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

APPLICATION OF MACK ENERGY CORPORATION FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO

(DE NOVO)
CASE NO. 14763
ORDER NO. R-13519-E

ORDER OF THE COMMISSION

This matter comes before the Oil Conservation Commission ("Commission") on an Application for Hearing De Novo filed by Siana Oil and Gas LLP and Tom M. Ragsdale concerning Case No. 14763 which concerns an application for compulsory pooling filed by Mack Energy Corporation. The Commission having conducted a hearing on September 13, 2012, in Santa Fe, New Mexico, and having considered the testimony and record in this Case, enters the following findings, conclusions and order.

THE COMMISSION FINDS THAT:

1. Due public notice has been given, and the Commission has jurisdiction of this case and its subject matter.

2. Mack Energy Corporation ("Applicant"), seeks an order pooling all uncommitted interests from the surface to the base of the Abo formation in the SE/4 NW/4 of Section 32, Township 17 South, Range 33 East, NMPM, in Lea County, New Mexico, to form a standard 40-acre oil spacing and proration unit ("the Unit") for all formations or pools spaced on 40 acres within this vertical extent, which presently include, but are not necessarily limited to, the Corbin- Abo Pool (Pool Code 13150).

3. The Unit is to be dedicated to Applicant's existing Cockburn A State Well No. 5 (API No. 30-025-25286), (the "Well") located at a standard location 1980 feet from the North line and 1980 feet from the West line (Unit F) of Section 32.

4. A hearing was held before a Division Examiner on January 5, 2012. The Division approved the application to pool interests in the Unit subject to a number of conditions set forth in Order No. R-13519, dated February 21, 2012.

5. Siana Oil and Gas LLP and Tom M. Ragsdale ("Petitioner") filed an Application for Hearing De Novo with the Commission on March 1, 2012. On March 20, 2012, the Division issued a partial stay of Order No. R-13519 (Order No. R-13519-A).

6. The Commission held a hearing on September 13, 2012 in Santa Fe, New Mexico. Both Applicant and Petitioner appeared at the hearing through counsel and

presented evidence. Staci Sanders, Michael McCoy, and William Livingstone testified for the Applicant. Tom M. Ragsdale testified for the Petitioner.

7. Ownership of the Unit is divided. OXY USA Inc. assigned its interests in the Unit to Siana Operating, LLC ("Siana") in 1998 (Applicant Exhibit 2A). Siana assigned its interests to Caza Energy LLC ("Caza") in 2004. (Applicant Ex. 2; Petitioner Ex. 1) Caza then assigned a portion of its interests to several individuals including a 6.25% working interest to Tom M. Ragsdale (Applicant Ex. 3; Petitioner Ex. 3). Caza also assigned to Tom M. Ragsdale, in 2004, an overriding royalty interest of 1.041667%. (Petitioner Ex. 2). In 2007, Caza assigned its interests to Chase Oil Corporation. (Applicant Ex. 3A). There is no dispute that Petitioner owns both a working interest as well as an overriding royalty interest.

8. Applicant is the operator of the Well and in 2004 received approval to reenter the well in 2004. (Applicant Ex. 4). The Well has been in production since then.

9. No joint operating agreement exists with respect to the well or the Unit. Applicant claims that it was unaware that no operating agreement existed until August 2011. There was a document titled "Operating Agreement" from 1960 (Applicant Ex. 5) which Applicant later determined was not a true operating agreement.

10. Petitioner paid his share of operating expenses until October 2010, at which time he ceased paying joint interest billings. (Applicant Ex. 17, 18). Revenue payments were made to Petitioner until September 2011. (Applicant Ex. 19, 21A, 21B). Applicant also provided evidence concerning Well information provided by Applicant to Petitioner over the last several years. (Applicant Ex. 11 - 14).

11. Applicant seeks to recomplete the Well in an attempt to stimulate production through a fracture treatment. Applicant provided testimony concerning the costs of the recompletion and the potential increased production and revenue resulting from the recompletion. (Applicant Ex. 25-28). Applicant's expert witnesses testified that the treatment will significantly accelerate production and result in an increase in overall production from the Well.

12. Applicant notified Petitioner in August 2011 of its proposal to recomplete the Well and provided Petitioner with an Authorization for Expenditure ("AFE") for Applicant's "review and approval". The AFE lists the estimated costs of the recompletion. (Applicant Ex. 6; Petitioner Ex. 6).

13. Applicant filed its application for compulsory pooling with the Division in November 2011. (Applicant Ex. 29). Upon request from Petitioner's attorney, Applicant sent Petitioner a proposed Joint Operating Agreement for the Unit ("JOA") in December, 2011, which Petitioner received on December 8. 2011. (Applicant Ex. 8; Petitioner Ex. 8). Applicant provided testimony concerning contacts with Petitioner to convince Petitioner to approve the AFE and/or sign the JOA. (Applicant Ex. 7). Applicant also provided testimony concerning information regarding the Well that Applicant has

provided Petitioner in the last several years. Petitioner has neither approved the AFE nor signed the JOA.

14. Petitioner requests that the application for compulsory pooling be denied because the Applicant did not act with diligence and the evidence does not support that there was a good faith effort to obtain the voluntary participation of the owner of the unpooled interest. Petitioner also argues that the Applicant failed to demonstrate that the fracture recompletion of the well was necessary to preserve the well or the lease. If the application is to be granted, then Petitioner requests that certain conditions be placed on the approval.

15. Petitioner presented testimony from Mr. Ragsdale that he stopped paying his share of operating expenses because there was no operating agreement, that he did not sign the proposed JOA because he feared waiving his rights and that he believes the proposed fracture recompletion is speculative and unnecessary.

THE COMMISSION CONCLUDES THAT:

1. There are undivided interests in oil and gas minerals in the Unit that are separately owned.

2. An owner of an oil and gas working interest within the Unit has drilled the Well to a common source of supply within the Unit.

3. There are interest owners in the Unit who have not agreed to pool their interests. There are, however, no unlocated owners, and no evidence of a title dispute.

4. NMSA 1978, Section 70-2-18 requires that an operator of a unit with two or more separately owned tracts or royalty or mineral interests must obtain a voluntary pooling agreement or an order of the Division pooling such interests. The Applicant did seek both a voluntary agreement and a pooling order. The Division found that Applicant's actions, including sending Petitioner an AFE two months prior to its pooling application, sending a proposed JOA when requested by Petitioner and contacting Petitioner to discuss the AFE or JOA, complied with the Division's policy on good faith negotiation provided in Division Orders No. R-13155 and R-13165. There is also no evidence that Applicant ever refused to discuss its proposal with Petitioner or refused any request for information, or that Petitioner made any proposal that Applicant rejected or did not consider. The Commission concludes that the Applicant has complied with NMSA 1978, Section 70-2-18.

5. Although the Well was drilled at a remote date, and the operator had not obtained voluntary or compulsory pooling as required by NMSA 1978, Section 70-2-18, the provision of that statute that an interest owner is entitled to "the amount to which each interest owner would be entitled if pooling had occurred or the amount to which each interest is entitled in the absence of pooling, whichever is greater" does not apply, since Petitioner, as owner of an undivided interest in the

entire Unit, would not have been entitled to any different or greater amount in the absence of pooling.

6. To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste, and afford to the owner of each interest in the Unit the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

7. Applicant should be designated the operator of the Well and of the Unit.

8. Both Applicant's expert witnesses and Ragsdale testified that Applicant's fracing recompletion proposal involves risk; however, the risk is less than the risk would be for drilling a new Well. Applicant's witness further testified that the proposed operation would involve a high rate of return and a short payout.

9. Accordingly, a pooled working interest owner who does not pay its share of estimated well costs associated with the proposed fracing operation should have withheld from production its share of reasonable fracing costs plus an additional 100% (rather than the usual 200%) thereof, as a reasonable charge for the risk involved in the proposed operation.

10. Reasonable charges for supervision (combined fixed rates) should be fixed at $6,500 per month while drilling and $650 per month while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled *"Accounting Procedure-Joint Operations."*

IT IS THEREFORE ORDERED THAT:

1. Pursuant to the application of Mack Energy Corporation, all uncommitted interests, whatever they may be, in the oil and gas from the surface to the base of the Abo formation in the SE/4 NW/4 of Section 32, Township 17 South, Range 33 East, NMPM, in Lea County, New Mexico, are pooled to form a standard 40-acre oil spacing and proration unit for all formations or pools spaced on 40 acres within this vertical extent, which presently include, but are not necessarily limited to, the Corbin-Abo Pool. This paragraph shall be effective from and after the date of first production of the well described in Finding Paragraph 3.

2. The Unit shall be dedicated to Applicant's Cockburn A State Well No. 5 (API No. 30-025-25286), located at a standard location 1980 feet from the North line and 1980 feet from the West line (Unit F) of Section 32, Township 17 South, Range 33 East.

3. Upon final plugging and abandonment of the well and any other well drilled on the Unit pursuant to Division Rules 19.15.13.9 through 19.15.13.11, the pooled unit created by this Order shall terminate, unless this Order has been amended to authorize further operations.

4. Mack Energy Corporation (OGRID 13837) is hereby designated the operator of the Well and of the Unit.

5. After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Unit who are not parties to an operating agreement governing the Unit.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of its proposed fracing recompletion operation ("fracing costs").

6. Within 30 days from the date the schedule of estimated fracing costs is furnished, any pooled working interest owner shall have the right to pay its share of estimated fracing costs to the operator in lieu of paying its share of reasonable fracing costs out of production as hereinafter provided, and any such owner who pays its share of estimated fracing costs as provided above shall remain liable for operating costs but shall not be liable for risk charges. Pooled working interest owners who elect not to pay their share of estimated fracing costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

7. The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual fracing costs within 90 days following completion of the proposed operation. The operator shall also furnish, within 90 days after completion of the proposed operation, an accounting of all costs charged to the joint account for the well (historical costs) since October 2010. If no objection to the actual fracing costs or historical costs is received by the Division, and the Division has not objected, within 45 days following receipt of the schedule, the actual fracing costs and historical costs shall be deemed to be the reasonable costs. If there is an objection to any actual costs within the 45-day period, the Division will determine reasonable costs after public notice and hearing.

8. Within 60 days following determination of reasonable costs, any pooled working interest owner who has paid its share of estimated fracing costs in advance as provided above shall pay to the operator its share of the amount that reasonable fracing costs exceed estimated fracing costs and shall receive from the operator the amount, if any, that the estimated fracing costs it has paid exceed its share of reasonable fracing costs.

9. Within 60 days following determination of reasonable historical costs, any pooled working interest shall pay to the operator the amount that its share of reasonable historical costs exceed the amount of historical costs it has paid, and shall receive from the operator the amount, if any, that the historical costs it has paid exceed its share of reasonable historical costs.

10. The operator is hereby authorized to withhold the following costs and charges from production:

(a) the proportionate share of reasonable fracing costs attributable to each non-consenting working interest owner; and

(b) as a charge for the risk involved in fracing the well, 100% of the above costs.

11. The operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the fracing costs.

12. Reasonable charges for supervision (combined fixed rates) are hereby fixed at $6,500 per month while drilling and $650 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations." The operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to pooled working interest owners.

13. Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this Order, this Order shall thereafter be of no further effect.

14. The operator of the Well and Unit shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

15. Jurisdiction of this case is retained for the entry of such further orders as the Commission may deem necessary.

Done in Santa Fe, New Mexico, this 25th day of October, 2012.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

SCOTT DAWSON, Member

ROBERT BALCH, Member

JAMI BAILEY, Chair Non Participant

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