STATE OF NEW MEXICO

ENERGY, MINERALS, AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

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

ORIGINAL

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

Case No. 15363

REPORTER'S TRANSCRIPT OF PROCEEDINGS

MOTION TO DISMISS APPLICATION

COMMISSION HEARING

AUGUST 25, 2016

SANTA FE, NEW MEXICO

This matter came on for hearing before the New Mexico Oil Conservation Commission, Thursday, August 25, 2016, at the New Mexico Energy, Minerals, and Natural Resources Department, Wendell Chino Building, 1220 South St. Francis Drive, Porter Hall, Room 102, Santa Fe, New Mexico.

BEFORE: David Catenach, Commission Chairman
Dr. Robert Balch, Commissioner
Patrick Padilla, Commissioner
Cheryl Bada, Esq., Legal Examiner

REPORTED BY: Mary Therese Macfarlane
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I N D E X

(Time noted: 9:10 a.m.)

COMMISSIONER CATENACH: All right. The next order of business today is Case No. 15363, which I will call at this time. That is the Application of Matador Production Company for a Non-standard Oil Spacing and Proration Unit and Compulsory Pooling, Lea County, New Mexico.

It's my understanding that pursuant to Order No. 14053-D, which Order established a schedule for proceeding forward with this case, that the Commission is scheduled on this day only to hear dispositive motions filed by the parties, including Jalapeno Corporation and Matador Production Company.

So at this time I will call for appearances.

MR. GALLEGOS: Mr. Chairman, members of the Commission, I'm Gene Gallegos, Santa Fe, New Mexico, appearing for Jalapeno.

MR. BRUCE: Mr. Chairman, Jim Bruce of Santa Fe representing Matador Production Company.

MR. BROOKS: Mr. Chairman, David Brooks, Energy, Minerals and Natural Resources Department. I filed an entry of appearance and Notice of Intervention yesterday on behalf of the Oil Conservation Division, so I'm appearing in that capacity.

COMMISSIONER CATENACH: Any other appearances in this case?

(Note: No response.)

So, again, it's my understanding we are hearing arguments on the motion to dismiss the application.

MR. GALLEGOS: That's correct, Mr. Chairman. That's the subject today.

COMMISSIONER CATENACH: Okay. So, Mr. Brooks, do you have a statement today?

MR. BROOKS: Mr. Chairman, Honorable Commissioners, I would like to make a statement relevant to one of the points in Jalapeno's motion. I recognize, however, that since our intervention was late by the deadlines that would apply to this hearing, that it is entirely in the Commission's discretion. And my reading of the rules whether or not I would be permitted to make that statement, I would point out in that regard Rule 19.15.4.11.B, the Division Examiner or the Commission Chairman may, at their discretion, allow late Intervenors to participate.

Rule 19.15.14.C: Participation in adjudicatory hearing shall be limited to the parties. The Commission, or the Division Examiner shall have the discretion to allow other persons present at the hearing

to make a relevant statement.

MR. BRANCARD: Do the parties have any objection?

MR. BRUCE: I have no objection.

MR. GALLEGOS: I have not seen any pleading by the Division. If something was filed, we weren't served with it. So I think it's kind of a -- puts us in a --

MR. BROOKS: Mr. Chairman --

MR. GALLEGOS: I don't know what the purpose is of the Division to be here, nor do I think it's probably appropriate, so on our part we do not agree to this intervention at the 11th hour.

COMMISSIONER CATENACH: Mr. Brooks, is it just a statement, you don't have anything that you are presenting?

MR. BROOKS: No evidence. I wanted to make a statement, a legal argument, but as to the service, it was served by email yesterday afternoon, or at least attempted. I did not receive a notice of nonreceipt.

COMMISSIONER CATENACH: I think I'm going to go ahead and allow the statement by the Division for this proceeding, but why don't we wait till the other parties...

MR. BROOKS: I think that would be appropriate. Thank you, your Honor.

COMMISSIONER CATENACH: I guess for the purpose of not getting too far into this, can we limit it to about 45 minutes each.

MR. GALLEGOS: Mr. Chairman, I think we will be able to do that. I do want to emphasize that this is really a watershed group of issues for this Commission and Division; this is an important point that is being reached here. And so we will -- I think we could manage in 45 minutes, but I don't think the issues are such that either our position or that of Matador or of the Division should not be fully heard.

COMMISSIONER CATENACH: I understand.

You may proceed, Mr. Gallegos.

MR. GALLEGOS: Thank you, Mr. Chairman and members of the Oil Conservation Commission.

Jalapeno wants to make it very clear that we are not adversaries of the Commission or the Division; we are not opposed to the beneficial advent of horizontal well drilling and all that has meant in terms of the economy of New Mexico. What has happened is that technology has advanced in this industry rapidly, and the Division in particular has been struggling for five or six years with dealing with what Director Bailey called back in the OGX case, being besieged with applications for approval of non-standard spacing units for horizontal

wells. The problem is while technology has advanced, and those things have happened rapidly, the law has not kept up with it. And that's where we are today and that's why what we would like to do is walk through for the Commission where we are on the law, what has happened, and face up to what I think is, as I have said, really a crossroad as to what's to be done and how do we accommodate the circumstances in the industry, given statutes that were enacted many years ago and never contemplated the state of the industry, in particular the development of horizontal wells.

I have placed before members of the Commission and the attorney a booklet, and what I'd like to do is walk through this rapidly, because I think it provides the picture that's necessary for your deliberations on the issues we've raised.

Essentially the issues are that the plain language of the statutes do not allow, do not allow what's being called non-standard spacing units and called project areas by which regular 40-acre spacing units for oil wells are being consumed into 160-, 200-, 240-acre so-called project areas. Not permitted by the statute.

The other key issues are what I call the Rule 35 advent of the Commission deciding that a 200 percent risk penalty simply automatically applied for any

applicant who seeks to compulsory pool interests that are not joined. And within that group there has been a definition of well costs which comply with the statute, because the statute allows a risk penalty which "may" be assessed -- not "shall" be assessed, but "may" be assessed -- on presentation of evidence on drilling and completion. And what has happened is under this rule the surface equipment, at a point which there's no longer any risk, the well is completed, you're putting on the surface equipment, the Division is allowing in these Orders and under Rule 35 three times assessment against a nonconsenting owner for tanks, for surface facilities.

Again contrary to law.

Let me start out by asking your attention to Tab 1 which is the Marbob versus this Commission case.

The New Mexico Supreme Court in 2009 said that when the Commission decided that it would ignore the statute which says if there's going to be a violation and there's going to be a company brought to bear for it, it's the responsibility and the authority of the Attorney General to bring that action, and the Commission instead said, No, we're going to do it. We're going to enforce compliance. And that regulation was held by the Supreme Court to be inappropriate, contrary to law, and set aside. And the principle that's stated in the Marbob case, which

I would ask the Commission to keep in mind today as we walk through these issues, is stated this way in the New Mexico Reports, and I quote:

> The Commission's specialized expertise pertains to the regulation and conservation of oil and gas. See 70-2-4 stating that the commissioners shall be persons who have expertise in the regulation of petroleum production by virtue of education and training. Nothing in the Act requires the commissioners to be trained in matters of statutory interpretation. Thus we conclude that statutory construction is not within the Commission's specialized expertise.

And goes on to say when the statutory language is clear and unambiguous it must be given effect, and there's no other way around it, room for interpretation.

So our key statute is at Tab 2 of my booklet, and it's 70-2-17. And I think frequently when anything is argued, and I'm sure we're guilty of it in our papers, immediately attention turns to Subsection C of 70-2-17, because that's the compulsory pooling authority. But I think it's important for what we are talking about today that the commissioners give attention to Section A. That says: The Rules, Regulations or Orders of the

Division, so far as it is practicable to do so, afford the owner of each property in the pool the opportunity to produce his just and equitable share of the oil or gas, or both.

Another statement of basically, your duty to protect the correlative rights of all interest owners in the mineral properties.

And I'll come back to that.

But when we reach the issue concerning this 200 percent penalty and well cost, and the way they are implemented, basically take the property of nonconsenting owners, working interest owners. And bear in mind that there is this obligation to protect those interests, and correlative rights means every owner is entitled to produce their fair share and enjoy the revenue from their fair share of the production.

Now, there is nothing in the statute, you will find nothing in the statute that refers to project area. There's no such animal. Only in Division Orders and in a rulemaking I'll refer to.

But basically this statute refers to spacing units which are declared in pools. And we know in the Southeast New Mexico we are talking about 40-acre spacing units in all the oil pools. And it provides in Section C that there can be a reimbursement of costs. In

the case of someone who elects not to pay his proportionate share in advance, there can be a reimbursement of those costs by the participating parties. And of course there's no argument about the 100 percent for drilling or completion or surface facilities.

And then the statute goes on to say that the drilling and completion charges "may," may be subject to a risk penalty of up to 200 percent.

Now, as I said, for probably as far as I can tell, and maybe longer, for five or six years the Division and Commission has been struggling. Okay. That's what the statute says, but we've got companies coming in, they want to drill wells, they are productive, what are we going to do?

Finally in 2012 there was a rulemaking to address the whole issue of horizontal wells and how that was to be handled.

The Division came forward and said: We want certain provisions, and we want compulsory pooling, and we want project areas.

What is important in that rulemaking, and Commissioner Balch was a participant in this Order that I am referring to that is found at Tab 3, what's important, I think, is that the Commission recognized the problem with the limitations of its authority.

And I'm looking at page 11 of Order R-13499 and paragraph 73 and 74 and 75. And the Commission basically said: We recognize we've got the problem that I'm speaking to.

Paragraph 73 says: The extent of the Commission's and Division's authority to establish non-standard spacing of proration units, or special spacing or proration for horizontal wells has not been clearly delineated by either judicial or Commission precedent.

74 says: Accordingly the Commission concludes that it would be inappropriate to adopt a rule on this subject at this time.

And Paragraph 75: In order to forestall any possibility that the rule amendments being adopted would be construed to authorize compulsory pooling of horizontal well, quote, "project areas," end quote, without regard to applicable statutory and regulatory limitations, the proposed -- cited the rule -- should not be adopted, and the change discussed in paragraph 6 should be adopted.

And paragraph 6 goes on to say that in the case of voluntary agreement or compulsory -- in the absence of voluntary agreement, compulsory pooling will be allowed, quote, and the words read, "if applicable".

So at that point the Commission has said: We realize we've got a problem with the statute.

But what happens? What happens is that the rule is enacted, and that's at Tab 4, and a definition is adopted of what is a project area.

And then on the pool rule itself, which is at page 5 of 8, there's reference to an operator applying for a horizontal well to receive the consent of parties, or obtain a compulsory pooling Order from the Division.

And yet over at subsection F the rule says, "consolidation of project area," and it refers to: If a horizontal well is dedicated to a project area in which there is more than one owner of any interest in the mineral estate, the operator of the horizontal well shall cause the project area to be consolidated by voluntary agreement, or, if applicable, compulsory pooling, before the Division may approve a request for Form C-104 for the horizontal well.

"If applicable" just hangs out there in space.

And what happens after that?

Basically what happens is the Division proceeds to deal with application after application for so-called project areas, non-standard spacing for horizontal wells. And sometimes the Order calls it

project area, sometimes they just call it unit, sometimes they just call it non-standard spacing -- and it's a 200 foot, I mean 200-acre compilation of 40-acre well spacing units -- and goes on about its business.

And that's where we are. The Division, as I say again with sympathy, has just had to deal with it, and applicants are coming before it.

And the question raised in this rulemaking proceeding back in 2012, do we have the statutory authority, just remains there. Remains there unresolved. Except I think now it's going to be resolved, and that's why we're here.

Let me turn now to Tab 5, and I'm going to talk about Tab 5 and what is at Tab 6.

Matador says: Well, be that as it may, and the statute says what it says, and the rulemaking in 2012 recognizes that the Commission itself sees that there's a problem and a lack of statutory authority, but it's all okay, because there's a New Mexico Supreme Court case called Rutter Wilbanks, and that is authority for what's going on, and then the Order, what I call the Cimarex case.

Here's the situation with Rutter Wilbanks.

That case was decided in 1975.

Rutter Wilbanks you've got an odd section,

odd survey section. Which happens. It's a 906-acre section. And one party, because it's to their advantage, says you've got to have 320-acre spacing, because that's the standard spacing and we'll just leave out, you know, that additional 80 acres, 89 acres.

And the Division said: No, we are going to form two non-standard spacing units, a 409 and a 407 unit. We have got authority under our statutory authority to define the spacing units, and they can be different. In this case it was a difference of -- pointed out by the Court, Justice Stephenson, it's 127 percent difference, variation from what it would have been, because you have got to accommodate the unusual configuration of the section.

How in the world it can be argued that that means that you can go across existing 40-acre spacing units for 160 acres? It simply is not authority to that, has no application to that.

In what I call the OGX case in 2011, Director Bailey's case, she recognized this. She said that doesn't say that. Rutter Wilbanks didn't say we can do that.

So then the other -- the only other thing that anybody can hold up their hands and say, is "Well there's got to be some way around this." And we are not

talking about law.

Let's look at the -- what I call the Cimarex case. That is at Tab 5 and that was Order 13708-A.

And this is an Order of the Commission.

What happens in that case is this: Cimarex comes in, and they had drilled the well. Bear in mind in this case the well is already drilled. Cimarex comes in and says: We want a 240-acre spacing unit, so we're going to overlap six defined existing 40-acre oil spacing units in this particular pool, the Abo/Wolfcamp pool.

The Division -- hearkening back to the OGX case in which the Division said we're going to do this thing. These horizontal well non-standard units are going to be 160 acres.

So the Division says -- let me see. I think it's the second page.

The Division denies the application, and one of the reasons they denied it is under Division Order R-13425-A, that's the OGX case, the Division HELD that non-standard units exceeding 160 acres should only be granted in unusual cases. This isn't an unusual case and you're including some unproductive acreage with this 240-acre well unit.

So nobody is opposing the application,

there's no intervention in opposition, only Cimarex, and then in comes Concho, COG Resources, Concho, and says: By the way, we like what's going on, because we are planning to drill a total of 17 horizontal wells in 2013, and they are going to have a lateral longer than one mile and extend it, so we think this is just fine. Don't worry about -- don't worry about anything, basically. Don't worry about the early Order that said these ought to be 160 acres, don't worry about the doubts of the Commission in its rulemaking proceeding that we don't have the authority.

And the Commission in that case, and again with a well already drilled, decides that -- and the Order has an interesting provision at page 4 in which there's a reference, the following reference:

(Reading) The Commission adopted amended rule specific to the regulation of horizontal wells by Order R-13499.

That's the rule, what I have been calling the rulemaking proceeding.

(Reading) These rules were effective February 15, 2012. Division Order No. 13425A predates Commission Order No. R-13499.

I suppose the idea in fashioning the Order in that way was to sort of suggest, without saying: Well,

whatever was said in the OGX case about 160 acres, that was before the rulemaking proceeding, and I guess the idea is maybe that overrules or trumps that.

But what we are dealing with, members of the Commission, when we are talking about this Cimarex case, what I call the Cimarex/Concho case, is not a rulemaking. This is just a single adjudicatory proceeding which only applies to those parties. In fact, Director Bailey's Order in the OGX case was not rulemaking, although she sort of set forth a rule and said let's call these 160-acres standard.

Those are not rulemaking. Those are adjudicatory cases that don't overcome or become a rule or regulation of the Commission in any shape or form.

So in this case the Commission overruled the Division, said: Do the 240 acres. The well is already drilled, and go do the completion of the well. The operators shall commence completion of the horizontal well on or before December 1, 2013.

That's what Matador has got to offer up to this Commission as a way to circumvent 70-2-17C, the compulsory pooling provision which applies to "a" spacing unit. Not linking a chain of spacing units and calling that non-standard.

That and Rutter Wilbanks, which I have

explained.

That goes to the portion of our motion that says the application should be dismissed because there is not authority to create the project area that's being sought by Matador.

Now I want to talk about the risk issue.

Part of the picture that we're talking about in these horizontal wells is such that basically -- and I've read several of the Division transcripts on these cases. And the Applicants comes in, no intervention, and they basically, the landman says: We'd like 200 percent risk penalty.

That's it.

And the engineers or geologists say: Geology is great. We know it's there, we know it's going to be fine, there's no impediment from the geological standpoint. Oh, and the reservoir, we've got cross sections, and it's 600 feet thick, it's 1,000 feet thick, and the permeability and porosity is such that we are going to have productive wells.

And there goes a 200 percent risk penalty assessed on drilling, completion, surface facilities. And somebody with a 5 percent or 2 percent or 10 percent interest, nonconsent on an $800 million well, has lost their interest.

Correlative rights? Forget the correlative rights. It's gone. The right per party-owning interest to produce their share, enjoy the benefit is gone.

And basically this comes about with the advent of what for short I call Rule 35. This is a rulemaking proceeding, and the Order which sets forth the testimony is at Tab 7 of this booklet.

But basically this was the case in which Examiner Stogner was the primary witness, but industry had several witnesses, and they basically came in and said, "Oh, you know it's a lot of trouble. We have to bring a witness, it takes time" -- you know, I don't know how much time. 10 minutes? -- "to establish that there's a risk, and to try to establish the quantum of that risk. Why should we have to do that? Let's don't do that. We'll speed things up."

And beside, the evidence is, is that out there in business, in the industry 200 percent is common, that's custom and practice, and so automatically there should be 200 percent. And if anybody doesn't like it, some Intervenors can -- how many cases are there Intervenors -- the Intervenor has the burden of proof, which is completely opposite to any legal authority you'd find anywhere in which a Movant, and Applicant or a Plaintiff has the burden of proof. Rule 35 says: No,

anybody opposing it has the burden of proof to come in and show that 200 percent is not appropriate.

That rule is also the rule -- and it appears after going through the Order and various industry participants saying why they wanted it that way. The rule comes up, in what I say is very much akin to the idea of "project area," an invention because of a circumstance with which this agency has been faced. So "project area" was invented.

Here "well costs" is invented as a term not to be found otherwise in regulation. But what it says in Rule 35, compulsory pooling, quote:

> (Reading) Unless otherwise ordered, pursuant to Subsection B of this section, the charge for risk shall be 200 percent of well cost.

Shall be. The statute says may, the rule says shall.

Well costs, the statute says drilling and completion, the rule says well costs. And well costs means drilling, completion, and equipping the well for production.

You've got a well, it's completed, you know it's a producer. Now you're going to put the well equipment on, now you're going to put the pump jack on, the pump jack motor, put a flow line. So 200 percent risk

penalties on that? Obviously, obviously unjustified.

And when you want to talk about custom and practice, which is part of the idea about 200 percent, if you look at a JOA operating agreement on surface equipment, it's going to be 100 percent, and then it will have a 200 or 300 or whatever on the drilling and completion. It's totally inappropriate.

And finally, when it comes to the matter of the risk penalty, which of course should be assessed in accordance with the statute, drilling and completion, then we refer to the last tab in your booklet, which is the Viking Petroleum versus Oil Conservation Commission case.

Because that case tells us that when the statute says there "may" be a risk penalty not "shall" be, it tells us, and I read at the last page, which is page 455 of The Reporter.

(Reading) This section -- that's referring to 72-17.

> This section further allows the inclusion of a charge for the risk involved in the drilling of such well, which charge shall not exceed 200 percent, of the nonconsenting working interest owner or owners' pro rata share in the cost of drilling and completing the well.

And then the amount to be reimbursed is,

and I quote: The percentage risk charge to be assessed, if any, are determinations to be made by the Commission on a case-to-case basis, and upon the particular facts in each case.

Absolutely contrary, both by statute and the Supreme Court statement, absolutely contrary to the idea that you don't have to establish the facts, you don't have to have any proof, and you just get the risk penalty.

And we all know, and I repeat somewhat myself, we all know what it means for small nonconsenting working interest owners. It means when you apply that, and you apply it to all those costs, and you have to have your share of the revenue go three times into the pockets of the operator, you probably never receive any benefit and your correlative rights are gone and your interest is gone.

The motion of Jalapeno, Mr. Chairman and members of the Commission, brings before -- as I said in the opening, brings before you the matter of finally facing what the Division and Commission have struggled with for several years. It's time to say the law is the law. It has not kept up with the science, with the technology. It's time to be in front of the legislature. It can be done, but let's get the statute that either does or does not accommodate the horizontal well drilling, and

at the same time protect the rights of all the parties, including nonconsenting parties or small participating parties.

But simply put, the Division can't, nor can this Commission, justify on a case-by-case basis, ignore what the law is, and for that reason we submit that the motion should be granted. Thank you.

COMMISSIONER CATENACH: Thank you, Mr. Gallegos.

MR. BRANCARD: Would counsel want to reserve some time for rebuttal?

MR. GALLEGOS: I would like to. I didn't watch my time.

MR. BRANCARD: He's got about 10 minutes left, I think.

MR. GALLEGOS: I have about 10 minutes left?

MR. BRUCE: Use it all now.

MR. GALLEGOS: I'm going to save it, but -- I'll hold on to a little bit.

COMMISSIONER CATENACH: Do you want to ask any questions?

MR. BRANCARD: No, I'm fine.

COMMISSIONER CATENACH: Okay. Mr. Bruce, you may proceed.

MR. BRUCE: Thank you. Before I do, Mr. Examiner, I have a number of Division Orders. Several

of them were submitted to you by Mr. Gallegos, but...

Commissioners, Jalapeno's essential position is that there is no authority under statute, case law, regulations, or Division Orders to form non-standard spacing and proration units for vertical wells and force pooling.

Well, first of all 70-2-17 clearly and plainly provides for pooling of oil and gas wells if the parties can't reach voluntary agreement. So force pooling takes the place of a voluntary agreement, and in fact the statute requires force pooling if there is no voluntary agreement.

Now, Jalapeno said it again today, they said it at the Division hearing, that Matador is just taking its interest. No. It is specifically provided for in the forced pooling statute that if a party does not voluntarily join, revenue from its interest goes towards paying off its proportionate share of well costs, and the Division can assess a risk charge.

But it's not stealing minerals, it's not taking the mineral interest. It's taking its revenue in a specific well. It always has the chance to join in that well and other wells drilled in that well unit, and it does that by making its own risk assessment. The operators obviously take a risk in drilling the well, and

this is just a way of burden sharing.

Jalapeno says forming a voluntary project area is acceptable for a horizontal well, but again force pooling is a statutorily approved substitute for a voluntary agreement, therefore we think it's argument must fail.

Notice that Mr. Gallegos did not submit to you either 70-2-18 or 70-2-11.

70-2-18.C states: Non-standard spacing and proration units may be established by the Division, and all mineral and leasehold interests in any such non-standard unit "shall" share in production from that unit from the date of the Order establishing the said non-standard well unit.

An Order. An Adjudicatory Order. You don't need a Regulation establishing non-standard well units.

And furthermore, that statute 18 was adopted in 1969, some 34 years after 70-2-17, and therefore 70-2-18 amends or revises, you might say, 70-2-17. It modified 70-2-17.

Then the key thing I think today is 70-2-11. It sets forth the Division's and the Commission's primary duties: Preventing waste, protecting correlative rights. And in order to do that 70-2-11

grants the Division and the Commission the authority to make and enforce Rules, Regulations and Orders to do whatever is necessary to carry out the purposes of the Oil and Gas Act.

That's pretty broad, Very broad. And it has given the Division the flexibility to evolve with time and with changing technology.

Now Jalapeno's complaint is the statute does not specifically use the term horizontal wells. And this reminds me -- not to get really political but to go into history, back when the Soviet Union still existed there was a saying that one difference between the Soviet Union and the United States was that in the Soviet Union whatever was not specifically allowed was forbidden, and in the United States whatever was not specifically forbidden was allowed.

The Oil and Gas Act applies to oil and gas wells and that's what we are here about today, an oil well that Matador wants to drill. And 70-2-11 gives the Commission broad authority which would include oil and gas wells, whether vertical or horizontal.

There are other things that have been going on for many years that the Oil and Gas Act doesn't discuss. Fracking. How about directional drilling, which was probably the immediate precursor to horizontal

drilling, yet that has been going on for a long time, no problem?

Let's move on to the case law. Rutter and Wilbanks approved, as Mr. Gallegos said, two non-standard units under 70-2-18, and at the same time force pooled those well units.

Mr. Gallegos has talked in his brief saying: Well, it has to be an existing well unit. A non-standard well unit is not an existing well unit until it's created by an Order. There is no Division Regulation that sets forth what a non-standard unit acreage is going to be for a vertical well, for instance. So if I was drilling a Morrow well and I wanted a vertical non-standard Morrow well unit, I'd have to come before the Division, if I was seeking forced pooling, get a non-standard unit approved for forced pooling. It's no different from what we are asking for the horizontal wells.

As the Court said, relying on both 70-2-18 and 70-2-11, it would be absurd to hold that the Commission's Orders could not pool separate tracts in a non-standard unit.

As a matter of fact, we are much better off with non-standard horizontal well units. In Rutter versus Wilbank they had four 180-acre well units penetrated

solely by a single vertical well in each unit. In horizontal wells, whether 160 acre, 240, 320, you have a well bore which penetrates and is fracked in every 40-acre tract. What could be fairer than that?

Mr. Gallegos also cited Santa Fe Exploration, saying: Well, the Commission can't force unitize what he calls non-standard units, exploratory units, exploratory production units, and the Commission cannot force pool them or force anybody to join in them.

The problem with Santa Fe Exploration is that the Commission did precisely that. It made the owners of all interests, royalty, working interests, overrides, agree, voluntarily agree to production allocation between two 160-acre well units before they could produce.

The Court approved it and said that statutory unitization doesn't apply, but 70-2-11, conventional waste, protection of correlative rights, allows the Commission to essentially unitize those two tracts. And that's what the Commission did.

And then as to Rules and Regulations, the Division's horizontal drilling Rule 19.15.16.15, in both Subsections A and F specifically refers to compulsory pooling of horizontal well units.

Again there's regulatory authority adopted

by the Commission, and that's done to prevent waste and protect correlative rights.

Now, Mr. Gallegos cited R-13499 which adopted the horizontal drilling rules. And I think the key finding there is that Finding 78.

(Reading) Since the Division has the mandatory duty to compulsory pool its phasing or proration units, upon the appropriate applications where the prescribed predicate facts are shown. The Commission lacks the power to limit by rule the Division's authority to pool spacing units or to require the consent of particular owners to l compulsory pool.

And the Division, starting even before this Order was adopted, was force pooling well units, non-standard well units, and the very first Order was R-12682-A, which, by coincidence, also required the forced pooling of Wolfcamp production from a well in Lea County.

That Order was issued in 2007, and for nine years the Division and the Commission have been forming by adjudicatory Orders non-standard well units and force pooling interest owners in the wells so that people could drill wells, prevent waste, and protect their correlative rights.

I don't have an exact well count again, but

since that Order was issued in Case 13777 -- we're at about Case 15777 these days, so almost 2000 cases have been heard since then, and I would guess well above half of those have been compulsory pooling. Very few for vertical wells.

So there is a large case body before the Division and the Commission forming non-standard units and force pooling them.

Mr. Gallegos also spoke about the Commission's order R-13708-A in the Cimarex case. That Order was dated later than the Rulemaking Order R-13499. Mr. Gallegos said in his oral argument that there was nonproductive acreage in that well unit, but the Commission in ordering paragraph 2 concluded that all 40-acre well units in the non-standard unit are productive.

And the Division and the Commission, as it says, makes similar findings, is the entire horizontal well unit productive. And why did they make that finding? To protect the parties' correlative rights.

I have also included in these packets of Orders three vertical well non-standard units, non-standard unit Orders that the Division has approved.

Mr. Gallegos says that you can only force pool an existing well unit, and he's saying, for instance,

that Matador can only force pool the 40 acres where the surface location of the proposed well is going to be.

Well, the first Order, R-13736, CML Exploration started to drill a Devonian on a proposed 80-acre well unit. Of course because of geology they needed to hit the top of the Devonian structure, and the well had to be severely unorthodox, so they sought a non-standard 80-acre well unit for a pool that was based on 40 acres. Why? It was the only way to protect correlative rights.

I suppose they could have sought just to drill on 40 acres with an unorthodox location, but when you're only, say in this case 30 feet from the offsetting well unit, I don't think the Commission or the Division would have approved that unorthodox location, because it's plain adverse effect on correlative rights on the offsetting 40-acre tracts. So the Commission and the Division have the authority, for a vertical well, to take two 40-acre units, join them together in an 80-acre well unit, join them together for production, which will protect everyone's correlative rights.

Same holds true in Case -- or Order No. R-13747 and in Order R-13939. The only difference with Order R-13939, the JLA Resources Company well unit, it was in a field space on 80 acres. They were drilling more or

less in the middle of those two 40-acre tracts. But because of the geology, the Devonian geology, they took one quarter quarter section from Section 1 and one quarter quarter section from Section 2, again preventing waste, allowing them to develop their resource, and protecting correlative rights.

The fact is without Division and Commission policies and procedures horizontal drilling would be at a standstill, causing waste. And there is substantial statutory authority, Supreme Court case law, Regulations, Division Orders and Commission Orders, adjudicatory Orders granting the Commission the authority to do what Matador requests, and therefore the portion of Jalapeno's Order seeking to dismiss this case should be denied.

As to the 200 percent risk charge, I believe this was an exercise of the Commission's discretion in establishing risk charge. In Finding 38 of order R-11992 the Commission found that in the majority of cases the risk charge is reasonable and is equal to or less than the risk charge factors customarily provided in voluntary agreements.

And that still holds true today.

The fact of the matter is you have a preset 200 percent risk charge. If it wasn't there, of course the applicant would come to hearing with a landman and a

geologist, maybe an engineer, and would present evidence as to the risk charge. If there's no opposition, the only evidence of record would be for a 200 percent risk charge. And it should be granted.

But working interest owners are always given notice of a forced pooling and a request for a risk charge, and they are given notice of the hearing date, and they have the right to come in and oppose it, and there's nothing wrong with that process.

Matador asserts you need not address that issue because before the Division Matador came forward with evidence of supporting its risk charge, Jalapeno showed up with its evidence opposing the risk charge. The same thing will happen at the Commission hearing. Matador and Jalapeno are preparing exhibits for submission to the Commission and are preparing their witnesses to testify about risk charge. So obviously it's at issue, and I don't think you need to address ruling or overruling -- ruling in favor of or ruling against the regulation that cites an automatic 200 percent risk charge.

As to the evidentiary burden, I assert the same thing. You need not decide this issue because both parties are presenting their evidence on their side.

In addition, Rule 19.15.4.17.A provides that the rules of evidence in district court generally

apply before the Division or Commission but only as guidance.

We are not in a district court, and again you don't have to worry about ruling on that, because the parties will fight it out before the Commission.

When it comes to risk factor I would also points out when Mr. Gallegos cited the Marbob case, that case had to do with civil penalties, not a risk charge. That case simply held for the proposition that the Division or Commission couldn't assess penalties and collect penalties on their own. That had to be done by the AG, the Attorney General. That is specifically in the statute. So that case, I'm sorry, is not on point.

One thing I would also like to state. In talking about risk charge Mr. Gallegos said that the parties come before and say there's no impediment to drilling, and they say, "Well, there's really no risk."

Actually, what the geologists and engineers come in and state is that there's no geologic impediment to drilling, physically drilling a horizontal well. For instance, there's no faulting which would mess up with a horizontal well bore. That's different than saying there's no impediment to drilling a well. No other impediments to drilling a well. It's just they are basically saying, We can drill that mile long or mile and

a half long lateral, as we hope to do.

Furthermore, when you're looking at geology, a geologist comes in, talks about risk. Well, you know, you're looking at formations, 8-, 9, 10,000 feet under the ground. Yeah, there might be some offsetting well data, but what the geologist is not saying, "There's no risk." He's saying, "Based on what we know, we think it's worth taking a risk." He's not saying there's no risk.

I think the Continental Oil versus Oil Conservation Division case, the Court said something like they refused to speculate as to geologic factors 10,000 feet below ground. And that's what we are dealing with in these wells.

Is there risk involved? There's always risk involved. I defy someone in this room to tell us with 100 percent certainty what Matador's proposed well in this case will produce, if anything.

As to the risk charge on equipping the well, Matador thinks that is appropriate. We think the Division, in the Order adopting that Rule, Finding 44. The definition of well costs set forth in the proposed rule is in accordance with accepted industry understanding, is very similar to the definition provided in operating agreements in general use in the industry

where there is voluntary agreements between the parties, and should be adopted.

And I cited in the brief, and Matador cited in the brief the Texas case which agrees with that proposition, and there are other cases that agree with it, too.

I think when the definition of a term is uncertain, deference is given to an administrative agency's interpretation of its governing statute, and that is simply what the Commission did when it provided for a risk charge on equipment costs.

Furthermore, in today's world before anything is produced most wells have to not just be complete but they have to have the surface facilities, they have to have the pipelines in place, everything else in place so that when they turn it on they can start producing, they are not flaring gas, they're not causing waste. To do that they need surface equipment, and surface equipment does cost a lot. There have been fights before the Division on the surface costs.

When you drill, produce and complete the well, and part of the completion is putting the surface equipment in, you don't know what you're going to get. Yes, you had oil shows, but you don't know what the productivity of the well is going to be, you don't know

what the ultimate reserves are going to be, you don't even know if the well is going to be economical until you turn it on and start producing. And to usually spend hundreds of thousands of dollars on surface facilities before you know that, that's a risk and it makes the well less economical, and therefore we think it's a proper charge.

With that, I'd say that Matador has spent a year trying to get the state leases drilled on this acreage, and it has been successfully slowed down. Matador needs approval to move forward and protect the correlative rights of all interest owners, and if the well is not drilled, waste will occur.

Thank you.

COMMISSIONER CATENACH: Thank you, Mr. Bruce.

MR. GALLEGOS: Mr. Chairman, members of the Commission --

COMMISSIONER CATENACH: Hang on a second. Let's --

MR. BROOKS: You stated that I could make a statement.

MR. GALLEGOS: Sorry.

MR. BROOKS: Mr. Chairman and Honorable Commissioners, I thank the Commission again for exercising their discretion to allow me to make a statement in this case.

I will not comment on any of the issues involving the compulsory pooling rule, because that is not the reason why the Division intervened in this case. The Division intervened in this case for one reason, and that is because the Movant argues that as a matter of law the Division and the Commission have no authority to establish non-standard spacing units for the purpose of drilling horizontal wells if those non-standard spacing units are larger than the standard spacing unit for the particular pool, which they almost always will be in the case of oil wells, because -- this is a matter of proof, so I'm appealing to the Division. I'm not offering any proof but I'm appealing to the Division's ability -- I mean the Commission's ability, which I believe it has, to apply its expertise, not in construction of the statutes but in the oil and gas business, that I don't think anybody believes that, save possibly in a few isolated cases, that it's economic or practical to -- I have to remember the distinction between practicable and practical. Practical means -- it's basically the same thing. Practical means it's not a good idea. Practicable has to do with what it's actually doing.

But it is not economic and practical to drill horizontal wells on 40-acre spacing units, and I think you are not going to find, in most places in New

Mexico, and I do not believe you will find many people that would disagree with that.

For that reason it is a very important issue whether or not the Division and the Commission have the authority, have the power in an appropriate case, when appropriate facts are shown, to establish non-standard spacing units and proration units that are of sufficient and appropriate size to allow the drilling of horizontal wells on a practical and economic basis.

And that importance greatly transcends the interest of the particular parties to this case, as important as those interest are, and that is why the Division has intervened.

Now, Mr. Bruce covered most of the points that I have in my outline of why the motion should be denied, but I do want to add a few additional thoughts. I am, after all, a lawyer and it would be contrary to that vocation if I didn't say something when given the opportunity to do so.

As Mr. Bruce has pointed out, there is a specific provision in the Oil and Gas Act in Section 70-2-18-C which says that the Commission has power to establish non-standard spacing units. That provision, incidentally, is in the same section, 70-2-18, all enacted at the same time, which says that it is the responsibility

of the operator to consolidate a spacing unit either by voluntary or compulsory pooling. In other words, back in 1969 the legislature simultaneously made two policy judgments. One is that an operator has a duty to consolidate ownership of a spacing or proration unit by voluntary or compulsory pooling; and the second judgment it made was that the Commission, and by 1977 amendment that was extended to the Division, can establish non-standard spacing units.

So what actually is Mr. Gallegos arguing? He's arguing that as a matter of law this proposed 154-acre unit is not a spacing unit and cannot be made a spacing unit because it includes other spacing units. In other words, it's critical to his argument that the spacing units cannot overlap.

But there is nothing in the Oil and Gas Act that says that spacing units cannot overlap, that the same area cannot be more than one spacing unit.

The details of what constitutes a spacing unit are left by statute to the Commission and the Division to flesh out the general provisions the legislature has adopted. This is not, as Mr. Bruce has pointed out, like Marbob, where there was no provision, there is no provision in the Oil and Gas Act authorizing the Commission to assess penalties.

We argued in Marbob that the Commission had that implied authority under its general powers. But we don't have to rely on implied authority under general powers in this case, because the Commission has express authority and authority without express limitations to establish non-standard spacing units.

Now, let me say that I do not argue that because there are no express limitations in 70-2-18C that the Commission has unlimited power to establish non-standard spacing units. I attended a meeting a couple of years ago that involved the infamous Mancos Formation up in the Northwest, and repartee between two landmen up there, the landman for one company said, "Well, that area is included in our super com," and the landman for the other oil company said, "Well, I thought the entire basin was included in your super com."

Well, if the Commission were to decide to establish a non-standard spacing unit that consisted of the entire San Juan Basin or the entire Delaware Basin in New Mexico, I think there would be very little doubt that the Court would hold that it has no power to do that. In other words, that power can be exceeded.

Well, what is the difference?

Well, the term spacing unit and proration unit have definite meanings, or the term -- the term

proration unit has a definite meaning, because it's defined in the Oil and Gas Act. The term spacing unit is not defined in the Oil and Gas Act, so it doesn't have a definite meaning, but it does have a meaning.

So let's explore those terms.

What is a proration unit? A proration unit is specifically defined in the Oil and Gas Act as the area that can be efficiently and economically drained by one well. It doesn't say one vertical well.

Now, we know that the legislature had no specific intent to establish, with regard to horizontal wells when that provision of the statute was enacted, which was before 1969. But they said, "well", and they didn't have to confine it to vertical well or horizontal well, because there was only one kind of well in New Mexico in those days.

But that does not mean that the legislature adopted a policy that the Oil Conservation Division has no power, Oil Conservation Commission has no power to deal with subsequent development in the industry. There is nothing in the Oil and Gas Act from which you can infer that conclusion. What the legislature did say is that a proration unit is an area that can be economically and efficiently drained by one well, as distinguished from an area that requires multiple wells, such as a field or unit

that is needed for a secondary or tertiary recovery process, which is going to be multiple wells in every case. We are focusing on one well.

Well, you, the commissioners, cannot decide whether this proposed 154-acre unit can be practically and economically drained by one well until you hear the evidence.

So our contention is that you must overrule this motion, and hear the evidence and decide whether Mr. Bruce and his clients make appropriate proof that this 154-acre unit is the right size of unit to be established as a proration unit. That is part of what the applicant asks in this case, and the applicant has a right to put on his evidence to show that that's the situation.

Now, what about spacing unit? That is a little more difficult because we don't have a statutory definition. The legislature surely had some idea what they meant by the term spacing unit, and if you go back to the oil and gas treatises and look at what is said about pooling and unitization in the oil and gas treatises -- and I'm relying on Williams and Meyers, Section 901, although Summers says basically the same thing.

The difference between pooling and unitization is pooling is putting together the land necessary to drill one well. Now, we've gotten away from

that in New Mexico, but the question of whether authorizations for in fill wells within spacing units is proper is not before us.

The history was, as I think most everyone familiar with the oil industry knows, that under the Rule of Capture whereby whatever came out of a wellhead belonged to the owner of the land on which the well was located at the surface, it was to the interest of every owner of every tract to drill as many wells as possible, because if you had more wells on your tract, even if it was only one acre, you're going to get more of the pool coming out of your wellheads than your neighbor who drills fewer wells.

Well, what does your neighbor do when you do that? He goes and drills more wells, because if you were draining a larger percentage of the reservoir because you've got more wells on your tract, then your neighbor has an incentive to drill more wells on his tract. And you get a mess, and that's what we had in the oil and gas world back in the 1930s.

Now, contrary to popular belief, I was not around in the 1930s, but I have read that in both Texas and Oklahoma it became necessary for the governors of those states to call out the National Guard to enforce proration in the oil fields.

Anyway, in response to that we got the Oil and Gas Conservation Act, and the legislature of New Mexico made a judgment -- not the same judgment made by every state, but we're only concerned with what was made in New Mexico. The legislature of New Mexico made a judgment that pooling could be allowed for a spacing unit. It did not make a judgment about unitization.

Now, it subsequently did make a much more limited delegation of authority over unitization when it adopted the Statutory Unitization Act, but the Statutory Unitization Act has nothing to do with this case.

So they did not define a spacing unit. What did they do instead? Well, way back, going to the 1935 statute, they adopted Section 70-2 -- what is now, it's been recodified, of course, several times, Section 70-2-12.B(10), which is one of the authorities delegated to the Commission in 1935. And it says that the Commission has the authority to make Rules and Orders concerning the spacing of wells.

Now, Rules and Orders is important because the Commission -- the Division does not have a rule that is pertinent to this case.

I will point out that the rule that has been cited is not pertinent, in a minute, but the Commission does not have a rule that is pertinent to this

case. It has chosen, for whatever reasons, to -- the Division has chosen to proceed by Order, and the Commission of course has simply reviewed the Orders and heard them de novo when somebody asked them to.

The Division has chosen to proceed by Order and decide in each case that is brought to it whether the unit is a proper unit, and whether a proposed non-standard spacing unit for drilling a horizontal well is an appropriate unit.

Now, I suggest that given that background it's reasonable to infer that the legislature meant by a spacing unit basically the same thing that they meant by proration unit. And they have said since, the courts have said that a spacing unit and proration unit are different things, and we know that to be true because the Supreme Court said it, but it's also logically true because you need spacing units even in a nonprorated pool.

So the need for proration for a pool or whether there is or should be proration in a pool is logically irrelevant to configuration of spacing units. And if we have overlapping spacing units, which we now do and hopefully will continue to have because of the requirements of Arizona Wells, there are going to be many situations in which the spacing units and the proration units in a pool will be different.

And that is okay, because we have two separate concepts here, spacing unit and proration unit. They are not the same thing, as the Supreme Court said in the Rutter and Wilbanks case.

So once again, whether you are talking about a proration unit or a spacing unit, either of which can be compulsory pooled under the statute, expressly provided, the Commission cannot decide whether this 154-acre unit is a proper proration unit or spacing unit until it hears the evidence.

Okay. Now let me talk just a second about the Rutter and Wilbanks case.

Mr. Bruce has given you the gem quote from the Rutter and Wilbanks case that it would be absurd to hold the Commission does not have authority to pool separately owned tracts within an oversized -- that is greater than standard -- area non-standard spacing unit.

It is true is that the units, the non-standard units in the Rutter and Wilbanks case were not a whole lot greater than standard units. They were like a third bigger than a standard unit, whereas the 154-acre unit proposed in this case is almost four times the size of the standard unit, and they did not overlap standard units.

But those distinctions are not the critical

distinctions. Now, applying stare decisis is not a science. Stare decisis is the doctrine under which courts follow the prior decisions of their own prior decisions and their own -- and those of others. I realize that in arguing to people who are not necessarily lawyers that I have to explain the Latin expressions that we are accustomed to using.

Stare decisis is an art not a science, and that art -- because no two cases are ever exactly alike. Lawyers talk about white horse cases. If the case involved a black horse it would have been distinguishable.

Well, in some cases that might be the critical fact, but in most cases it's not. There are always distinctions between cases, but what you have to pick out is the critical distinctions.

We have a treasure trove in Rutter and Wilbanks, because the Court itself has pointed out what matters in that case, by approving certain findings as adequate to support the Commission's decision, and the findings they quote are that the evidence presented at the de novo hearing indicates that the entire east half of the above-described Section 3 can reasonably be presumed to be productive of oil and gas from the well or Washington Ranch Morrow gas pool, and that the evidence establishes to the satisfaction of the Commission that the entire east

half of the above-described Section 3 can be efficiently and economically drained by the above-described federal well No. 2.

Now, I have been deeply involved in this. And I don't know what's in every Order that has be issued, but every Order that I have reviewed in my capacity as one of the reviewers of Orders in the engineering bureau, and every Order that I have written that establishes a non-standard spacing or proration unit for a horizontal well has included findings similar to these, and the record has included testimony that supports those findings, because I've made sure when I had anything to do with it that that was the case.

But the Commission cannot decide whether similar findings would be appropriate in this case until it hears the evidence, and for that reason the motion should be denied.

I think that's all I need to say, and when you've said enough, you should stop. Thank you.

COMMISSIONER CATENACH: Thank you, Mr. Brooks.

Mr. Gallegos.

MR. GALLEGOS: Thank you, Mr. Chairman.

Well, we have a very good appreciation for what has been happening, what's been going on, what -- Matador's presentation tells us this has gone on and

there's been a lot of cases and a lot of Orders. Absolutely true. And now we know that the Division would like to keep going on the way it has. And that's not the issue. Neither of those things are the issue, what the Division would like to continue doing and what it has done.

And we certainly don't disagree with some of the things about: Well, you don't drill horizontal wells on 40 acres, and not practical and so forth.

Here's the problem. It's right in front of you, and it's Tab 2, and it's the law.

And I'm not going to read verbatim, but I would really ask the commissioners to look at this first paragraph of 70-2-17C, because what it is saying is that when there are multiple tracts of land within a spacing unit, within a spacing unit, that the parties can voluntarily agree that their tracts and their interests will be developed and operated; or if they don't agree, there is authority to force their participation within the spacing or proration unit as a unit.

There's no possible reading of that paragraph that can be interpreted or construed to say: Oh, and this means that we can override and overlap existing spacing units and superimpose on them a project area, so-called project area.

And nobody argues that Section 18 doesn't allow for a non-standard spacing unit. You have 40 acres, it could be 42, or we know in Rutter-Wilbanks you've got an unusual section and 320 just doesn't work. But it's "a" spacing unit. It's not linking together combining spacing units. There is just simply no authority to do that.

And the Commission, one of -- Dr. Balch among them -- in the rulemaking, horizontal rulemaking case, along with the Chair Jamie Bailey and with Scott Dawson basically said what we're saying. It said: The Division's authority to establish non-standard spacing or proration units or special spacing and proration for horizontal wells has not been clearly delineated by either judicial or Commission precedent.

And it goes on to say you can't do this without regard to applicable statutory and regulatory authority.

What has to happen is this: This Commission has to take the bit in its teeth and say, We're sorry, Matador, Mewbourne, Cimarex, all you folks, but the law is the law. We have to follow it. We cannot continue doing this.

And as soon as you make that decision, the industry is going to be motivated to get before that

legislature, get their lobbyists, get going, and let's do what needs to be done with the law. You're not going to do that. It's not your obligation. What your obligation is, is to conform to the authority that you have now and to say: Companies, we want you to drill horizontal wells, we want this going on, but our hands are tied. And then as soon as that happens, they're going, the lobbyists are going to be, the association is going to be there, and let's get the Act to provide what it should, if the legislature agrees.

And, you know, you've got a public interest, too. It's not just the industry once you come before the legislature.

The same is true when you read the statute. I just referred to, the statutory language. Because if you go on down to the following paragraph, it doesn't -- there's no way that you can say this matter of the risk penalties isn't something that may be assessed, but the parties seeking that penalty to be imposed on other owners so that their interest becomes, in effect, the applicant's interest for some period of time, for years and years for a three-time payout, say that there's no way that can be read to say we are going to switch that around and say you just automatically get that.

And frankly, I didn't really hear any

defense of charging a risk penalty on surface facilities. The statute says drilling and completion. Matador's counsel says: Oh, well, you got to put all that stuff on to produce a well. Everybody knows that you don't produce it unless you put the equipment.

Well, yeah. And the nonconsenting party has to pay their share of that, but not three times their share of that. The statute doesn't allow that.

It's a difficult decision, because this Commission and the Division works with these companies. And we all want the resources of the state developed, but the law is the law, the authority is what it is, and it's being exceeded, and it's time to basically say we have got to do what we've got to do, and that would be in the form of granting this motion, which would then signal the industry, and the industry can take steps, if necessary, to, if the public interest and the legislature agrees, exceed -- or "enlarge" is the word. Enlarge the authority.

Thank you.

COMMISSIONER CATENACH: Thank you.

Anything further, Mr. Bruce?

MR. BRUCE: Just one thing.

Mr. Gallegos said there is nothing cited saying that surface facilities should be allowed. We cite

authority in our brief regarding including equipping as part of completing. And I think the Commission has the right to interpret its statutes, and it has discretion in doing that, and the courts have found that in so doing the Commission should be given deference in its interpretation of its governance statutes.

So we believe surface facilities are proper to be included in the risk charge.

COMMISSIONER CATENACH: Okay.

Questions, Commissioners?

COMMISSIONER PADILLA: Not me.

COMMISSIONER BALCH: Not me.

COMMISSIONER CATENACH: Mr. Brancard?

MR. BRANCARD: Just for Mr. Gallegos.

Just so I'm clear, your argument, then, is that 70-2-17 limits spacing units for oil wells to 40 acres?

MR. GALLEGOS: Well, it depends upon what the pool rule is. I think -- as far as I know, typically that is the spacing for established pools for oil wells. Now, that doesn't mean that in a given case it might be 45 acres or 36 or whatever because it's a non-standard, because there's some topographical or some other reason that you are not going to follow the 40 acres. But that's far different than just saying you can chain them

together, existing spacing units, and call it something else.

MR. BRANCARD: So that's totally based on the Regulations and Division Orders establishing pools. There's nothing in the statute about 40 acres, about pools.

MR. GALLEGOS: The statute --

MR. BRANCARD: About what is a standard spacing unit is not defined in the statute.

MR. GALLEGOS: That's correct.

MR. BRANCARD: So the Division Order approving this 154-acre unit established it as a spacing unit, proration unit, and a project area.

MR. GALLEGOS: Established it non-standard, calls it a non-standard spacing unit.

MR. BRANCARD: But it specifically says in the Order that it is a spacing unit, a project area, and a proration unit. And as has been brought out, in 70-2-17B there is a definition of a proration unit, which is essentially what can be efficiently and economically drained and developed by a well.

So wouldn't that apply, then, that a proration unit for a horizontal well is simply the area that can be drained by that horizontal well?

MR. GALLEGOS: What do you do with the existing

spacing unit, the 40 acres that can be drilled by a well, which now means that majority owner can't drill his well on that 40 acres because now it's been overlapped?

MR. BRANCARD: Right. But then C, Section C, which you're quoting, says that it can be voluntarily or compulsory combining of tracts within a spacing or proration unit.

MR. GALLEGOS: Right. And spacing and proration unit are basically synonymous in terms of the way they are used in the statutes, as far as I can tell. Proration unit, I believe, is referring to, you know, back when you had the allotment and limitations on actual amount of production.

MR. BRANCARD: Okay. Thank you. Nothing further.

COMMISSIONER CATENACH: I don't have any questions.

I suggest we take a break at this point. Do I have a motion to go into executive session?

COMMISSIONER BALCH: So moved.

MR. PADILLA: Second.

COMMISSIONER CATENACH: All right. All in favor?

COMMISSIONER BALCH: Aye.

COMMISSIONER PADILLA: Aye.

COMMISSIONER CATENACH: Aye.

MR. BRANCARD: In accordance with the Open Meetings Act.

(Note: In recess at 10:50 a.m.)

SPECIAL MASTER: Let's call the meeting back to order.

Do I have a motion to go back on?

COMMISSIONER PADILLA: So moved.

COMMISSIONER BALCH: Second.

COMMISSIONER CATENACH: All in favor?

COMMISSIONER BALCH: Aye.

COMMISSIONER Padilla: Aye.

COMMISSIONER CATENACH: Aye.

Pursuant to the Open Meetings Act we have been in executive session. And we have only discussed the issue that was brought up to the Commission this morning, and I think we have reached a decision on that, and Mr. Brancard can brief us on that.

MR. BRANCARD: Okay. The Commission considered the motion to dismiss the application of Matador for the following reasons: That the Commission, (A) has no authority to approve a non-standard spacing and proration unit for a horizontal well as proposed by Matador; and also that the Commission should invalidate portions of Rule 19.15.13.8 to the extent that the rule conflicts with

the Oil and Gas Act and mandates a 200 percent risk penalty without justifying such penalty. (2) it puts the burden on the party opposing the risk penalty to justify a lower risk penalty; and (3), allows certain well costs to be included within those costs that are affected by the risk penalty.

In regard to this motion to dismiss, the Commission proposes to deny the motion to dismiss. The Commission has authority under Section 70-2-17 to approve a proration and spacing unit for an area that efficiently and effectively is drained by a single well.

(2) The Commission finds that Rule 19.15.13.8 is a reasonable implementation of the statute and that there is not sufficient support presented today to invalidate such rule.

You'll have a motion to dismiss based on --

COMMISSIONER CATENACH: A vote?

MR. BRANCARD: - To deny the motion to dismiss.

COMMISSIONER BALCH: I'll make a motion to dismiss.

MR. BRANCARD: To deny the motion to dismiss.

COMMISSIONER BALCH: I'll make a motion to deny the motion to dismiss.

MR. PADILLA: Second.

COMMISSIONER CATENACH: All in favor?

COMMISSIONER BALCH: Aye.

COMMISSIONER PADILLA: Aye.

COMMISSIONER CATENACH: Aye.

Just another comment.

Mr. Gallegos, the Division will look at and will have some internal discussions regarding risk penalty and the way it's currently enforced and implemented. We will also probably have some internal discussions with regard to equipping of wells, and see what industry standards are applied to that.

We may at some point -- I can't say for sure, but there may be some changes to that that we make in the future.

But we will have some internal discussions.

MR. GALLEGOS: That's good. Thank you.

COMMISSIONER CATENACH: Thank you.

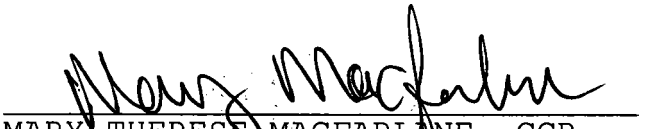
(Time noted: 11:57 a.m.)

STATE OF NEW MEXICO)
) SS
COUNTY OF TAOS)

REPORTER'S CERTIFICATE

I, MARY THERESE MACFARLANE, New Mexico Reporter CCR No. 122, DO HEREBY CERTIFY that on Thursday, August 25, 2016, the proceedings in the above-captioned matter were taken before me, that I did report in stenographic shorthand the proceedings set forth herein, and the foreoing pages are a true and correct transcription to the best of my ability and control.

I FURTHER CERTIFY that I am neither employed by nor related to nor contracted with (unless excepted by the rules) any of the parties or attorneys in this case, and that I have no interest whatsoever in the final disposition of this case in any court.



MARY THERESE MACFARLANE, CCR
NM Certified Court Reporter No. 122
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