrow; is that right?

A. We plan to produce any formation that will make oil or gas.

Q. Oh, you're going to commingle the production?

A. If the Commission will allow us and that's the economic thing to do, we may do that.

Q. So you'd have to come back and get approval from the Commission?

A. Yes.

Q. Okay. So you'd have to have some kind of a hearing on an administrative application?

A. Yes.

Q. I want to look at your Exhibit Number 6. This

shows your -- Let's see, am I reading -- This is a Morrow production map?

A. Yes, it is.

Q. Okay.

A. And a structure map at the top of the lower Morrow.

Q. Now, I think you have testified that there has been success in drilling in these middle Morrow zones; is that right?

A. Yes.

Q. Has Mewbourne had success?

A. Oh, yes.

Q. Now, are any of these wells on here, are they Mewbourne wells?

A. No.

Q. They're not?

A. No.

Q. Okay. But other operators have had success in drilling in this area?

A. Yes.

Q. Okay, and they've had commercial wells?

A. Yes.

Q. And that's why you're trying to produce from the -- That's why your target is Morrow?

A. Yes.

Q. If I look at your Exhibit Number 5, I think you identified -- Did you try to identify in your Exhibit Number 5 all the potential producing zones or formations in this area?

A. Yes, I did.

Q. Is that what you tried to do with your legend down here?

A. Yes, sir.

Q. Okay, I'm going to get oriented here. The first producing zone you identified is the Yates; is that right?

A. That's correct.

Q. Okay, now that would be above our line that we marked in yellow here?

A. As a matter of fact, that zone is not even on your -- right.

Q. Yeah, I mean that's up here.

A. That's right.

Q. Okay. Now, the next zone you identified is Delaware production; is that right?

A. Yes sir, and it is again above your type log.

Q. Okay. Next zone is the Bone Spring?

A. Above your type log.

Q. And the next zone is the Wolfcamp; is that right?

A. That's correct.

Q. All right. And then you show some Strawn

production. Is that below the type log?

A. No, that's in the middle of your type log there. I think you have it colored purple.

Q. Right down here?

A. Yes.

Q. I'm sorry, so that's below the yellow line?

A. Yes.

Q. I got you. And then you show some Atoka; is that right?

A. That's correct.

Q. And that's below -- down here as well?

A. Right, that's between the Morrow at the very bottom and your purple zone there in the Strawn, about the middle of the type log.

Q. Okay, then you've got the Morrow down at the bottom, right?

A. Yes, sir.

Q. That well to the north that's shown on this map, is that 2.6 billion cubic feet of gas that's been produced?

A. Be specific of which well you're talking about.

Q. I'm sorry, you're right. If I looked at your pink dot, your pink dot here, you show a well up here.

A. Right.

Q. Okay, is that -- There's two production figures there, am I reading that right?

A. That's correct.

Q. 2.6 -- is that billion cubic feet?

A. That's billion cubic feet. It's colored red so that means it came from the Morrow formation.

Q. What's the difference between -- And then there's a 1.7; do you see that?

A. That means -- That's the oil production. If you'll look kind of down there in the key, it shows that the gas production is in billion cubic feet, and it's at the top. And then the oil production is in thousands of barrels of oil, and it's shown just below it. So that means that well has made approximately 2.6 billion cubic feet of gas and 1716 barrels of oil from the Morrow formation.

Q. Okay, and that is from the Morrow?

A. Yes.

Q. Okay, that's a pretty good well, isn't it?

A. That's a real good well.

Q. And then the blue numbers are what? Is that the Strawn?

A. That's the Strawn formation.

Q. So that's why you show this well as having been producing from the Morrow and the Strawn?

A. That's correct.

Q. Is it still producing?

A. That well is plugged and abandoned. There's a slash through it there. Again, if you'll look at the key down there, I put a slash through the wells that have been plugged and abandoned.

Q. And how long did that well produce?

A. You know, I cannot answer that. I know that -- I can't answer that for you.

MR. FELDEWERT: Okay, that's fine. That's fine. That's all I have, thank you.

THE WITNESS: Thank you.

CHAIRMAN WROTENBERY: Commissioner Lee, any questions for Mr. Burke?

EXAMINATION

BY COMMISSIONER LEE:

Q. What is your target production for today?

A. Of a rate?

Q. Right.

A. Our engineer will testify this, but I would probably say around a million cubic feet of gas a day from the Morrow formation initially.

Q. A million cubic feet, 1000 MCF.

A. Yes, sir.

Q. What's the water?

A. Not a lot, less than a barrel or so a day, I would guess. Again, you might want to ask our engineer to

really get specific with that.

Q. Why do you say 20 years? Twenty years is based on what?

A. Based on the --

Q. On your cutoff point? What's your cutoff point of your production?

A. Can I refer that to the engineer? He'll testify to all of that in detail.

COMMISSIONER LEE: All right, no further questions.

CHAIRMAN WROTENBERY: Commissioner Bailey?

EXAMINATION

BY COMMISSIONER BAILEY:

Q. Did Mewbourne run seismic?

A. No, ma'am.

Q. So all of this was developed from the well logs in the area?

A. Yes, ma'am.

Q. Okay. There's been testimony that this location was chosen because of surface considerations and also because it appears to be better for geologic reasons for the Morrow.

A. Yes, ma'am.

Q. Does that advantage of the Morrow -- is that also reflected in the shallower zones, or is there any

advantage/disadvantage at all for this location for the shallower zones?

A. In my opinion -- I feel like this location is the best possible location that we could drill for the Morrow and the Strawn formation and as good as any other location, from my analysis, for the other formations. Some people may have different opinions, but I think this location is as good a location for all of the formations that are productive out here as anywhere that we could have gotten.

Now, I have not spent -- I will say, I have not spent nearly the time on the shallower formations developing the geology as I have on the deeper formations. And you know, we will gain information from this well when we drill it that may make me change my mind about where a shallower formation could be drilled for in here. But with the data we have available right here, this was the best location we could get to for the Morrow and as good as any other location for any of the other zones, in my opinion.

COMMISSIONER LEE: Certainly you carry the risk?

THE WITNESS: Yes, sir.

COMMISSIONER LEE: You may not hit anything, you may not deplete, you may not have a pressure?

THE WITNESS: We could drill a dry hole, yes, sir. Not highly likely, but it could happen.

Q. (By Commissioner Bailey) You were asked several

questions about needing to come back in for administrative hearings --

A. Yes, ma'am.

Q. -- if the upper zones prove productive. Do you agree that it's cheaper to come in for an administrative hearing than to drill a new well?

A. Do I agree that it's cheaper to come in for an administrative hearing than to drill a new well? Of course.

COMMISSIONER BAILEY: Just want to make that point.

No, I'll save the financial questions for the engineer. That's all.

CHAIRMAN WROTENBERY: Any follow-up, Mr. Bruce?

MR. BRUCE: I don't have any follow-up.

MR. FELDEWERT: No.

CHAIRMAN WROTENBERY: Thank you for your testimony, Mr. Burke.

THE WITNESS: Thank you.

MR. BRUCE: How does the Commission wish to proceed? Take my final witness and then break for lunch?

CHAIRMAN WROTENBERY: We'll see how it goes, but we'll continue on for the time being.

MR. BRUCE: I'll try to shut up my next witness.

COMMISSIONER LEE: Okay, if you want to ask a

question, ask the question and know what your purpose is, all right? Don't run around and ask a lot of questions that are not relevant to the case.

MR. BRUCE: This is our engineer, Commissioners.

BRYAN M. MONTGOMERY,

the witness herein, after having been first duly sworn upon his oath, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. BRUCE:

Q. Would you please state your name for the record?

A. My name is Bryan Montgomery.

Q. And who do you work for?

A. I work for Mewbourne Oil Company.

Q. What is your job with Mewbourne?

A. I'm a reservoir and economics manager.

Q. Have you previously testified before the Division or the Commission as a reservoir engineer?

A. I have.

Q. And were your credentials as an expert accepted as a matter of record?

A. They were.

Q. And are you familiar with the engineering related to this particular Application?

A. Very much so.

MR. BRUCE: Madame Chair, I tender Mr. Montgomery

as an expert reservoir engineer.

CHAIRMAN WROTENBERY: Any objection?

MR. FELDEWERT: I have no objection.

CHAIRMAN WROTENBERY: His qualifications are accepted.

Q. (By Mr. Bruce) First off, Mr. Montgomery, how long have you spent evaluating this prospect?

A. My notes go back to 1999 when I first began looking in this area.

Q. So Mewbourne spent substantial time, effort and money beyond what's going to be required to drill the well?

A. That's absolutely correct.

Q. Now, when you began to reach your conclusions on this prospect, what were the main points involved in the conclusions to your study?

A. Well, the main points were that we had a middle Morrow ID out here that looked really, really good. To me it looked like it was bypassed pay. It's a lower porosity, we've heard testimony from our geologists.

And what's happened in this area is, in the 1970s many wells were drilled that were produced out of the lower Morrow and in even the Strawn formation that were quite good, prolific producers. They would come on at high rates, 5 million cubic feet a day, 10 million cubic feet a day, would make 5 BCF of gas and had done that over a

period of years.

But many of the zones that were in the middle Morrow were tested and abandoned or were tested and produced commingled with the lower Morrow, and even in the decline curves you can see evidence of lower-perm rocks in combination with the higher-perm production when they were commingled.

So as I started to review the different zones -- and I've gone through probably -- well, many of these zones -- I've found that the lower Morrow was the initial idea out here, and it was fairly depleted. What I mean by that is, the current rates and pressures of the current producing lower Morrow wells or the wells that were plugged had very low pressure.

When I estimated drainage volumes of how much they drained and combined that with our geologic mapping, all the bubbles touch. You know, they're fairly drained reservoirs. And we found that off the structures we found before, that many of the zones were just wet. The sands were there but they were full of water, and we saw those tests.

But there were some real interesting middle Morrow tests that led me to believe that there was potential in the middle Morrow.

Q. And in your opinion, is the middle Morrow a

lower-permeability reservoir than the lower Morrow?

A. It is. In general it is, and specifically in this section it is.

Q. But do you hope with more modern completion techniques to produce a fair amount of reserves out of the middle Morrow?

A. Yes. One point that we shouldn't pass up is that many of the wells -- all of the wells on this map that we see, except for one, that were completed in the middle Morrow were not fracture-treated. They were basically added to the lower Morrow, except for one, in my opinion. That one we're going to talk about in a minute made 600 million cubic feet of gas and looked like a tight zone but made some production.

There's been a well most recently completed --

Q. Well, let's skip that for a minute --

A. Okay.

Q. -- and we'll get to that in a second, but I think you had in front of your Mr. Burke's Exhibit 5. Could you discuss just briefly, referring to that, just how the geology interacts with the pressure and production just overall in these wells?

A. Well, this is zone by zone, and so what we do is go through -- you know, we map every zone, we study all the production and pressure from every zone, and we try to come

up with analysis of what's happened in the past and what remaining potential there is in the future.

And I think, if I understand where we're heading with this question, is that once again we found that these big, large cumulative lower Morrow -- or Morrow production numbers -- and the Commission doesn't discriminate between lower Morrow and middle Morrow in their production reporting -- they came from these lower Morrow reserves.

Q. And does the middle Morrow, when you've been able to more or less isolate that, come on at much lower rates of initial production?

A. It does, it does.

Q. Okay. Well, let's look at that then, your sole exhibit, or your primary exhibit, Exhibit 12, Mr. Montgomery. The first page says Reserves and Economics, but before we get to that, could you turn to page 2 of that exhibit, which is a decline graph, and discuss what that exhibit shows in your opinion?

A. Okay. Well, like I said, we looked at all the zones, and when we narrowed it down tot he zones with the most economic value, we found the middle Morrow to be the primary zone and the Wolfcamp to be the secondary zone.

And the first page is what I refer to as 14C. I apologize, I just like to refer to the section that they're from and the unit letter. So if you look on this

production map in Section 14, in what we call 14C, this Concho Resources-operated well that shows a plugged-out symbol now and has produced from both the Atoka and the middle Morrow, that well's production from just the middle Morrow is represented on this page that I have, a decline curve of 14C.

This decline curve, of course, is just the production over time on a semilog plot, and what it shows is the initial rate back just prior to 1976, and this well again was not fracture treated. The initial rate is -- the units are in monthly volumes, so it's just over 20,000 MCF per month or about 800 MCF a day.

The well then began a decline, what we call a hyperbolic decline, and lasted 15, probably 17 years, and produced, as you can see on the far right-hand side at the top, a cumulative production of 635 million cubic feet. That's just the accumulation of all those months. That's also on Exhibit 5, the map, 635.

And so what we see is, when you find wells that are commingled and your main zone is one of those two commingled zones, it's very important to find wells where that's the only zone open, to try to determine how does that zone produce? And when you do that, it helps you go back to the zones that may have been commingled and try to separate out how much of this was lower Morrow and how much

was middle Morrow. So that's the first decline curve.

Q. Okay, why don't you move on to the next page, which is marked 27A, and discuss that? Now, that's a newer well, is it not?

A. This is a newer well. This is a prospect we tried to drill and couldn't get to it, and I wish we could have. It's starting out nicely. It's in the middle Morrow zone only, drilled by OXY in the year 2000, I believe. There's some weird dates on that symbol, because the well produced in 8 of 2000 but was completed in 2001.

And I remember calling them and saying, Where's the completion record, I need this for my information?

And they said, It's a testing allowable that hasn't been done.

And I said, Well, there's been six months of production.

And the Commission did a great job, they called OXY and we got that production report.

We found that they did frac the well, when we got that report. We found from the logs that it was only in the middle Morrow blue and an upper middle Morrow zone that we call the pink. And when they frac'd it, it came on, as you can see, a little higher rate than the well we just talked about. It came on at 30,000 a month or about 1 million cubic feet a day after frac.

And we also got some pressure data showing it was just minor pressure depletion from that zone. And it has only produced for approximately a year, is the updated records that I have with me, and that's about 200 million. Over to the right you see the cumulative production here is 210 million, and I will tell you that's more in the first year or so than the well we just talked about made, because it came on at a higher rate, although the geology looked very similar when you look at the two logs.

Q. Now, when you look at the declines on these first two Morrow wells you talked about, it flattens out relatively well?

A. That's correct, it declines at a decreasing rate, what we call hyperbolic decline.

Q. What does that indicate to you?

A. That's indicative of lower-perm rock. You're slowly feeling further and further out as you produce the well. You may never eventually drain large areas with lower-perm rock efficiently, down to a low pressure, but the hyperbolic nature is indicative of lower perm and layer production.

Q. Now, in looking at these two wells and what you hope to encounter in Section 15, do you hope they're similar, do you believe they're similar?

A. I think that our best analysis, we better not

fool ourselves, we're going to be somewhere in this range in the middle Morrow. It's not the high-perm rock. We're not going to get 5 million cubic feet a day and have initial virgin pressures in the lower Morrow-type production and have these large 5-BCF-type production numbers. These are two very reasonable estimates for me to run economics on. In fact, that's what I've done.

Q. Okay, and before we get to the economics, why don't you move to the final page of your Exhibit 12? What does that show?

A. This shows the Wolfcamp production from a well in Section 15 that I call 15I, but it's the key well that's in the southeast quarter of this section; it's a deep test. And that well is key for many reasons. One, the lower Morrow has tested wet, and we won't be much updip from that.

Two, the middle Morrow was bypassed, and yet it was thick and tight and looked productive to me.

Three, the Wolfcamp was actually tested, and the production you see here is the Wolfcamp production from that record. It was produced in the mid-1960s, and we don't have that production to show you because I didn't go by hand and dig out the production. But I know prior to 1970 the cumulative production was 250 million, and I've drawn a little line estimating about what it would have

taken for that well to have produced 250 million over three or four years.

It has since then, since 1970, produced another 200 million, not at the best of rates. In fact, that well never produced at high rates, in my opinion, other than maybe the first week or two when they initially tested the well. But it's a well that has significant reserves, and we're offsetting it fairly closely. So we analyzed this zone, and we feel like this is a good, strong secondary objective to pursue, and this is how I will use something similar to this in my calculations for our Wolfcamp potential, although I think we'll have some depletion from this well.

Well, why don't you then flip finally back to the first page of your Exhibit 12 and discuss the economics of Mewbourne's proposed well?

A. Okay. I really tried to -- You know, we've done a lot of work in this area, and I've just tried to simplify it down to what we really think the main economic questions and reserve questions are, and of course that includes this middle Morrow mainly and this Wolfcamp. And I have four cases here.

The first case, Case A, is a Morrow case only, what I call Morrow (low), and that's based on modeling something like that poorer of the two Morrow wells, 14C.

We very well may end up with a well like that. We need to see, how does that impact our economics? What I've done is used our estimate for drilling and completing the well of almost $1.5 million and run a similar decline shape of what we just saw in that 14C well that makes 650 million over 17 or 18 years.

And I find we didn't pay the well out. If we get a well like that, we will not pay out our drilling and completion cost, based on my estimates. We will get close. And what you see here on the third-to-the-last column, this Undiscounted ROI is the return on investment. If that was 1.0 we would exactly make back our drilling and completion dollars but no profit. So we're below payout under that scenario.

The next case was the new OXY well. It's a better well. What if we make something like that? I think that will make close to a BCF over a little longer life because it's coming on a little higher, but it's also hyperbolic in nature. And as you can see, it does pay out. It takes six years, you see the second-to-the-last column. So for six years you're not getting your money back. But then when you do, the 1.33 ROI shows that there will be another 30 percent or so above and beyond the $1.5 million. That would be close to $500,000 for 100 percent of the working interest owners.

And by the way, this table is all based on just 100 percent of all working interest owners, with assumptions for net revenue interest that we feel like is a good rough estimate, gas-pricing, expenses and all the things that go into coming up with these economics.

The third case, we go ahead and stack the Morrow production, the good Morrow production, with the Wolfcamp, and I'm able to add some Wolfcamp reserves and bring the total reserves up to almost 1.2 BCF and 6000 barrels of oil. That can be done by commingling -- we've talked about things -- I'm sure we would answer some questions here pretty soon about that -- or stacking them consecutively, depending on what situation is best for the owners.

But as you see, that improves the economics. In other words, by adding this backup zone with the better of the two Morrow estimates, we not only pay out again but we have a little better payout time, 4.7 years, and we have a little better return on investment, one-point-almost-seven to one.

That last column is Internal Rate of Return, and that is similar to a savings-account-type interest. If you put your money in the bank and they say you're going to get nine percent, that would be a similar investment to putting this into drilling.

So nine percent is not the best internal rate of

return, and the reason those are so low is because these do take a long time to pay out, and that drives down your internal rate of return.

The fourth case is the Wolfcamp, and what this case is, is something we know intuitively but we just ran the economics for it. What if we just drilled just to the Wolfcamp and we were able to reduce our drilling and completion dollars to this $820,000 estimate, but then only recovered $225 million, which is my estimate for the Wolfcamp production here? And it shows you would not pay out there either. In fact, you would get about half your money back, and you wouldn't have a payout or an internal rate of return. So those are not applicable.

Q. So drilling to the Wolfcamp alone doesn't make economic sense to you?

A. No, I could not convince Mr. Mewbourne to drill a Wolfcamp well with these estimates.

Q. Okay. And based on what you've seen, the geology combined with your own engineering studies, the Morrow is definitely the main pay zone?

A. Yes.

Q. Okay. Now, taking a step back to Exhibit 3, which is the AFE, shows a completed well cost of $1.45 million. Is that amount fair and reasonable?

A. That is.

Q. And is it similar to the cost of other wells drilled to this depth in this area of New Mexico?

A. It is.

Q. Now, keeping that AFE in front of you, approximately what is the incremental cost of drilling from the Wolfcamp down to the Morrow?

A. Well, that's a good question, because if you're going to drill just to the Wolfcamp and you feel like the economics are good to do that, you should also take a look at, well, what are the incremental costs to go to the Morrow? And you'd need to have a Morrow estimate of reserves and a cost for that incremental amount. And what you see on the AFE is $950,000 dryhole cost to the Morrow. Well, I have my notes in my other AFE for the Wolfcamp, only the dryhole costs are $500,000.

So for an incremental $450,000, which isn't insignificant, but in my opinion you would certainly benefit by going to look at the Morrow, you know, the incremental cost would be $450,000 to go test -- look at the Morrow with your logs.

Q. And in your opinion, is the 200-percent risk penalty appropriate?

A. It is. And the reason it is is, you can see, like we talked about before, an internal rate of return that we might expect under our best-case scenario of 13

percent, which is not that great, is only provided after you get 1.7 to 1 on your money. Not a 200-percent, I have nothing on here that shows 200 percent. We'll have to do better than this, which is possible.

We could drill a dry hole and have nothing, and we could certainly do better. But even if we just get 170 percent of our drilling costs and completion costs back, our return is only 13 percent.

So for the risk that the participating partners take in drilling and spending $1.5 million, you know, to get just a 13-percent rate of return is not that great. And certainly, if we tried to give away interest after payout or after 200-percent payout or after 300-percent payout, that would make an impact.

And so what I see here is, 200-percent payout makes sense to me, because even if we achieve 200-percent of our drilling and completion costs, our internal rate of return may only be 15 or 20 percent, and that is still what we need to have to be able to take a risk to drill this well.

Q. To justify the drilling of the well?

A. That's correct.

Q. Just a couple of final things. A question has come up about either dually completing a well or downhole commingling of a well. Mewbourne would be interested in

looking at that if the Wolfcamp zone was good, would it not?

A. We would love to be able to have a great Wolfcamp zone and get right to it as soon as possible.

Q. I mean, it's not your job as the economics manager to reduce the rate of return for Mewbourne Oil Company?

A. No, sir, we would maximize that. And there are easy ways to get both zones going if they're both -- if that's in the economic interest of the owners.

Q. Were Exhibits 3 and 12 prepared by you or under your supervision?

A. They were.

Q. And in your opinion is the granting of Mewbourne's Application in the interests of conservation and the prevention of waste?

A. It is.

MR. BRUCE: Madame Chair, I'd move the admission of Mewbourne Exhibits 3 and 12.

CHAIRMAN WROTENBERY: Any objection?

MR. FELDEWERT: No.

CHAIRMAN WROTENBERY: Okay, Exhibits 3 and 12 are admitted into the record.

MR. FELDEWERT: I'll be brief.

CHAIRMAN WROTENBERY: Okay, great.

CROSS-EXAMINATION

BY MR. FELDEWERT:

Q. Mr. Montgomery, you testified the extra cost of going from the Wolfcamp to the base of the Morrow was $450,000?

A. That's correct, dryhole cost.

Q. Okay, and that's, as I understand it, from here to here, if I'm looking at my type log, assuming the base of Wolfcamp --

A. Okay, well then maybe I misspoke. See your Wolfcamp porosity zone?

Q. Up here?

A. Right. It would be just below that, enough rathole to be able to log it, somewhere around where your finger is, yeah.

Q. Okay. So roughly we're looking at trying to figure out -- I think the cost, you said, is about $450,000 to go down to the Morrow?

A. That's my estimate.

Q. Through the Strawn and down into the Morrow?

A. That's correct.

Q. Okay. Now, I assume that you believe that there is a reasonable chance that you will be able to recover your extra $450,000 from the Morrow sands from the Strawn; is that right?

A. The Strawn, I predict, will be very poor.

Q. Okay.

A. But we would love to take a look at it, and we certainly want it pooled. We would produce it to maximize the total return for everybody that participated in drilling this venture, and the Morrow would be -- in my estimate, would be certainly worth drilling for $450,000. I expect it's worth drilling if you can add the Wolfcamp, for $1.45 million.

Q. Okay, so if I understand it, you believe there's a reasonable chance that you will be able to recover your extra $450,000 from the Morrow?

A. Exactly.

Q. Okay, and that there is a reasonable chance that you could actually recover more than that?

A. Exactly.

Q. But therein lies the risk, right? I mean, you might be wrong, you might be right?

A. You might get zero, that's right --

Q. Okay, does your --

A. -- but --

Q. -- does your numbers here factor into this penalty that you've asked the Division to impose upon the nonparticipating interest owners?

A. No, these are somewhat generic. They're based on

100-percent working interest and 80-percent net revenue interest --

Q. Okay.

A. -- so we can just get a general picture.

Q. And what you're asking the Division to do is, in essence, pool or tie up the shallow zones now in order to improve your overall economics for the wells; is that --

A. I'm not so sure we'd tie anything up, but we would like to be able to produce all zones. When we drill to the Morrow --

Q. Uh-huh.

A. -- we would like to be able to produce all zones at any given point in time, that's economically the right thing to do.

Q. Okay, but you could also try your project now, take a look at what you'd get if you drilled a well, and then come back and seek to pool whatever shallow zone you think is most appropriate; isn't that right?

A. I suppose you could pool after the fact, sure, I think that's done.

Q. In essence, after your drill your well, you may have the best information to ascertain which formations are most likely prospects for pooling?

A. Exactly, everybody that looked at those logs, those that paid for them and those that didn't, would know

much more about all these uphole zones.

MR. FELDEWERT: That's all I have. Thank you.

CHAIRMAN WROTENBERY: Commissioners?

EXAMINATION

BY COMMISSIONER BAILEY:

Q. You anticipated a lot of my questions in your testimony, but I do have a few questions about your Exhibit 12 --

A. Okay.

Q. -- in comparison with Mewbourne's Exhibit 5A.

A. Okay.

Q. I wondered why you used the numbers you did for the reserves for the Wolfcamp-only scenario, D, when Exhibit 5A shows Wolfcamp-Penn figures, not significantly different but quite different.

A. Right, there is a difference and there's a reason. These are average, as you know, and my numbers were based on incorporating those averages in general. But what I really did was, I took the well in 15I that made 450 million, approximately, cubic feet and risked that 50 percent. And that risk is based on a few things.

First of all, when that well produced its 450 million it did some kind of drainage, and I have estimated that drainage area to be close to 160 acres. We plan to drill inside that 160-acre circle, if you just draw a

circle around there. So I expect to encounter depletion and therefore less reserves.

That doesn't mean that the formation doesn't continue on after 160 acres. That's not a perfect wall, those drainage calculations. But it tells me that, just like in the lower Morrow, I feel like severe depletion is going to be a problem in the Strawn, the depletion better be factored in here. So the averages were close. But really what I did was just take a 50-percent reduction, not really arbitrary but somewhat on a different tack, based on depletion analysis of the nearest offsetting well.

COMMISSIONER BAILEY: That's all I have.

CHAIRMAN WROTENBERY: Do you have any questions of Mr. Montgomery?

COMMISSIONER LEE: (Shakes head)

CHAIRMAN WROTENBERY: Thank you, Mr. Montgomery. I should ask, did you have anything -- follow-up?

MR. BRUCE: I have nothing, no, I don't.

CHAIRMAN WROTENBERY: Okay, thank you.

MR. BRUCE: That concludes my presentation in this matter, Madame Chair.

CHAIRMAN WROTENBERY: Mr. Feldewert, how long do you think it will take you to make your case here?

MR. FELDEWERT: I think my witness will take probably 20 minutes, maybe a little longer.

CHAIRMAN WROTENBERY: Okay.

MR. FELDEWERT: And then we have a brief summary and wrap-up, so --

CHAIRMAN WROTENBERY: Okay.

MR. FELDEWERT: -- I don't know what the Commission's desire is at this point in time.

CHAIRMAN WROTENBERY: Okay, Commissioner Lee has to leave us in about 20 minutes, and so if it would be okay with everybody, I think let's go ahead and get as far as we can.

MR. FELDEWERT: Yes.

CHAIRMAN WROTENBERY: Let's take five, and then we'll come back.

(Thereupon, a recess was taken at 12:15 p.m.)

(The following proceedings had at 12:20 p.m.)

CHAIRMAN WROTENBERY: We'll go back on the record. Mr. Feldewert, you may proceed.

MR. FELDEWERT: Call Ramon Reyes to the stand.

RAMON G. REYES,

the witness herein, after having been first duly sworn upon his oath, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. FELDEWERT:

Q. I've believe you've been sworn in, right, Mr. Reyes?

A. Yes.

Q. Okay. Would you please state your full name and address for the record?

A. My name is Ramon Reyes.

Q. And by whom are you employed and in what capacity?

A. I'm employed by Harvey E. Yates Company, I'm a petroleum geologist.

Q. And have you previously testified before the New Mexico Oil Conservation Division and had your credentials as a petroleum geologist accepted and made a matter of record?

A. Yes, I have.

Q. Are you familiar with the Application that's been filed by Mewbourne in this case?

A. Yes, I am.

Q. And have you studied their exhibits?

A. Yes, I have.

Q. And have you conducted a study of the area that is the subject of this Application?

A. Yes, I have.

Q. And are you prepared to share the results of your work with the Examiners -- or with the Commission?

A. Yes, I am.

Q. Are the witness's qualifications acceptable?

CHAIRMAN WROTENBERY: Yes, they are.

Q. (By Mr. Feldewert) Briefly for the record, would you identify what we've marked as Heyco Exhibit Number 1?

A. Okay, Heyco Exhibit Number 1 is a type log. It's a well that's located in Section 15, in the west half of the same section, and that's something we've been talking about and referring to, and I'll briefly go back and talk about that every once in a while.

Q. Okay. And does Heyco today ask that the Division modify the pooling order to only include an east-half spacing unit from the base of the Wolfcamp to the base of the Morrow?

A. Yes, I do.

Q. And you've depicted that interval as below the yellow line on Exhibit Number 1; is that correct?

A. That's correct.

Q. All right. Why does Heyco ask this relief?

A. Would you repeat the question again?

Q. Why does Heyco ask that the Division only pool from the base of the Wolfcamp to the base of the Morrow?

A. Because we believe there's a good opportunity to develop the shallow oil and gas reserves, producing intervals, in the southwest quarter of Section 15.

Q. Okay, and that would be the intervals above the yellow line on Exhibit Number 1?

A. Yes, that is correct.

Q. Okay. Now, have you studied the structure map and the isopachs and the cross-sections that were offered by Mewbourne?

A. Yes, I have.

Q. Okay. And the Burton Flat-Morrow field -- Pool, which they seek to produce from is located in what geologic section?

A. In the Pennsylvanian section.

Q. Okay, and is that shown on what's been marked as Heyco Exhibit Number 2?

A. Yes, sir.

Q. All right. Have you conducted a study of the Pennsylvanian section in this area?

A. Yes, I have.

Q. All right. And why don't you then, to the extent you need to, let's turn to Exhibit Number 3. Why don't you identify that and review that for the Examiner?

A. Okay, Exhibit Number 3 is a cross-section, pretty much what Mewbourne has shown already in their cross-section.

Q. Let me interrupt. Commissioners, I can hold it up so -- I'd be happy to hold this up.

A. What this cross-section is showing is the producing zones that we are willing to give Mewbourne the

opportunity to exploit and produce. We'll start at the very bottom. The bottom streak going across at the bottom is Morrow pay. It's a one-inch scale, so it's kind of small. So what Mr. Burke showed on his cross-section, the orange, blue, brown, green sands, all those sands that he showed in detail and talked about, that's roughly the whole interval that we're talking about. That's in yellow.

The purple streak on top is the Strawn pay that's in the area. It's also in the Burton Flat field. And again, it's very pronounced. It's very easy to follow. Like Mr. Burke testified on the record, we pretty much agree on the geologic picture that's in the area. The Strawn and the Morrow sand channels tend to have a north-south trend, and that's evident by the cross-section, that it has a north-south trend, and it's fairly easy and straightforward to understand what's going on.

Q. Okay. Does this cross-section match up with the type log which is marked as Exhibit Number 1?

A. That is correct. The purple goes with what's -- the Strawn producing zone, and the bottom, the yellow, is a little more detail. Again, it's those multiple Morrow sands that are in that section.

Q. All right. What have you concluded with respect to Mewbourne's ability to complete a commercial well in the Pennsylvanian section?

A. What I've heard this morning -- now it's afternoon, I guess -- I pretty much agree with everything they've said. We'll start at the bottom, at the Morrow, the lower Morrow sand that was talked about. That lower sand package is the main package that has produced from this field for many years. It's been very prolific and it's produced a lot of gas.

The middle Morrow sand, the upper sand above that, which I also agree tends to be a little more shaky as far as productive and what you can produce out of it, but it is very productive in the area and has done so.

As you move up there's also an Atoka sand, an Atoka bank, whatever you want to call it. It has a very marginal chance of producing in this area, there's not a whole lot of Atoka in the area, so I don't give that a very high priority on that.

And then of course we're talking about the Strawn pay that's in the well just directly north and to the east of the location that they're talking about, that has been productive in this area as well.

So overall, I tend to agree with everything they've talked about as far as permeability, the sands being wet and being tight and whatnot. All that, I have no disagreement with that, other than the fact that the issue coming up about why not participate in this Morrow sand?

It's more of an economic decision for us. We're talking about drainage, we're talking about, you know, closelology, if you want to call it that. They're very close to two existing wells that have been produced. So your reservoir and your risk.

It's low risk geologically, because you are surrounded by wells and you have a real good control. That's not the problem or the issue in our eyes. It's just more of a drainage issue and a risk factor of, yeah, you'll find the sands -- how productive are they going to be? Are they going to be wet, are they going to be tight? Are you going to have to frac it? That adds cost to the completion costs.

So in our eyes, that's a deciding factor as far as completing it in the Morrow.

Q. Okay. Now, I want to focus real quick on the -- what we've colored yellow on this Exhibit Number 1, and then we'll go on to Exhibit Number 3, the Morrow sands.

Is it your opinion, is there a reasonable chance that Mewbourne's Esperanza well will pay out with production from the Burton Flat-Morrow Pool or from the Morrow formation?

A. I believe it can and will.

Q. Okay. Let me ask you to turn to Heyco Exhibit Number 4. Why don't you identify that for the Examiners

and explain how it supports your opinion? That's the production map.

A. If you look at Exhibit Number 4, it's pretty much the same. It's a cumulative production map. It looks exactly, or pretty much close to what was shown on Exhibit 5 by Mewbourne. The only difference is, its scale is a little bit smaller and it's a picture that's taken out a little farther to show you more of a regional look at the area, rather than really focusing on just Section 15 like it's shown here, just a little nine-section area.

Q. Okay, now where is the proposed well site?

A. The proposed well is pretty much in the middle of the map, and it's a little red circle that's been drawn in there.

Q. Okay.

A. Again, the color code is pretty much almost the same. The red numbers are production from the Morrow section, green is Bone Spring, yellow is Delaware and so on and so on. So what you're looking at is an area that's been drilled and produced in multiple zones.

There's a lot more wells that are on there. The Yates that's shown in here, in the south half of 15, I didn't show. That's very shallow, and that's something that we don't even have to the Yates, but that's something I didn't include to muddy up the waters here.

So what you're seeing, just again, is just a picture that's a little farther out, identifying all the other fields that are in the -- all the wells in the certain fields.

Q. Okay, now what on this map supports your conclusion that there's a reasonable chance that Mewbourne's well will pay out from production in the Morrow?

A. Again, it's going to be low-risk. They will encounter the sands, in my opinion, and I think again the depletion issue is relative to what our conclusion is, as far as going down to the Morrow.

Q. Okay. You have an offsetting well to the north, right, that produced a lot of gas?

A. Yes, sir.

Q. Which well is that?

A. That would be the Cedar Hills Unit Number 2.

Q. And where is that shown on this map?

A. It's in Section 15, it's just right above their location. That well has already produced -- or it's plugged already, but it's already produced 2.6 billion cubic feet of gas. That's quite a bit of gas from that one well. And you're offsetting that -- You're less than a thousand feet from that location and drilling another well, and your main objective is to that zone, so that's a

concern of ours as far as --

Q. Do you believe there's a chance that reserves still exist, at the well at the proposed location?

A. I do believe that there are reserves in the sands. Again, depletion is an issue.

Q. Okay. Now, why do you think there are still reserves that are available for recovery by Mewbourne from the Morrow?

A. The well to the south is -- it's in purple -- is the Cedar Hills Unit Number 1, I believe. That well was tested back in 19- -- a while back, 1958, I believe. 1964, October of 1964, and it was potentialed at absolute open flow at 515 cubic feet of gas a day. They tested it -- This well has a lengthy history, it's been produced from the Wolfcamp, what's in blue on the type log, Number 1. It's also produced from the purple, which is the Strawn, as well as the bottom, the yellow stuff down at the bottom of the Morrow. This has had a checkered history; it's a pretty wild-looking history on that, and we can get into that if you like.

But the reason I believe there's still production, because this well did produce for a little while -- I don't know the exact numbers, because all that production was put together as one, and they called it Cedar Hills-Upper Penn because it, you know, finally ended

up producing from the Wolfcamp. So I was not able to find how much it produced from the Morrow, from the Strawn and the Wolfcamp, so it was all just kind of put together for whatever reason again, because we're talking 1968, 1964, a long time back.

Saying that, you know, there is potential and there is some -- you know, a good chance that they'll find some more gas because that well didn't drain the reservoir as well. Had that well produced real high, and now you're straddling two big wells, then it looks really grim. But having said that, their chances are fairly well to produce from that.

Q. Okay. And is there a chance fairly well to have commercial production from that -- from the Morrow in their present location?

A. Yes.

Q. Okay. Do you agree with their geologist's observation that if you are successful with a Morrow well in this area that it could produce for 10 to 20 years?

A. And even longer.

Q. Okay. Do you believe there is potential secondary targets for their proposed well in the Pennsylvanian section, which is below the Wolfcamp formation?

A. Yes, I do.

Q. And is that the Strawn which is shown in purple on Exhibit Number 1?

A. Right, that would be the Strawn in the Burton Flat Gas Pool. Like Mr. Burke and their engineer explained, this reservoir tends to have potential problems as far as producing water and watering out. It is more riskier than if it's produced from the Morrow, but there's still a good chance of producing from that zone. How good or how much is yet to be determined.

But the offset well in Section 15, which is also the type log, that well has produced 613 million cubic feet of gas.

Q. Is that the -- shown in purple in Section 15?

A. Correct, it's just directly --

Q. North --

A. -- west location, right. And so we feel that that Wolfcamp has a very good chance of making that if not more.

Q. I'm sorry, the Wolfcamp?

A. I mean the Strawn, I'm sorry, the Strawn.

Q. Okay. Now, is there some other good Strawn wells to the north of Section 15?

A. Yes, there are. In Section 10 and Section 3, as noted earlier, those wells to the north were even better producers from the Strawn, and they perform very well.

Q. Okay, and in your examination of this area, what is the trend out here for the Strawn?

A. The Strawn, again noting your cross-section in Exhibit 4 or 3, whatever that was --

Q. The big map we looked at.

A. -- the big map, they both -- again, that's a pretty easy pick and trend to follow in this area, so...

Q. Is it a north-south, or east or west?

A. It's pretty much a north-south trend to that.

Q. Okay. In your opinion does this secondary target for Mewbourne's proposed well in the Pennsylvanian section represent another reasonable chance of commercial production?

A. Reasonable chance, yes.

Q. Okay. And do you agree with their geologist's observation that if they successfully produce the well in the Strawn formation, that it could produce five or ten years?

A. It could possibly do that, yes.

Q. I want to turn now to another topic, and that is Heyco's plans in this case. Does Heyco actually have plans to develop the shallower producing zones in the southeast quarter of Section 15?

A. Yes, we do.

Q. Okay, and what are those plans?

A. We'll start off the Wolfcamp, it's -- and we're designated -- the Undesignated Carlsbad East-Wolfcamp Pool area, and that's developed on 320s, that's the proration for that.

Q. Do you have a well, a Wolfcamp well, in your drilling schedule?

A. Yes, we do.

Q. Is it very high up on your drilling schedule?

A. No, it's not.

Q. Okay, are you still evaluating this area for that potential drill site?

A. Yes, we are. It's not high. It's on our drilling schedule, but it's not a priority, it's farther down. We're hoping to plan to drill it here within the next year or two.

Q. Okay. What general geologic section is the Wolfcamp located in, just to get oriented, on Exhibit --

A. That would be in the Permian.

Q. In the Permian, okay. And have you conducted a study of this Permian section?

A. Yes, I have.

Q. Okay, what are the potential gas-producing zones in this Permian formation that Heyco would like the opportunity to pursue with a well in the southeast quarter of Section 15?

A. Well, for right now, let's just -- let's focus on the Wolfcamp --

Q. Okay.

A. -- and then we'll work our way up so we won't get all turned around.

Q. Turn to your Exhibits, then, what, 5? Heyco Exhibits 5, 6 and 7.

A. Exhibit 5 is a subsea structure map on top of the third Bone Springs sand.

And Exhibit Number 6 is, again, another structure map on the subsea of the upper Penn or the Penn shale.

And then Exhibit Number 7 is an isopach map, which an isopach map is just the thickness of the section, in other words, from the bottom of the -- where the third Bone Spring sand ends, and then the -- and it -- I mean begins and where it ends. It's just a -- It's a thickness map, and it shows you where your thicks and your thins are in your section.

If you'll look at Exhibit Number 5, we've noted that there -- in the blue in Exhibit 5 and 6, outlined in blue are -- we have a little closure there, a Wolfcamp closure, and we're having a little porosity pinchout, if you want to call it that, on the west side. And then on the east side it really downdips and drops hard, and we just believe that there is a Wolfcamp prospect within that

blue area.

Q. And does your map show some kind of a -- It shows on Exhibit Number 7 a thin area. What's that mean?

A. Right, the thinning just shows you where it's really -- your section on the west side has really thickened up, and you know, your section is pretty much gone. And if you start going to the east, it really starts dropping off. So you really -- It's a small fairway where you have a -- you know, where your closure in your Wolfcamp is developed there, and that's your best potential to drill. As Mr. Burke said earlier, that's probably one of the better spots in this section to drill for a Wolfcamp well.

Q. Okay. And so in your opinion is there a potential for commercial production from this shallower gas zone?

A. Yes, I do. I'd like to refer back to Mewbourne's Exhibit -- the one with the Wolfcamp, the Wolfcamp, the green. Do you know which one that is?

Q. Why don't you hold it up? What's it look like? Is it this map?

A. Yes, whatever exhibit number that is.

Q. That would be their Exhibit Number 5. Do you have it in front of you?

A. That's fine. As it was stated earlier, there's

not a whole lot of Wolfcamp production in the area, and whatever Wolfcamp wells that have been produced there are not very good. And they're pretty much spread around, almost in a circle from our location, the closest one being the Cedar Lake -- Cedar Hills Number 1 to the east.

I'd just like to point out that those wells, when they were drilled, they were drilled for a Morrow prospect. In other words, they were generated for the Morrow sands and not for the Wolfcamp. So the production and the history of the Wolfcamp in this area, it's not really dictated by drilling Wolfcamp wells. It was drilled by drilling Morrow wells, and then they came back as a secondary producing zone to drill -- or the Wolfcamps. We believe those were not the primary locations to drill the Wolfcamp. We believe that our area is more -- a little bit more better defined and we can pinpoint to that -- find that production.

On the map you'll see on Exhibit Number 5, down in Section 23, that well --

Q. This would be Heyco's Exhibit Number 5?

A. Right, Heyco's Exhibit Number 5. In the northwest quarter of 23 that well produced from the Wolfcamp. And that well produced roughly 124 million cubic feet of gas and just a little over 5000 barrels of oil from the Wolfcamp.

That well sits structurally lower than what we're talking about, so that really helped us define if we were moving up and having to pinch out to the west, that that's a prime location to drill a Wolfcamp well. So that's what we're basing up our deal for the Wolfcamp.

Again, we talked about going up the hole. Bone Spring, you've got the Avalon East field to the northeast, you've also got Carlsbad East down to the south.

Q. Okay, why don't -- What are you looking at?

A. This is Exhibit 4, our Exhibit Number 4.

Q. Heyco's Exhibit Number 4?

A. Right.

Q. That's the map that has all the names on it?

A. Yeah, from back into the upper right-hand corner, the Avalon East field for Bone Spring, you've got the Carlsbad East down to the south of that, you've got La Huerta Delaware production that's nearby, you've got -- you know, so you've got multiple fields in the area that have a fair chance of being exploited and produced from this location and from this area.

Q. Are these potential oil-producing zones?

A. The Bone Spring is mainly gas. It's a high GOR, so it's mainly going to be gas. The wells up to the northeast, I believe, are more oil because of their prorations are 40-acre spacing, so I believe those are oil,

more oil-production wells than gas.

Q. And in your opinion, is there a reasonable chance of encountering and producing from these shallower oil-producing zones from a well in the same quarter-quarter section as the -- as Mewbourne proposes to drill?

A. Yes, I believe that's a reasonable...

Q. Okay. Let me ask you, what will be the effect on Heyco's drilling plans in the southeast quarter if Mewbourne is allowed to pool all the way from the base of the Yates formation to the base of the Morrow formation?

A. Well, that's really going to throw us for a loop, because if they do produce from the Morrow sands that could tie up that acreage because of the 320 proration for, you know, over 20 years, and we won't have the opportunity to try to establish a Wolfcamp field in that section, along with Bone Spring or anything else that we encounter. So that would deter us from drilling in this area.

Q. Okay. Of course if their well is not successful, then you could always look at alternatives for using -- with Mewbourne, to use the wellbore for -- to explore these shallower zones; is that --

A. That is correct.

Q. Okay. I mean, is Heyco going to go out there and drill a Wolfcamp well tomorrow while Mewbourne is out there drilling their Morrow well?

A. No, we will not.

Q. I mean, that wouldn't be prudent, would it?

A. It would not.

Q. Okay. In your opinion, is the granting of Mewbourne's Application to pool all the way from the base of the Yates to the base of the Morrow in the best interest of conservation, the prevention of waste and the protection of correlative rights?

A. No, in fact, it would be -- reasonably be impaired. Correlative rights in our property interests in these shallower zones would be affected.

MR. FELDEWERT: Okay. At this time I would move the admission into evidence of Heyco Exhibits 1 through 7.

MR. BRUCE: No objection.

MR. FELDEWERT: And that concludes my examination of the witness.

CHAIRMAN WROTENBERY: Thank you, Mr. Feldewert. Before I admit these exhibits into the record I'm just wanting to ask, did you receive a letter from Steve Ross concerning the prefiling of exhibits with the Commission?

MR. FELDEWERT: I don't recall that I got one in this case. I've seen that practiced in the past, and I actually spoke with Mr. Ross shortly before this hearing, and I apologize I didn't get these to the Division sooner. I'm aware now that there should be -- and I think it's a

good idea to have a policy where the exhibits are -- try to provide it to the Commission, I think, the Friday before the hearing.

CHAIRMAN WROTENBERY: I believe that's what Mr. Ross requested, and that is at the request of the Commissioners that he is --

MR. FELDEWERT: Okay.

CHAIRMAN WROTENBERY: -- sending out those letters, because it does help us prepare for the hearings to have the exhibits in advance. So in the future, if you would, please --

MR. FELDEWERT: I certainly will.

CHAIRMAN WROTENBERY: -- make every effort to get those exhibits filed --

MR. FELDEWERT: I will.

CHAIRMAN WROTENBERY: -- before the hearing. We understand that there will be some exhibits that are necessarily based on information that becomes available right before the hearing, and we can make some accommodation for that, but anything that you could have planned for in advance, then, we would like to see that prefiled.

MR. FELDEWERT: Okay, and I apologize. Actually, we didn't get these exhibits until yesterday, so...

CHAIRMAN WROTENBERY: Well, what we are asking is

that --

MR. FELDEWERT: Get them ready.

CHAIRMAN WROTENBERY: -- your witnesses go ahead and prepare what they can prepare a week in advance --

MR. FELDEWERT: Okay.

CHAIRMAN WROTENBERY: -- of the hearing date, and get that filed. I'm just talking about for the material that becomes available the week before the hearing. I'm really just talking about information that wasn't known at the time that we asked the exhibits to be prefiled.

So anyway, we'll go ahead and admit Exhibits 1 through 7 into the record.

Now, you had also an Exhibit 8 that you had distributed to us --

MR. FELDEWERT: Yeah, I don't know --

CHAIRMAN WROTENBERY: -- earlier --

MR. FELDEWERT: Yeah, we should probably move to admit that. I think I had asked that that be included in the record. I think it was missing from Mewbourne, so we should -- thank you for reminding me of that -- we should include that.

And then I'll also note that we have filed in the record a prehearing statement which has two attachments to it, one being their file, the Division's file, from their unorthodox well location, and the other attachment was

actually this Exhibit Number 2, so I would ask that all that material be included and admitted into the record for purposes of consideration in this case.

CHAIRMAN WROTENBERY: Any objection?

MR. BRUCE: No objection.

CHAIRMAN WROTENBERY: Then we will -- in addition to Exhibits 1 through 7, we'll admit Exhibit Number 8 into the record, and then also the attachments that you had submitted with your prehearing statement.

MR. FELDEWERT: Thank you.

CHAIRMAN WROTENBERY: Mr. Bruce?

CROSS-EXAMINATION

BY MR. BRUCE:

Q. Yeah, Mr. Reyes, could you refer to your Exhibit 4, your production plat? Okay? And first let's look at the big red dot in Section 15, which I think you said is the Cedar Hills Unit Well Number 1 --

A. Yes --

Q. -- in the northeast of the southeast --

A. Yes.

Q. -- of Section 15?

A. Yes.

Q. Now, you said it produced from several zones?

A. Are you talking about the one in 15, in purple?

Q. In Section 15 -- Mine looks red, but maybe that's

just --

A. Okay, well --

Q. It's right under the "C" on "Cedar Hills".

A. Right. That well was -- What's your question?

Q. Was it your testimony that that well produced from several zones?

A. Yes.

Q. Including which ones?

A. It would be the Morrow, the Strawn and the Wolfcamp.

Q. Okay. Are you aware that Harvey E. Yates plugged that well back and only produced it from the Wolfcamp after, oh, April of 1967?

A. Was I aware of it? Recently I have been, yes.

Q. Okay. And didn't most of the -- the vast bulk of the production, in fact, come from the Wolfcamp in that well?

A. Again, like I testified early, all that production was commingled. We have the well files and the documentation that were very hard to decipher as far as how it was -- you know, how it was produced and where it was produced from. As a matter of fact, in Mewbourne's production map as well, it was colored in gray instead of green, as in Wolfcamp production, to indicate that that's where it was coming from.

So I think we both came to the conclusion that we really don't know where all that production came from.

Q. Is there a good chance that the Strawn is wet -- was wet at that Cedar Hills well?

A. The Strawn has a history of being wet, and there would be no reason why it wouldn't be wet here as well.

Q. Okay, and it may well be wet at Mewbourne's proposed location?

A. It could very well be.

Q. Now, do you have any specific -- has Heyco calculated reserves just for the Wolfcamp in a well in the southeast quarter of Section 15?

A. Not to my knowledge.

Q. Looking at your Exhibit 4, is there a commercial Wolfcamp well on that plat?

A. In Exhibit 4, a commercial well?

Q. Commercial Wolfcamp well on that plat?

A. Well, the well in Section 23, like I stated earlier, made 124 million cubic feet of gas and 5000 barrels of oil. Do you consider that commercial? Possibly. Economically? No.

Q. That well wouldn't have paid out, would it?

A. That well would not have paid out, no.

Q. Okay. And in deciding on a potential future Wolfcamp well in Section 15, would it first help to see the

logs from Mewbourne's proposed well?

A. Oh, it would always help to have more new data.

Q. But let me get this clear: Heyco has not filed an APD for any well in this half-section of land?

A. Not at the present time.

Q. It hasn't checked out the surface for a well location?

A. Has not.

Q. It hasn't contacted the other working interest owners regarding a Wolfcamp-only well?

A. We have not.

Q. And it hasn't sent out a formal well proposal for such a well?

A. No, we haven't.

Q. Now, when you say Heyco won't be able to do anything out here, you realize that for oil wells we're only pooling 40 acres, or Mewbourne is only pooling 40 acres?

A. Say that again?

Q. For an oil well, Mewbourne is only pooling that specific 40-acre northwest quarter of the southeast quarter.

A. But not if they're drilling a Morrow well. Then their proration is 320. That prohibits us from --

Q. Well, the 320 acres only applies to the

formations below the base of the Wolfcamp, below the top of the Wolfcamp?

A. Right, but the prorations in Section 15, and if we're talking Wolfcamp production, it's gas, it's not oil, and the proration for that, I mean, would be 160s.

Q. Heyco has an interest in the northeast quarter of the southeast quarter. It could go drill an oil well tomorrow on that acreage, could it not?

A. We could, yes.

Q. And has acreage -- It owns interest in the entire northeast quarter of Section 15, does it not?

A. Yes, we have acreage there.

Q. And it could go out tomorrow and drill a 40-acre oil well on that acreage?

A. Yes, we could.

Q. And it could drill a Bone Spring gas well on that acreage?

A. Very much so.

Q. And it could also, after Mewbourne's well is drilled, it could propose the drilling of a well in the northeast quarter of the Section, couldn't it?

A. Yes.

Q. So Heyco isn't totally forbidden from drilling wells just because Mewbourne wants to drill a Morrow well?

MR. FELDEWERT: Drilling a well in what location?

Object to the form.

Q. (By Mr. Bruce) I'm saying Heyco is not forbidden completely from drilling wells in this 320 acres simply because Mewbourne is drilling a well at its proposed location?

A. True.

Q. Now, just a couple more questions. I think you said that based on your study you think Mewbourne could drill -- economically drill a well just to the Pennsylvanian formations only, at its proposed location; is that correct?

A. Sure, they can drill a well to the -- Yeah.

Q. Economically?

A. That will be -- yes.

Q. If it can be economically drilled, then why won't Heyco join in that well?

A. Again, it doesn't fit our parameters, our economic parameters.

You know, we're talking again depletion being -- you know, we -- an economic value or assessment of any lease or property or location, as was stated, a lot of factors go into it, a lot of the factors that we have in-house don't fit that scenario, so -- to fit our economic parameters.

Q. Okay. But then if you're going to drill to the

Wolfcamp anyway and you think the Pennsylvanian was going to be economic, why wouldn't you spend the extra money to drill down to the Morrow?

A. Again, as it was stated, drilling a well down to the Morrow is going to cost -- dryhole cost is $950,000, almost a million dollars to do that. To drill the Wolfcamp well is half of that.

We don't have the drainage issue or -- you know, we have a better -- clearer picture on what's going on in the Wolfcamp.

And I believe that we, in our shop, that drilling a Wolfcamp well for half a million dollars, it makes more economic sense with the Bone Spring and the Delaware bailouts, than it would be to drill -- to spend another half a million dollars to go down to the Morrow and have again the opportunity to run into drainage, tight rock, being wet and whatnot. That's just our -- that's our stance on that.

Q. And one final thing: In looking at your production map again, I don't -- if you could point it out for me, is there a commercial Bone Spring or Delaware well within a mile of Mewbourne's proposed well?

A. Bone Spring, not in anything nearby, no.

MR. BRUCE: Thank you, that's all I have.

CHAIRMAN WROTENBERY: Questions?

EXAMINATION

BY COMMISSIONER BAILEY:

Q. Just a couple of questions. Has Heyco done any seismic work, or is all of your work based on the well logs at the locations?

A. Ma'am, we have not done any seismic work in the area. There's enough well control, and a lot of wells have penetrated a lot of the zones of interest that we feel comfortable with what's -- you know, what the picture is on here.

Q. On your Exhibit 4 --

A. Yes, ma'am.

Q. -- which wells does Heyco operate?

A. Heyco doesn't operate any wells in Section 15. Both the wells in the east half of this section have all been plugged, but the lease is being held by the well in the west half of 15. That's operated by Bass, Bass Enterprises. That well is still currently producing from the Morrow and the Strawn and has for -- since 1974.

Q. But my question was about all of these wells on your Exhibit 4. Which ones does Heyco operate?

A. Well, we don't operate any wells in this area --

Q. Okay.

A. -- in this immediate area.

Q. So you've shown no interest in drilling or

operating any wells within -- how many sections are on your Exhibit 4?

A. Right, well, most of our acreage is right in 15 and part of 16 -- Do we have some in 16? This is -- Again, this well, again, looking at why we haven't anything in 15, in Section 15 alone there's already three wells, Morrow wells that have been drilled in there. Until recently the downspacing for drilling in 160s has been available.

At this time in our drilling schedule, as well as drilling costs, economical costs, it does not fit our picture to do anything in here. We're hoping to see what this well in 15 does once it's plugged back to the Wolfcamp and see what kind of production that gives us again, more information to go on as far as developing this field, this Wolfcamp field, there is one, but at this juncture right now that's where we stand.

Q. Where is Heyco concentrating their drilling program right now?

A. Harvey E. Yates Company drilled -- 95 percent of our drilling is in Eddy County and Lea County.

Q. Any particular pool?

A. Recently we've been drilling Morrow wells, gas wells, quite a few.

COMMISSIONER BAILEY: That's all I have. Thank you.

EXAMINATION

BY CHAIRMAN WROTENBERY:

Q. Mr. Reyes, could you explain to me again what the red circle is on your Exhibit Number 5 that's in Section 15?

A. Okay, that's our location, and I think I may have misplaced it. I think it's a little farther south. It might --

Q. Okay, because this looks like it's in the northeast quarter and --

A. It's in the northeast quarter, it should be in the south- --

Q. And the proposed --

A. -- -east quarter, right.

Q. -- location is in the --

A. In our haste last night, in my rush in trying to get them out I marked it, right, it's just a -- it's a little bit off, yes.

Q. And does Harvey E. Yates Company have any applications pending with the Oil Conservation Division for any well in the east half of Section 15?

A. Not at the present time.

CHAIRMAN WROTENBERY: Mr. Feldewert, anything else?

MR. FELDEWERT: No, no further questions.

CHAIRMAN WROTENBERY: Okay, thank you for your testimony, Mr. Reyes.

THE WITNESS: Thank you. Thank you for your time.

CHAIRMAN WROTENBERY: Any other witnesses?

MR. FELDEWERT: No, that concludes our presentation. I do have a closing statement.

CHAIRMAN WROTENBERY: Okay.

(Off the record)

CHAIRMAN WROTENBERY: Mr. Bruce, do you have a closing statement?

MR. BRUCE: This time I promise it's a minute long.

CHAIRMAN WROTENBERY: Okay, would you like to proceed with yours, and then --

MR. BRUCE: That would be fine, that would be fine.

Madame Chair, in my opening, which was actually designed for my closing, I've summarized the reasons for granting Mewbourne's Application.

I would simply note that the operator needs to stack the zones in this well to make it economic. Therefore all zones from the base of the Yates to the base of the Morrow should be pooled. If not, the well may not be economic, and it may not get drilled.

I'd note that Mewbourne acquired its interest in January, 2001, and now seeks to drill a well. Heyco has owned its interest for over 30 years, and there's been no well drilled in this half section of land to the deep zone since 1975.

We don't think Heyco should be permitted to impede someone who wants to drill a well, because we believe that will impair the correlative rights of Mewbourne and its partners. We don't think that's fair, and we don't think it's proper.

As far as drilling additional wells in this half section, as Mr. Reyes admits, Heyco can go out at any point and drill other oil wells in this half section of land; it owns interest in all but 40 acres. It could drill a number of 40-acre oil wells out there if it so desired.

As far as the Wolfcamp, yes, it may be tied up. For how long? We don't know. But there are the possibilities of dual completion of the well and downhole commingling.

I'd also suggest that if the Wolfcamp in Mewbourne's well is poor, Heyco could always come back and seek to amend the order to exclude the Wolfcamp formation from the order so it could drill its other well, or it could seek a simultaneous dedication. We think that is the proper way to go.

One final matter. If the Commission upholds the Division's Order, no additional election period should be granted to these four corporations that were force pooled. Mewbourne mailed the election letters on August 13th to the interest owners, and none of the pooled parties paid their share of well costs. No stay was requested in this order, and we believe the 30-day election period has run, and therefore they do not get another election period.

Thank you.

CHAIRMAN WROTENBERY: Thank you, Mr. Bruce.

Mr. Feldewert?

MR. FELDEWERT: May it please the Commission, you know, we sit here today and it's pretty clear that Mewbourne wants to drill their Morrow well, and Heyco thinks maybe we ought just drill a Wolfcamp well out there. I mean, we have those issues all over New Mexico, and those are operator issues, and they all sit down and they all decide, okay, what's the risk, what should we do? Okay?

We're not impeding their ability to drill this well. We have not denied their ability to pool the interests that are necessary to give them the opportunity to produce this well, to drill this well, to protect their correlative rights or to exercise their correlative rights. I have not heard any testimony today that they're not going to drill their well if they can't stack the formations.

They're going to drill a well, they've got a rig scheduled, they're going to go forward, they're estimating based on our testimony that there's a good chance that they're going to be able to recover their costs and there's a good chance that they're going to be able to get more out of the Morrow.

The issue here is whether we're going to use the regulatory takings, but I do believe it's a takings process here, because if you pool these interests from the base of the Yates to the base of the Morrow, you are preventing Heyco, you are preventing the other working interest owners out there, Jalapeno and the other interest owners, either on that 40 or in that 160 or in that 320 from exploring any other shallower formations. They are tied to this wellbore.

And there's been testimony that this wellbore could produce 10, 15, 20 years if they are successful. Meanwhile, everybody sits back and does not have the opportunity on this tract of land to explore these shallower rights. I submit to you that that is a violation of their correlative rights.

There is a saying, justice delayed is justice denied. Production delayed, I submit to you, is production denied. And when you deny their ability to produce their reserves, particularly the shallow reserves here, you are

denying, you are impairing, you are impeding, you are violating their correlative rights.

My question to you is, why do we need to invoke the compulsory pooling process of the Oil Conservation Division to tie up formations from the base of the Yates all the way down to the base of the Morrow, when there is a reasonable opportunity for them to pursue their project with a much more limited pooling order? That's the issue.

And that is what we are concerned about, because when you start agreeing to pool from the surface to the base just automatically every single time, you are in essence impairing the correlative rights of the other parties to pursue those rights.

Now, all I've heard here today is, Well, it would improve the economics of our well. That is not a reason to invoke the compulsory pooling authority of this Division, that is not a statutory reason.

They say, well, it will give them a free look at the information out there. Well, I guarantee you, every single one of these cross-sections that we looked at here today, the parties didn't participate in the drilling of those wells, they didn't pay for the drilling of those wells. They used the information from those wells to make the most logical choice for their target, but there's nothing wrong with using it -- You don't have to pay for a

well to use the information in there to make some logical choice.

And they're saying, Well, don't give them a free look, let us tie up their rights.

Well, I submit to you it's worse to tie up their rights than it is to give them a free look at the information and make some informed decision.

They also talk about, well, we'll have to come back and we'll have to pool. You know, if we don't get this relief now, my goodness, we're going to have to come back, we're going to have to file another pooling application and we're going to have to come before the Division.

Well, I think I've demonstrated that they're going to have to do that anyway for some of these other shallower formations. I mean, if they've got to come back and get a pool for an unorthodox well location in that 160 gas, why can't they come back and get a pooling order at the same time? It takes about the same amount of effort, the same amount of time, there's no delay there.

Plus it's more focused, we'll have more information, we will know what we need, and we're not impairing any more correlative rights than what is necessary to give them a reasonable opportunity to pursue their project. That's the point here.

They are receiving under the compulsory pooling process already a 200-percent risk penalty to improve the economics of their well. They're saying to the Division now, Give us more, take away their correlative rights in these shallower formations, take that away now to improve the economics of our well. Not to give us an opportunity, but to improve the economics.

And I submit to you that that's improper, that's not what our compulsory pooling statute is for, and that the Division has the authority to look at these on a case-by-case basis.

Weigh both sides and decide, okay, what do we need to give them, to give them their opportunity to produce, and what can we do to protect the correlative rights of the other working interest owners while they go out and pursue this project.

Thank you for hearing us here today, and I appreciate the time.

CHAIRMAN WROTENBERY: Thank you, Mr. Feldewert and Mr. Bruce and all the witnesses who testified today. We appreciate your participation.

And at this point we will take this case under advisement. We will plan to deliberate on this matter at the Commission's next meeting on November 6th and make our final decision at that point. I anticipate we'll be able

to do that. Thank you very much.

MR. FELDEWERT: Thank you.

CHAIRMAN WROTENBERY: Florene, is there anything else we need to cover today?

MS. DAVIDSON: No.

CHAIRMAN WROTENBERY: In that case, I think we'll just declare this meeting adjourned.

Thank you.

(Thereupon, these proceedings were concluded at 1:10 p.m.)

* * *

CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

I, Steven T. Brenner, Certified Court Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Commission was reported by me; that I transcribed my notes; and that the foregoing is a true and accurate record of the proceedings.

I FURTHER CERTIFY that I am not a relative or employee of any of the parties or attorneys involved in this matter and that I have no personal interest in the final disposition of this matter.

WITNESS MY HAND AND SEAL October 18th, 2001.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002