MONTGOMERY & ANDREWS
LAW FIRM

J. SCOTT HALL
Office: (505) 986-2646
Email: shall@montand.com
Reply To: Santa Fe Office
www.montand.com

September 30, 2011

Ms. Florene Davidson
NM Oil Conservation Division
1220 S. St. Francis Drive
Santa Fe, NM 87505

Hand Delivered

Re: NMOCD Case No. 14741: Application of Cimarex Energy Co. of Colorado for a Non-Standard Spacing and Proration Unit and Compulsory Pooling, Eddy County, NM

Dear Ms. Davidson:

On behalf of Nearburg Producing Company, enclosed for filing is Nearburg's Response to Cimarex's Motion to Quash in the above-referenced case.

Thank you.

Very truly yours,

Karen Williams

Karen Williams
Assistant to J. Scott Hall

JSH:kw
Enclosure

cc via e-mail:
W. Thomas Kellahin, Esq.
David Brooks, Esq.
Richard Ezeanyim, P.E
Mr. Terry Warnell

317167

REPLY TO:
325 Paseo de Peralta
Santa Fe, New Mexico 87501
Telephone (505) 982-3873 • Fax (505) 982-4289

Post Office Box 2307
Santa Fe, New Mexico 87504-2307

6301 Indian School Road NE, Suite 400
Albuquerque, New Mexico 87110
Telephone (505) 884-4200 • Fax (505) 888-8929

Post Office Box 36210
Albuquerque, New Mexico 87176-6210

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

APPLICATION OF CIMAREX ENERGY CO. OF COLORADO FOR A NON-STANDARD SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY COUNTY, NM

CASE NO. 14741

NEARBURG PRODUCING COMPANY'S RESPONSE TO CIMAREX'S MOTION TO QUASH

Nearburg Producing Company, ("Nearburg"), for its Response to the Motion To Quash filed on behalf of Cimarex Energy Co. of Colorado, ("Cimarex"), states:

The Applicant, Cimarex Energy Co. of Colorado, ("Cimarex"), seeks the designation of a non-standard unit and the compulsory pooling of unjoined interests in the Bone Spring formation underlying the E/2 W/2 of Section 32, T-18-S, R-31-E, NMPM in Eddy County for its West Shugart 32 State Com Well No. 2-H. In addition to being designated operator of the proposed well, Cimarex also seeks the imposition of a 200% risk-penalty against interest owners who elect not to participate in the well. Nearburg is the owner of significant working interests in the lands that are the subject of the Cimarex Application. Nearburg has previously indicated its intent to challenge the Cimarex request for a 200% risk penalty pursuant to Division Rule 19.15.13.8. In order to do so, Nearburg requested the Division to issue to Cimarex a subpoena duce tecum seeking the production of well information from an adjacent well, the West Shugart 32 State Com No. 1-H. The subpoena is attached as Exhibit "A", attached. Rather than comply with the Division's subpoena, Cimarex filed a Motion To Quash.

Cimarex now seeks to avoid compliance with legitimate discovery. It attempts to do so by the improper assertion of objections based on (1) relevance[1], and, (2) in two instances[2], trade secrets. In addition, Cimarex asserts a patently inconsistent "objection" to the effect that Nearburg may have the information when it pays its share of well costs, relevance or trade secret status notwithstanding.

Point I: Cimarex has an affirmative obligation to comply with the subpoena. It is not an option. The relevance objection cannot be asserted as a basis to avoid a party's pre-hearing discovery obligations. Relevance is an *admissibility* objection which must wait for the hearing on the merits at the time the supposedly "non-relevant" material or information is offered into evidence. Further, Division policy supports the discovery sought by Nearburg.

Point II: Cimarex has not properly invoked the trade secret privilege. Mere unsupported assertions by counsel that well logs and daily drilling reports qualify as trade secrets are not permissible. Cimarex does not follow the existing protocol established under New Mexico law for the protection of trade secret information.

Point III: Nearburg has both a property right and contractual right to the information. Cimarex cannot use a motion to quash to deny Nearburg information and materials it has a right as a litigant, and as an owner, to receive.

THE CENTRAL ISSUE

May groundless discovery objections be used as a tool to deny a force-pooled interest owner's right under Division Rule 19.15.13.8 to challenge the risk penalty sought by a compulsory pooling applicant?

[1] Items 1, 2, 4, 5, 6, 7, 8 and 9.
[2] Items 1 (well logs) and 4 (daily drilling reports).

POINT I: The Relevance Objections Do Not Work

In its Motion to Quash, Cimarex cut and pasted an identical, autonomic relevance objection eight times. The objection should be stricken eight times, for relevance is not a permissible basis for withholding discoverable information or materials in the discovery process here. The time for Cimarex to assert its relevance objections is at a hearing on the merits when the information or materials are offered into evidence. For now, during discovery, Nearburg is not obliged to demonstrate the relevance of the materials it seeks in the manner contemplated by NMRA 11-401 or 11-402 of the Rules of Evidence. It need only show that it is "pertinent" under NMSA 1978 §70-2-8.

Cimarex's cavalier assertion of the objection is evinced by its devotion of only eleven lines of discussion to the topic of relevance. The discussion contains no citations to authority and is devoid of any explanation at all why the objection/motion would refer to trial objections to admissibility when the issue concerns a party's obligation to comply with pre-hearing discovery.[3] It is a different context altogether and the law providing for broad and liberal pre-hearing discovery is firmly established.

In the past, the Division and the Commission have consistently applied the broadest pertinence standard in the adjudication of discovery disputes. In this instance, the Division's Rule 19.15.13.8 providing for challenges to 200% risk penalty applications directly establishes the materiality of the need to obtain well data from a well operated by the Applicant in the adjoining spacing unit in the same formation. Therefore, the "pertinence" standard for subpoenas under NMSA 1978 §70-2-8 is clearly met and Rule 1-026(B)(1) is satisfied.

[3] NMRA 1-026(B)(1) provides, in part: "It is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence."

The law favors liberal discovery in any proceeding. Carter v. Burns Constr. Co., 85 N.M. 27, 31, 508 P.2d 1324, 1328 (Ct. App. 1973); cert. denied, 85 N.M. 5, 508 P.2d 1302 (1973). The applicable relevance standard in discovery is also broadly construed. Smith v. MCI Telecommunications Corp., 137 F.R.D. 454, 463 (S.D.N.Y.). Objections based on relevance must be viewed in light of the broad and liberal discovery principle consciously built into the rules of civil procedure. "The boundaries defining information relevant to the subject matter involved in an action are necessarily vague, making it practically impossible to formulate a general rule by which they can be drawn." Because courts [and the Division] "are not shackled with strict interpretations of relevancy," discovery is permitted on matters that "are or may become relevant" or "might conceivably have a bearing" on the subject matter of the action, or where there is "any possibility" or "some possibility" that the matters inquired into will contain relevant information. Conversely, courts have said that discovery will be permitted unless the matters inquired into can have "no possible bearing upon," or are "clearly irrelevant" to the subject matter of the action. United Nuclear Corp., 96 N.M. at 174, 629 P.2d at 250. In view of the express remedy provided under Rule 19.15.13.8 to interest owners being force pooled, Cimarex has failed make the required showing under United Nuclear.

Established Division policy on discovery supports Nearburg.

Through their orders, the Commission and Division articulate agency policy. Unless distinguished or expressly overruled, earlier Commission and Division orders are standing precedent and must be followed. Compelling the production of subpoenaed well data is the exact result reached by the Division in precedent cases with fact backgrounds analogous to this case.

In 2005, Chesapeake Operating, Inc. drilled a well before commencing compulsory pooling proceedings. As here, one of the other working interest owners in the spacing unit

obtained a subpoena duces tecum from the Division seeking well logs and well data. Chesapeake objected on the grounds of relevance and trade-secret privilege. The Division threw-out Chesapeake's objections and ordered it to honor the subpoena. (Case No. 13492; *Application of Mewbourne Oil Company for Cancellation of Two Drilling Permits and Approval of a Drilling Permit, Lea County, New Mexico; Order No. R-12343-A*, Exhibit "B", attached.) It should do the same here.

In 2006, Devon Energy Corporation and LCX Energy LLC both filed competing compulsory pooling applications, each seeking to pool the same acreage. However, LCX Energy was compelled to commence drilling before the compulsory pooling proceedings were complete in order to save an expiring lease. Devon obtained a subpoena for the well data on the LCX well. LCX moved to quash the subpoena and interposed objections similar to those at issue here based on: (1) the trade secret privilege and (2) for the reason that the subpoena was not reasonably calculated to lead to the discovery of admissible evidence per Rule 1-033(B)(1).

The Division again followed its established policy by overruling these objections and ordering LCX to produce well logs, completion reports, reservoir pressure information, bottomhole pressure tests, buildup tests, current well rates, flowing tubing pressures and choke sizes. (Case No. 13603; *Application of Devon Energy Corporation for Compulsory Pooling*; consolidated with Case No. 13628; *Application of LCX Energy LLC for Compulsory Pooling, Lea County, New Mexico; Order No. R-12511*, Exhibit "C", attached.) These prior orders of the Division have not been overruled or distinguished and are to be followed here.

Cimarex's motion fails to disclose Orders R-12343-A and R-12511. Instead, Cimarex relies on Order No. R-13156 as support for its position,[4] (the "XTO Order"), but that case is distinguishable. In that case, an interest owner being force pooled after drilling and completion sought to subpoena information which the order subsequently defined as "well specific data" (e.g., not from an offsetting well) in order to challenge the risk penalty. In the order, the Division reasoned that the "well specific data" would not have a bearing on the risk penalty issue because the Applicant, XTO, "made its decision to incur the risks associated with drilling the well prior to commencement thereof, at a time when it did not have the well-specific data." That is not the case here. It is obvious that Cimarex has made the decision to drill the West Shugart 32 State Com No. 2-H in the E/2 W/2 of Section 32 because of the information it obtained when it drilled the West Shugart 32 State Com No. 1-H in the adjoining unit. The risk-based decision to drill the 2-H well using the information from the 1-H well has a direct bearing on Nearburg's right under Rule 19.15.13.8 to challenge the full-up risk penalty that Cimarex has asked the Division to award it.

POINT II: The Trade Secret Privilege Objection.

Orders R-12343-A and R-12511-A discussed above reflect the Division's policy toward the invocation of objections based on the trade secrets privilege or the proprietary nature of information.

Under Rule 11-508 NMRA 2004 (Trade Secrets), a person has a privilege to refuse to disclose and to prevent others from disclosing a trade secret owned by the person, but only if assertion of the privilege will not tend to conceal fraud or otherwise work injustice. If the

[4] Case No. 14331; *Application of XTO Energy, Inc. for Compulsory Pooling and Downhole Commingling, San Juan County, New Mexico*

assertion of the privilege would otherwise work an injustice, then the Court should order disclosure of the material while taking such protective measures as the interests of the privilege-holder and the furtherance of justice may require. *Id.* Further, the privilege is waived if the holder of the privilege has voluntarily disclosed any significant part of the matter to anyone under circumstances where the disclosure is not privileged. Rule 11-511 NMRA 2004.

With the ownership of its lease interest in the W/2 of Section 32, Nearburg is the undisputed owner of a "right to exploration", a protected property right. See Phillips Petroleum Co. v. Cowden, 241 F.2d 586, 590 (5th Cir. 1957.) In Cowden, the specific right protected by the court was that of the landowner to acquire information regarding the subsurface structure of his land through geophysical operations performed within the boundaries of his land.

Further, the right to exploration is an exclusive right and includes the right to the geological and geophysical information. Layne Louisiana Co. v. Superior Oil Co., 26 So.2d 20 (La. 1946). See, also, Grynberg v. City of Northglenn, 739 P.2d 230 (Colo. 1987). In Grynberg, the Colorado Supreme Court held that only the mineral owner or its lessee could authorize geological testing, noting that "the recognition of the exclusivity of the right of the mineral owner to consent to such exploration is based upon the central importance of information concerning mineral deposits to the value of the mineral estate." Grynberg v. City of Northglenn, at 234. It is clear under the facts of this case that the data derived from drilling, including geologic data, are owned by Nearburg as well as Cimarex. Indeed, the reasoning of Cowden, Lane Louisiana, and Grynberg was expressly followed by the Division in Order No R-12343-A. Correspondingly, Cimarex is not in a position to assert the exclusivity of trade secrets privilege under Rule 11-508.

Cimarex has not properly invoked the trade secret privilege.

If Cimarex is serious about the trade secret privilege, it has not properly invoked it. A protocol for invoking the trade secrets privilege is well-established under New Mexico law, but Cimarex has disregarded it. Cimarex may not unilaterally decide that information is to be accorded trade secret status and the unsupported conclusory assertion of counsel is not enough. A determination of trade secret status is to be made by the tribunal.

In *Pincheira v. Allstate Insurance Company*, 2008-NMSC-049, 144 N.M. 601, 190 P.3d 322, the New Mexico Supreme Court outlined the procedure a litigant must follow when seeking to protect information purportedly containing trade secrets. The procedure applies whether the litigant seeks this protection by protective order or by assertion of an evidentiary privilege. The *Pincheira* case arose out of an insurance coverage dispute between Plaintiffs Jose and Olivia Pincheira and Defendant Allstate Insurance Company. *See Pincheira v. Allstate Ins. Co. (Pincheira II)*, 2007-NMCA-094, ¶ 3, 142 N.M. 283, 164 P.3d 982. After Plaintiffs won a declaratory judgment in district court on the coverage issue, they brought additional claims of bad faith, fraud, unfair trade practices, and others against Allstate and sought discovery of certain materials. *Id.* ¶ 4. On subsequent appeal, the Supreme Court's *Pincheira* opinion addressed Plaintiffs' attempts to compel discovery of documents purportedly relating to their bad faith claims. Allstate objected that these documents contained trade secrets and refused to turn them over without a protective order. *Id.* Because of Allstate's refusal, the trial court entered a default judgment on liability, with damages to be determined at trial. *Id.* In the subsequent proceedings, the Supreme Court took the opportunity "to clarify the procedure to be used when seeking to protect an alleged trade secret and the factors that trial courts should consider when issuing

protective orders covering trade secrets." *Pincheira*, 2008-NMSC-049, ¶ 3. The Supreme Court outlined the following steps:

A. Establishing the Existence of a Trade Secret

1. The party seeking protection must make a good faith assertion that the information is a trade secret.

The Court did not define a "good faith claim" in the trade secret context, but in *Pincheira*, said that "[i]f the party opposing production gives nothing more than an initial conclusory assertion of a trade secret's existence, the trial court may decline further review and order production without a protective order." *Id.* ¶ 37. This is what Cimarex has done here.

2. The court should then order production for the limited purpose of determining the trade secret status of the information and simultaneously enter a preliminary, limited, protective order.

When supported by a good faith claim, "the trial court should readily order production of the information," and issue a preliminary protective order "on the conditions that [the information] be used solely for the purpose of determining trade secret status and that it not be disseminated to anyone other than the parties." *Id.* ¶ 35. "[T]he trial court should then hold a closed, adversarial hearing in which it determines the trade secret status of the materials." *Id.*

3. The court then holds a closed, adversarial hearing to determine the trade secret status of the information.

The good faith assertion of the party opposing discovery or production is then tested in an adversarial hearing. Whether the trade secret is claimed in the context of a discovery order or evidentiary privilege, its existence "is evaluated as a preliminary question of fact under Rule 11-104(A) NMRA." *Id. 34.*

4. The court then decides whether the information is a trade secret by consulting the Uniform Trade Secrets Act's definition of "trade secret" and the six Restatement factors.

In *Pincheira*, the Supreme Court adopted the definition of "trade secret" used in the Uniform Trade Secrets Act (TSA), NMSA 1978, § 57-3A-2(D). *Pincheira*, 2008-NMSC-049, ¶ 15. The TSA defines a trade secret as:

> Information, including a formula, pattern, compilation, program, device, method, technique or process, that:
>
> (1) derives independent economic value, actual or potential, from not being generally known to or not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use; **and**
>
> (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Section 57-3A-2(D) (emphasis added).

Additionally, the Court adopted six factors from the Restatement (First) of Torts that "provide helpful guidance to determine whether the information in a given case constitutes 'trade secrets' within the definition of the TSA." *Id.* ¶ 19 (internal punctuation omitted). These factors are:

> (1) the extent to which the information is known outside of his business;(2) the extent to which it is known by employees and others involved in his business; (3) the extent of measures taken by him to guard the secrecy of the information; (4) the value of the information to him and to his competitors; (5) the amount of effort or money expended by him in developing the information; [and] (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.

Restatement (First) of Torts § 757 cmt. B (1939).

Post-determination procedure: protective orders.

"If the trial court determines, or the parties agree, that the contested information does not comprise a trade secret [under the TSA definition and the Restatement guidance], the initial

protective order should be lifted and full disclosure ordered." *Id.* ¶ 39. "However, if the conclusion is that the information does comprise a trade secret, the court should craft an appropriate protective order covering use and dissemination of the information (including, possibly, post-trial dissemination)." *Id.* "Once this protective order is entered, the trial court should not have to concern itself with the material again unless and until the compelling party seeks to admit it at trial." *Id.*

POINT III: Nearburg Has Contractual And Property Rights To The Information

In six instances,[5] Cimarex has interposed an identical but baseless objection:

> Objection. Cimarex has no obligation to provide data to Nearburg until such time as Nearburg has paid its share of the total well costs pursuant to a voluntary agreement or as a participating party that has joined pursuant to a compulsory pooling order.

No law, decision or rule supports such an objection and Cimarex's motion should therefore be stricken.[6] Cimarex has an affirmative obligation to comply with discovery. It is not optional. No person has the privilege to refuse to disclose any matter, refuse to be a witness or refuse to produce any object or writing. Rule 11-501 NMRA 2004; Public Service Company of New Mexico v. John Lyons, 2000-NMCA-077, ¶11, 129 N.M. 487, 491, 10 P.3d 166, 170.

Cimarex is holding the well data for ransom, demanding that Nearburg pay first and refusing to release anything until it does so. This "pay to play" objection is in conflict with Cimarex's relevance and trade-secret privileges. And as Cimarex would have it, if Nearburg were only to pay first, then these other two objections wouldn't really apply.

Not only is there an absence of legal ground for such an objection, neither is it supported by the facts. Cimarex is indeed receiving payment for Nearburg's share of well costs, *plus 200%*,

[5] Items 2,4,7,8,9,10.
[6] Rule 1-011(A) NMRA.

under the non-consent provisions of Order No. R-14581, the compulsory pooling order for the West Shugart 32 State Com No. 1-H.

Nearburg's contractual right.

Moreover, Nearburg has a contractual right to receive the well information that, to now, Cimarex has avoided even acknowledging. The lands that are the subject of this compulsory pooling case, as well as those upon which the West Shugart 32 State Com No. 1-H is situated, are the subject to two Operating Agreements[7] dated December 1, 2002 between Chi Operating, Inc.[8] as operator and Nearburg (and others) as non-operating working interest owners. The Operating Agreement covers the depths from at least the base of the Queen formation down to the base of the Morrow formation in the N/2 and the S/2 of Section 32. The contract acreage has been earned by the KC Strip State No. 1 and Porterhouse State Com No.1 wells, and under the terms of the Operating Agreements, the well data from the wells, *as well as from any other subsequently developed well* on the contract acreage is to be provided to all of the working interest owners under Article VI D (*See* Excerpted December 21, 2002 Operating Agreements, Exhibit "D, attached.) Under these circumstances, for Cimarex to say that it can withhold the well data under the guise of a discovery objection is wrong.

Nearburg's property right and Cimarex's duty.

The co-tenancy relationship between Cimarex and Nearburg has been altered. Cimarex is in a superior position and has a duty to Nearburg to provide the information that they both own.

With the ownership of their respective lease interests in the W/2 of Section 32, it should be undisputed that both Cimarex and Nearburg are the owners of the "right to exploration", a

[7] AAPL Form 610-1982.
[8] Now Cimarex.

protected property right. See Phillips Petroleum Co. v. Cowden, 241 F.2d 586, 590 (5th Cir. 1957.) Each company could reasonably said to be a co-tenant to the other and each had operating rights or the "right to drill" within the meaning of NMSA 1978 §70-2-17. This relationship was fundamentally changed when Cimarex force pooled the W/2 W/2 of Section 32, had itself designated as the operator of the unit and then drilled the West Shugart State Com No. 1-H. By doing so, Cimarex appropriated exclusively to itself the right to drill and operate on the W/2 W/2, effectively precluding Nearburg from obtaining any data on its own. Consequently, the co-tenancy relationship was altered: one co-tenant has appropriated an outstanding *adversarial* or superior interest of claim to one element of the co-tenancy property that it seeks to assert exclusively for itself: the operating rights. Under such circumstances, courts have determined that a fiduciary relationship will arise under the co-tenancy. *See generally,* 2 The American Law of Property § 6.16 at 67 – 69 (A. Casner, ed. 1952).

Now in a superior position, the withholding of well information by Cimarex is inconsistent with the fiduciary duties that Cimarex may have to its disadvantaged co-tenant. At a minimum, withholding the data would also be inconsistent with the duties of "utmost" good faith and fair dealing that the owner of the executive rights or the operating rights would owe its co-owners. When a superior or paramount right exists, one cotenant cannot make an *adversary* claim to the common estate and assert it for his exclusive benefit, to the injury and prejudice of the other co-tenants. *Sharples Corp. v. Sinclair Wyoming Co.,* 167 P.2d 29, 37, 62 Wyo. 341, 360 (Wyo. 1946).

A fiduciary duty arises not from any contract between them, but from the *relationship* of the parties, which requires that the holder of the executive right acquire for the non-executive

party every benefit that he exacts for himself. *Manges v. Guerra,* 673 S.W.2d 180, 183 (Tex. 1984).

In *Manges v. Guerra,* 673 S.W.2d 180, (Tex. 1984), the defendant purchased mineral rights from various estates, and thereby created a co-tenancy between him and the plaintiffs. The sale made to the defendant included the executive right to the one-half mineral interest reserved by the plaintiffs. The plaintiffs allege that the defendant used its executive powers to only benefit himself and not extend the same benefit to the non-executive co-tenants by selling all of the oil and gas produced by the estate, without consulting or even informing the plaintiffs of this transaction. *Id.* at.182

The Court held that the possessor of an executive right owes to the co-mineral owners a duty to use the "utmost good faith and fair dealing" as to the interest of the non-executive mineral interest owners. The court went on to say that while a contract or deed may create the relationship, the duty of the executive arises from the relationship and not from express or implied terms of the contract or deed. "That duty requires the holder of the executive right . . . to acquire for the non-executive every benefit that he exacts for himself." *Id.* at 184 citing to R. Hemmingway, The Law of Oil & Gas, 2.2(D) (2d ed. 1983). In other words, the benefits must be shared and this should by logic apply to well information.

Conclusion

Cimarex's objections by-way-of-motion directly contravene the well-established authority requiring compliance with a pre-hearing discovery subpoena. The objections should be rejected, the motion stricken and the materials ordered immediately produced. If Cimarex is serious about invoking the privilege accorded trade secrets, then it should follow the correct procedure for doing so. Finally, Cimarex has a duty to provide the information to Nearburg.

Respectfully submitted,

MONTGOMERY & ANDREWS, P.A.

By: _____

J. Scott Hall
Attorneys for Nearburg Producing Company
Post Office Box 2307
Santa Fe, New Mexico 87504-2307
(505) 982-3873

Certificate of Service

I hereby certify that a true and correct copy of the foregoing was e-mailed to the following on the 7 day of October, 2011:

Thomas Kellahin, Esq.
706 Gonzales Road
Santa Fe, New Mexico 87501-8744
Attorneys for Cimarex Energy Co.
tkellahin@comcast.net

David Brooks, Esq.
New Mexico Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87504
DKBrooks@state.nm.us

Mr. Richard Ezeanyim
New Mexico Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87504
richard.ezeanyim@state.nm.us

Mr. Terry Warnell
New Mexico Oil Conservation Division
1220 S. St. Francis Dr.
Santa Fe, NM 87505
terry.warnell@state.nm.us

_____
J. Scott Hall

317147

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

IN THE MATTER OF THE APPLICATION OF CIMAREX ENERGY CO. OF COLORADO FOR A NON-STANDARD SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO **CASE NO. 14741**

SUBPOENA DUCES TECUM

TO: Cimarex Energy Co. of Colorado
c/o ~~James Bruce, Esq.~~ W. THOMAS KELLAHIN, ESQ.
369 Montezuma, No. 213 706 GONZALES ROAD
P. O. Box 1056 SANTA FE, NM 87501
~~Santa Fe, NM 87504-1056~~

Pursuant to Section 70-2-8, NMSA (1978), and Rule 19.15.4.16 of the New Mexico Oil Conservation Division's Rules of Procedure, you are hereby ORDERED to appear at 9:00 a.m., September 30, 2011, at the offices of the Oil Conservation Division, 1220 South St. Francis Drive, Santa Fe, New Mexico 87505 and to produce and make available to Nearburg Producing Company and their attorney, J. Scott Hall, Esq., for copying, the documents and items specified below.

This subpoena is issued on application of Nearburg Producing Company through its attorneys Montgomery and Andrews, P.A., P.O. Box 2307 Santa Fe, New Mexico 87504.

Dated this 21st day of September, 2011.

NEW MEXICO OIL CONSERVATION DIVISION

By: J.B.
Jami Bailey, Director
By David K. Brooks
Assistant General Counsel

{00310279-1}

EXHIBIT A

EXHIBIT 'A'

TO SUBPOENA DUCES TECUM
TO CIMAREX ENERGY CO. OF COLORADO
IN NEW MEXICO OIL CONSERVATION DIVISION
CASE NO. 14741

For the West Shugart 32 State Com Well No. 1 (API 30-015-38294); W/2 W/2 Section 32, T-18-S, R-31-E, NMPM, Eddy County, New Mexico:

1. All open-hole and cased-hole logs from surface to total depth.

2. All mud logs from the surface to total depth.

3. All DST reports, including pressure charts, fluid recovery data and observed flow rates, together with service company analysis thereof with respect to reservoir parameters.

4. All daily drilling reports from commencement through completion of the well.

5. All data, analysis and reports for cores and side-wall cores.

6. All surface access, easements and use agreements, along with all surface damages agreements.

7. A copy of the drilling plan for the subject well.

8. All documents or a summary reflecting actual expenditures from commencement of operations on the well to drilling to total depth.

9. All completion reports.

10. All reservoir pressure information from the well including all bottomhole pressure tests and build-up test results, current well rates, flowing tubing pressures and choke sizes.

These subpoena items are ongoing and you have the obligation to supplement the production of documents and materials responsive hereto as new documents and materials become available.

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

IN THE MATTER OF THE APPLICATION OF MEWBOURNE OIL COMPANY FOR CANCELLATION OF TWO DRILLING PERMITS AND APPROVAL OF A DRILLING PERMIT, LEA COUNTY, NEW MEXICO

CASE NO. 13492
Order No. R-12343-A

ORDER ON PRE-HEARING MOTIONS

BY THE DIVISION;

This matter came before the director of the Oil Conservation Division (Division) on the following pre-hearing motions: 1) Chesapeake Operating Inc.'s Motion to Dismiss; 2) Chesapeake Operating Inc.'s Motion to Quash Subpoenas Issued at the Request of Kaiser-Francis Oil Company; 3) Joint Motion of Kaiser-Francis Oil Company and Samson Resources to Limit Drilling Operations; and 4) Joint Motion of Kaiser-Francis Oil Company and Samson Resources for Temporary Suspension of APD. All motions have been fully briefed by the parties, and argument on the first three motions was heard on May 16, 2005 at Santa Fe, New Mexico, before Examiner William V. Jones

NOW, on this 24th day of May, 2005, the Division Director, having considered the pleadings of the parties, and the recommendations of the Examiner,

FINDS THAT;

(1) This matter is before the Division pursuant to the application of Mewbourne Oil Company ("Mewbourne") for cancellation of two drilling permits issued to Chesapeake Operating Inc. ("Chesapeake") for Chesapeake's KF "4" State Well No. 1 (API No. 30-025-37129) and proposed Cattleman "4" State Comm Well No. 1 (API No. 30-025-37150), both to be located on tracts in the east of irregular Section 4, Township 21 South, Range 35 East, NMPM in Lea County, New Mexico. Mewbourne's application also seeks approval of a drilling permit for Mewbourne's proposed Osudo "4" State Com Well No. 1 to be located in a tract in the southeast of irregular Section 4.

(2) Chesapeake does not claim it has an interest in the drill sites for its proposed wells. Chesapeake claims that Chesapeake Permian, L.P. owns the lease covering tracts in irregular Section 4 that could be pooled with the drill site tracts to form standard spacing units, and that Chesapeake Permian, L.P. has proposed that Chesapeake Operating Inc. operate those units.

EXHIBIT B

(3) Chesapeake Permian, L.P. has filed an application for compulsory pooling seeking to create a standard lay-down 320-acre spacing unit consisting of the geographical south 1/3 of irregular Section 4 to be dedicated to the **KF** "4" State Well No. 1, designating Chesapeake Operating Inc. as the operator. Chesapeake Operating Inc. has begun drilling the KF "4" State Well No. 1.

(4) Chesapeake Permian, L.P. has filed an application for compulsory pooling seeking to create a standard stand-up 320-acre spacing unit consisting of the northern 2/3 of the eastern half of irregular Section 4 to be dedicated to its proposed Cattleman "4" State Com Well No. 1, designating Chesapeake as the operator of the unit. Chesapeake Operating Inc. has not begun drilling the Cattleman "4" State Com Well No. 1.

(5) Mewbourne, Kaiser-Francis Oil Company (Kaiser-Francis) and Samson Resources (Samson) seek to create a standard 320-acre stand-up spacing unit consisting of the southern 2/3 of the eastern half of irregular Section 4. The proposed unit is subject to a **Communitization** Agreement approved by the Commissioner of Public Lands effective April 1, 2005, and a Joint Operating Agreement dated March 24, 2005. Mewbourne applied for a permit to drill its proposed Osudo "4" State Com Well No. 1, but the Division denied the application because it had already issued permits to drill to Chesapeake in the same tract.

Chesapeake Operating Inc.'s Motion to Dismiss

(6) On May 10, 2005 Chesapeake moved to dismiss Mewbourne's application. As grounds, Chesapeake relies on Order R-12108-C **(Yates-Pride** Case); Order **R-11700 (TMBR/Sharp-Ocean** Case); and Order **R-12343,** denying Mewbourne's application for an emergency order in the instant case to halt drilling of the KF "4" State Well No. 1 pending the hearing on the merits.

(7) In the **TMBR/Sharp-Ocean** Case, the Oil Conservation Commission ("Commission") stated that the operator filing an application for a permit to drill **("APD")** must do so under a good faith claim of title and a good faith belief that it is authorized to drill the well applied for. (Order **R-11700-B,** Finding 28.)

(8) **In** the **Pride-Yates** Case, the Division found that an owner who would have a right to drill at its proposed location in the event of a voluntary or compulsory pooling of the unit it proposes to dedicate to the well has the necessary good faith claim of title to permit it to file an APD even though it has not yet filed a pooling application. (Order R-12108-C, Finding 8(i).)

(9) The Division may revoke an APD after notice and hearing if it determines that the APD was improvidently granted. The cases provide examples of good cause for revoking or denying an APD, including the following:

(a) A demonstration that the holder of the APD does not have a good faith claim of title. (Order R-11700-B (TMBR/Sharp-Ocean Case).)

(b) A demonstration that the applicant for the APD does not have authority for surface uses that will be required to conduct operations. (Order R-12093-A. Application of Valdes (sic) Caldera Trust).)

(c) A demonstration that the acreage can be developed better by inclusion in a different unit. (Order R-12108-C, Finding 8(i) (Pride-Yates Case).)

(10) In the instant case, Mewbourne applied for an emergency order to halt the drilling of the KF "4" State Well No. 1 pending the hearing of the case on the merits. Mewbourne argued that the Division's approval of Chesapeake's APD did not give Chesapeake the right to drill a well on land where it did not have an ownership interest prior to securing either voluntary or compulsory pooling. The Division denied Mewbourne's request because Mewbourne did not make a showing that cancellation of the APD prior to hearing on the merits was necessary to prevent injury to the correlative rights of any party, prevent waste, or protect human health, safety or the environment. Order R-12343. That Order did not, however, preclude Mewbourne from challenging the APD at the hearing on the merits.

(11) Mewbourne's application challenges Chesapeake's good faith claim of title and authority, and argues that the acreage can be developed better by inclusion in Mewbourne's proposed unit. These issues were not decided in Order R-12343 and require factual development at a hearing.

(12) Chesapeake's Motion to Dismiss should be denied.

Chesapeake Operating Inc.'s Motion to Quash Subpoenas Issued at the Request of Kaiser-Francis Oil Company

(13) On May 10, 2005, Chesapeake filed a motion to quash the subpoenas duces tecum issued by the Division on May 5, 2005 at the request of Kaiser-Francis Oil Company, on the grounds that the documents sought were irrelevant and protected from discovery by the trade secret privilege, and that Order R-12343 rendered the subpoenas moot.

(14) As discussed above, Order R-12343 did not render moot Mewbourne's arguments that Chesapeake does not have a good faith claim of title and authority, and that the acreage can be developed better by inclusion in Mewbourne's proposed unit.

(15) The documents requested by Kaiser-Francis' subpoenas are directly relevant or likely to lead to the discovery of evidence relevant to the issues raised in Mewbourne's application. Requests 1-5, 7-9 and 11 request geologic and cost evidence from the KF "4" State Well No. 1 that relates to the issue of unit orientation, Requests 6,

10 and 11 are relevant or may lead to the discovery of evidence relevant to the issue of good faith claim of title.

(16) Chesapeake cannot assert a trade secret privilege against Kaiser-Francis regarding documents related to the drilling of the KF "4" State Well No. 1. Kaiser-Francis holds the lease to the tract on which the KF "4" State Well No. 1 is located, and with it, the right to explore for minerals and conduct geologic investigations.

(17) Further, the trade secret privilege is available only "if the allowance of the privilege will not tend to conceal fraud or otherwise work injustice." Rule 11-508 NMRA 2004. Drilling data from the KF "4" State Well No. 1 may prove central to the determination of unit orientation and, therefore, to the question of whether **Chesapeake's** APD should be cancelled. Chesapeake cannot obtain information from its drilling operations on a lease held by another, and then withhold that information from the leaseholder in a hearing on whether **Chesapeake's** proposed unit is superior to the unit proposed by the leaseholder.

(18) **Chesapeake's** motion to quash should be denied.

Joint Motion of Kaiser-Francis Oil Company and Samson Resources to Limit Drilling Operations

(19) On May 11, 2005 Kaiser-Francis and Samson filed a joint motion requesting an order limiting drilling operations by Chesapeake at the KF "4" State Well No. 1. The **Movants** sought to prevent Chesapeake from completing, testing and producing the well, and requested an active supervisory role for Movants in drilling operations, including dictating the types of open hole logs to be run and the casing to be set.

(20) Movants argued that granting the motion would maintain the status quo pending resolution of disputes determining the operator of the well, the ownership of data obtained by drilling and the ownership of the wellbore itself. Movants argued that operators may disagree on the appropriate means of testing and completing a well, and there is a substantial risk that an improperly planned or executed completion would result in damage to the well or the potential loss of reserves, resulting in waste and potential damage to **Movants'** correlative rights.

(21) Chesapeake argued that Chesapeake Permian, L.P. leases a tract included in its proposed spacing unit, with the right to drill and operate the well under the name Chesapeake Operating Inc. Chesapeake argues that it is meeting or exceeding all of the drilling, evaluation and completion procedures suggested by Movants and that its drilling, logging, completion and testing programs are equal to or greater than those used by Mewbourne for the comparable Osudo "9" Well No. 1 and industry custom and practices. Chesapeake also argues that it will incur significant harm, including monetary damages and damage to its correlative rights, if drilling operations are halted.

(22) Movants have not shown that Chesapeake is not competent to drill and complete the well, or that **Chesapeake's** proposed drilling, completion and testing procedures will result in damage to the well or loss of reserves.

(23) To resolve issues related to unit configuration, it is important to both Movants and Chesapeake that information be obtained from drilling, completing and testing the KF "4" State Well No. 1. That information will be available to Movants through **Kaiser-Francis'** subpoenas.

(24) Allowing Chesapeake to produce from the KF "4" State Well No. 1 before a unit has been approved would violate 19.15.13.1104.C NMAC.

(25) **Movants'** request that Chesapeake be prevented from producing the KF "4" State Well No. 1 before a unit has been approved should be granted; the remainder of **Movants'** motion to limit drilling operations should be denied.

Joint Motion of Kaiser-Francis Oil Company and Samson Resources for Temporary Suspension of APD

(26) On May 13, 2005 Samson and Kaiser-Francis moved the Division to enter an order temporarily suspending the APD issued to Chesapeake for the Cattleman "4" State Com Well No. 1. The well has been staked but not spudded.

(27) Chesapeake has voluntarily agreed that it will not commence building a location or spud the Cattleman "4" State Com Well No. 1 until the Division has entered an order deciding the orientation of the spacing unit for the K-F State "4" Well No. 1, and requests that its APD not be suspended.

IT IS THEREFORE ORDERED THAT:

(1) The Motion of Chesapeake Operating, Inc. to dismiss the Application of Mewbourne Oil Company is denied.

(2) The Motion of Chesapeake Operating, Inc. to quash subpoenas issued at the request of Kaiser-Francis Oil Company is denied. Parties to case 13492 are directed to limit the use of the materials obtained under the subpoenas to the preparation and presentation of this case.

(3) The joint motion of Kaiser-Francis Oil Company and Samson Resources Company for an order limiting drilling operations is granted as to the request to prohibit production from the KF "4" State Well No. 1 prior to issuance of an approved unit; the remainder of the joint motion is denied.

(4) The joint motion of Kaiser-Francis Oil Company and Samson Resources Company for an order temporarily suspending the APD issued to Chesapeake Operating Inc. for the Cattleman "4 State Com Well No. 1 is **denied.** however, Chesapeake is

directed not to commence building a location or spud the Cattleman "4" State Com Well No. 1 until the Division has entered an order deciding the spacing unit orientation in this case.

(5) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

MARK E. FESMIRE, P-.E.
Director

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

IN THE MATTER OF THE PROCEEDING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING PRE-HEARING MOTIONS RELATING TO: 1) THE APPLICATION OF DEVON ENERGY CORPORATION IN CASE NO. 13603 FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO; AND 2) THE APPLICATION OF LCX ENERGY, LLC IN CASE NO. 13628 FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO

CASE NO. 13603
CASE NO. 13628
ORDER NO. R-12511

ORDER ON PRE-HEARING MOTIONS

BY THE DIVISION:

This matter came before Examiner David R. Catanach on February 16, 2006 for the purpose of hearing oral arguments regarding the following pre-hearing motions filed by Devon Energy Corporation ("Devon") and LCX Energy, LLC ("LCX Energy") in Cases No. 13603 and 13628: 1) Subpoena Duces Tecum issued by the Division on January 11, 2006 on behalf of Devon, and subsequently served on LCX Energy; 2) LCX Energy's Motion to Quash Devon's Subpoena Duces Tecum dated January 18, 2006; and 3) Devon's Response to LCX Energy's Motion to Quash dated January 26, 2006.

NOW, on this 20th day of February, 2006, the Division Director, having considered the pleadings of the parties and the recommendations of the Examiner,

FINDS THAT:

(1) This matter is before the Division pursuant to: 1) the application of Devon in Case No. 13603 to compulsory pool all mineral interests from the surface to the base of the Wolfcamp formation underlying the W/2 and the NW/4 of Section 6, Township 17 South, Range 25 East, NMPM, Eddy County, New Mexico, to form standard 320-acre and 160-acre, respectively, spacing and proration units for all formations and/or pools spaced on 320 and 160 acres within this vertical extent. These units are to be dedicated to the 1725 Federal Com Well No. 61 (API No. 30-015-34340) which has been drilled by LCX Energy as a horizontal well from a surface location 660 feet from the North line and

EXHIBIT C

760 feet from the West line (Unit D) to a bottomhole location approximately 660 feet from the South line and 760 feet from the West line (Unit M) of Section 6; and 2) the application of LCX Energy in Case No. 13628 to compulsory pool all mineral interests from the surface to the base of the Wolfcamp formation underlying the W/2 and the NW/4 of Section 6, Township 17 South, Range 25 East, NMPM, Eddy County, New Mexico, to form standard 320-acre and 160-acre, respectively, spacing and proration units for all formations and/or pools spaced on 320 and 160 acres within this vertical extent. These units are to be dedicated to the aforesaid 1725 Federal Com Well No. 61.

(2) Cases No. 13603 and 13628 are currently scheduled to be heard by the Division on March 2, 2006.

(3) LCX Energy applied to the United States Bureau of Land Management ("BLM") for a drilling permit for the 1725 Federal Com Well No. 61 on July 21, 2005. The permit to drill was approved by the BLM on September 14, 2005.

(4) LCX Energy spudded the 1725 Federal Com Well No. 61 on October 7, 2005, and as of this date, has completed drilling operations.

(5) LCX Energy and Devon own 65% and 35%, respectively, of the interest within the W/2 of Section 6.

(6) Prior to commencing drilling operations on the 1725 Federal Com Well No. 61, LCX Energy made no well proposals nor attempted to consolidate the interest within the W/2 of Section 6 for the purpose of drilling the subject well.

(7) LCX Energy contends that due to lease expirations within the W/2 of Section 6, it was necessary to commence drilling the subject well prior to initiating negotiations with Devon.

(8) Negotiations have ceased between LCX Energy and Devon with regards to Devon's participation in the drilling of the subject well.

(9) Devon contends that the information it seeks from LCX Energy is necessary in order to effectively prepare for the presentation of Case No. 13603.

(10) LCX Energy contends that much of the information Devon is seeking is either: 1) unavailable; 2) available from public or Division records; or, 3) proprietary in nature.

(11) LCX Energy further contends that the well information may be kept confidential for a period of 90 days from the date of completion of the well pursuant to Division Rule 19.15.13.1105(C).

(12) Division Rule 19.15.13.1105(C) is intended to restrict general public access to certain data, but does not limit the power of the Division to require production of data by subpoena in an appropriate case.

(13) Devon's request to obtain drilling and completion information from LXC Energy regarding the 1725 Federal Com Well No. 61 is justified and should therefore be approved. Accordingly, Requests No. 2 and 3, which relate to well logs, completion reports, reservoir pressure information, bottomhole pressure tests, buildup tests, current well rates, flowing tubing pressures and choke sizes, should be provided to Devon by LXC Energy.

(14) The remainder of information Devon seeks (Requests No. 1 and 4 through 10) is deemed by the Division to be either unavailable or not necessary to Devon to prepare its Case No. 13603 for presentation. Accordingly, LCX Energy's Motion to Quash Devon's Subpoena Duces Tecum with regards to Requests No. 1 and 4 through 10, is hereby granted.

IT IS THEREFORE ORDERED THAT:

(1) LCX Energy, LLC's Motion to Quash Devon's Subpoena Duces Tecum is hereby granted as to Requests No. 1 and 4 through 10.

(2) LCX Energy, LLC's Motion to Quash Devon's Subpoena Duces Tecum is hereby denied as to Requests No. 2 and 3.

(3) LCX Energy, LLC shall furnish Devon Energy Corporation with all information required by Requests No. 2 and 3 by 5:00 p.m. on February 24, 2006.

(4) Jurisdiction is hereby retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

MARK E. FESMIRE, P.E.
Director

A.A.P.L. FORM 610-1982

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

December 1 , 2002 ,
Year

OPERATOR Chi Operating, Inc.

CONTRACT AREA Township 18 South, Range 31 East, N.M.P.M.

Section 32: N/2

COUNTY OR PARISH OF Eddy STATE OF New Mexico

EXHIBIT D

A. Designation and Responsibilities of Operator:

Chi Operating, Inc. P.O. Box 1799, Midland, Texas 79702 shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest hereunder in the Contract Area, or is no longer capable of serving as Operator, Operator shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. The successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A"; provided, however, if an Operator which has been removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed shall be determined by Operator, and all such employees shall be the employees of Operator.

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the **1st** day of **May**, (year) **2003**, Operator shall commence the drilling of a well for oil and gas at the following location:

660' FNL & 660' FEL of Section 32, Township 18 South, Range 31 East, Eddy County, New Mexico.

and shall thereafter continue the drilling of the well with due diligence to

a depth sufficient to test the Morrow Formation, or 12,500', whichever is the lesser.

unless granite or other practically impenetrable substance or condition in the hole, which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

B. Subsequent Operations:

1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties ~~and not then producing in paying quantities~~, the party desiring to drill, rework, deepen or plug back such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the party in writing wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of a proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday, and legal holidays. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or response given by telephone shall be promptly confirmed in writing.

If all parties elect to participate in such a proposed operation, Operator shall, within ninety (90) days after expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period when a drilling rig is on location, as the case may be), actually commence the proposed operation and complete it with due diligence at the risk and expense of all parties hereto; provided, however, said commencement date may be extended upon written notice of same by Operator to the other parties, for a period of up to thirty (30) additional days if, in the sole opinion of Operator, such additional time is reasonably necessary to obtain permits from governmental authorities, surface rights (including rights-of-way) or appropriate drilling equipment, or to complete title examination or curative matter required for title approval or acceptance. Notwithstanding the force majeure provisions of Article XI, if the actual operation has not been commenced within the time provided (including any extension thereof as specifically permitted herein) and if any party hereto still desires to conduct said operation, written notice proposing same must be resubmitted to the other parties in accordance with the provisions hereof as if no prior proposal had been made.

2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VII.D.1. (Option No. 2) elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this Article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, within ninety (90) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period when a drilling rig is on location, as the case may be) actually commence the proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of the total interest of the parties approving such operation and its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of such notice, shall advise the proposing party in writing of its desire to (a) limit participation to such party's interest as shown on Exhibit "A" or (b) carry its proportionate part of Non-Consenting Parties' interests, and failure to advise the proposing party shall be deemed an election under (a). In the event a drilling rig is on location, the time permitted for such a response shall not exceed a total of forty-eight (48) hours (inclusive of Saturday, Sunday and legal holidays). The proposing party, at its election, may withdraw such proposal if there is insufficient participation and shall promptly notify all parties in writing of such decision.

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well and restore the surface location at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk,

except as provided in Article VI.B., shall be entitled to receive payment directly from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and/or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any gas balancing agreement between the parties hereto, whether such an agreement is attached as Exhibit "E", or is a separate agreement.

D. Access to Contract Area and Information:

Each party shall have access to the Contract Area at all reasonable times, at its sole cost and risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the Information.

E. Abandonment of Wells:

1. Abandonment of Dry Holes: Except for any well drilled or deepened pursuant to Article VI.B.2., any well which has been drilled or deepened under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling or deepening such well. Any party who objects to plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and/or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well in which a Non-Consent operation has been conducted hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of any well, all parties do not agree to the abandonment of such well, those wishing to continue its operation from the interval(s) of the formation(s) then open to production shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one (1) year and so long thereafter as oil and/or gas is produced from the interval or intervals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit

I. IDENTIFICATION OF LANDS SUBJECT TO THIS AGREEMENT:
Township 18 South, Range 31 East, N.M.P.M.
Section 32: N/2
Eddy County, New Mexico

II. LIMITATION OF DEPTHS: **Township 18 South, Range 31 East, N.M.P.M.**
Section 32: NW/4
Below base of Queen Formation down to the base of the Morrow formation in the W/2NW/4; SE/4NW/4; and below 3,676' down to the base of the Morrow formation in the NE/4NW/4.
Section 32: NE/4NE/4; S/2NE/4
Below the base of Queen formation down to the base of the Morrow Formation.
Section 32: NW/4NE/4
Below 3,670' beneath the surface.

III. PERCENTAGES OR FRACTIONAL INTERESTS OF PARTIES TO THIS AGREEMENT:

	Working Interest		
Chi Energy, Inc.	27.71125%	Storage Systems, LLC	1.75%
Concho Oil Gas Corp.	29.16375%	Thunderbolt Pet. Inc.	.875%
States, Inc.	13.125%	Permian Dev. Corp.	.875%
TMBR/ Sharp Drlg, Inc.	10.9375%	Sanco Resources	.875%
McVay Drilling, Inc.	2.625%	Westbrook Energy	.875%
Nearburg Exploration Company, LLC	12.5%		

IV. OIL AND GAS LEASES SUBJECT TO THIS AGREEMENT
(all in Eddy County, New Mexico):

Acreage subject to this agreement	State or Federal Lease #
Township 18 South, Range 31 East, N.M.P.M.	
Section 32: NW/4	**E-6947**
Section 32: NW/4NE/4	**B-2023**
Section 32: NE/4NE/4; S/2NE/4	**E-10001**

V. ADDRESSES OF PARTIES TO THIS AGREEMENT:

Chi Energy, Inc.
Attn: John W. Qualls
P. O. Box 1799
Midland, Texas 79702

Concho Oil & Gas Corp.
Attn: Mike Gray
110 W. Louisiana, Suite 410
Midland, Texas 79701

States, Inc.
Attn: John Connally
P. O. Box 911
Breckenridge, Texas 76424

TMBR/Shrp Drlg, Inc.
Attn: Dennis Hopkins
P. O. Drawer 10970
Midland, Texas 79702

Thunderbolt Pet. Inc.
P. O. Box 10523
Midland, Texas 79702

McVay Drilling, Inc.
P. O. Box 924
Hobbs, New Mexico 88241

Permian Dev. Corp.
1521 Oliver Street
Midland, Texas 79701

Storage Systems, LLC
P. O. Box 57180
Albuquerque, New Mexico 87187

Sanco Resources
1507 Princeton
Midland, Texas 79701

Westrook Energy
1507 Princeton
Midland, Texas 79701

Nearburg Exploration Company, LLC
3300 North "A" Street, Bldg. 2, Suite 120
Midland, Texas 79705

VI. AREA OF MUTUAL INTEREST: NONE

A.A.P.L. FORM 610-1982

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

December 1 , 2002 ,
Year

OPERATOR Chi Operating, Inc.

CONTRACT AREA Township 18 South, Range 31 East, N.M.P.M.

Section 32: S/2

COUNTY OR PARISH OF Eddy STATE OF New Mexico

Chi Operating, Inc. P.O. Box 1799, Midland, Texas 79702 shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest hereunder in the Contract Area, or is no longer capable of serving as Operator, Operator shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. The successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A"; provided, however, if an Operator which has been removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed shall be determined by Operator, and all such employees shall be the employees of Operator.

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the 1st day of January, *(year)* 2003, Operator shall commence the drilling of a well for oil and gas at the following location:
660' FSL & 660' FEL of Section 32, Township 18 South, Range 31 East, Eddy County, New Mexico.

and shall thereafter continue the drilling of the well with due diligence to
a depth sufficient to test the Morrow Formation, or 12,500', whichever is the lesser.

unless granite or other practically impenetrable substance or condition in the hole, which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

payment directly from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and/or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any gas balancing agreement between the parties hereto, whether such an agreement is attached as Exhibit "E", or is a separate agreement.

D. Access to Contract Area and Information:

Each party shall have access to the Contract Area at all reasonable times, at its sole cost and risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the Information.

E. Abandonment of Wells:

1. Abandonment of Dry Holes: Except for any well drilled or deepened pursuant to Article VI.B.2., any well which has been drilled or deepened under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling or deepening such well. Any party who objects to plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and/or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well in which a Non-Consent operation has been conducted hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of any well, all parties do not agree to the abandonment of such well, those wishing to continue its operation from the interval(s) of the formation(s) then open to production shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one (1) year and so long thereafter as oil and/or gas is produced from the interval or intervals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit

I. IDENTIFICATION OF LANDS SUBJECT TO THIS AGREEMENT:

Township 18 South, Range 31 East, N.M.P.M.
Section 32: S/2
Eddy County, New Mexico

II. LIMITATION OF DEPTHS: **Township 18 South, Range 31 East, N.M.P.M.**
Section 32: E/2SW/4; SE/4
Below base of Queen Formation down to the base of the Morrow formation in the W/2NW/4; SE/4NW/4; E/2SW/4; SE/4 and below 3,676' Down to the base of the Morrow formation in the NE/4NW/4.

III. PERCENTAGES OR FRACTIONAL INTERESTS OF PARTIES TO THIS AGREEMENT:

	Working Interest
Chi Energy, Inc.	18.408187%
Nearburg Exploration Company, LLC	21.875%
Concho Oil & Gas Corp.	19.373062%
Magnum Hunter Production, Inc.	12.5%
States, Inc.	8.71875%
William E. Harper	7.5%
TMBR/SHARP Drilling, Inc.	7.2656255
Jeremiah, LLC	1.74375%
Storage Systems, LLC	1.74375%
Thunderbolt Petroleum, Inc.	.58125%
Permian Development, Corp.	.290625%

IV. OIL AND GAS LEASES SUBJECT TO THIS AGREEMENT (all in Eddy County, New Mexico):

Acreage subject to this agreement	State or Federal Lease #
Township 18 South, Range 31 East, N.M.P.M.	
Section 32: E/2SW/4; SE/4	**E-6947**
Section 32: NW/4SW/4	**V-5221**
Section 32: SW/4SW/4	**E-10001**

V. ADDRESSES OF PARTIES TO THIS AGREEMENT:

Chi Energy, Inc.
Attn: John W. Qualls
P. O. Box 1799
Midland, Texas 79702

Concho Oil & Gas Corp.
Attn: Dave Chroback
110 West Louisiana, Suite 410
Midland, Texas 79701

William E. Harper
P. O. Box 311
Woodson, Texas 76491

TMBR/SHARP Drilling, Inc.
Attn: Tom Brown
P. O. Drawer 10970
Midland, Texas 79702

Storage Systems, LLC
Attn: Steve Dyer
P. O. Box 57180
Midland, Texas 87187

Petroleum Development, Corp.
Attn: Dan Linebarger
1521 Oliver Street
Midland, Texas 79701

Magnum Hunter Production, Inc.
Attn: Rick Farrell
3500 William D. Tate, Suite 200
Grapevine, Texas 76051

Nearburg Exploration Company, LLC
Attn: Bob Shelton
3300 North "A" Street, Building 2, Suite 120
Midland, Texas 79705

States, Inc.
Attn: John Connally
P. O. Box 911
Breckenridge, Texas 76242

Jeremiah, LLC
Attn: Ted McVay
P. O. Box 924
Hobbs, New Mexico 88241

Thunderbolt Petroleum, Inc.
Attn: Robert Lee
P. O. Box 10523
Midland, Texas 79702