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September 27, 2012

Hand delivered

Jami Bailey, Director
Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: Mack Energy Corporation/Case 14763 (*de novo*)

Dear Ms. Bailey:

Enclosed for filing, on behalf of Mack Energy Corporation, are six copies of its proposed order (findings and conclusions).

Very truly yours,

James Bruce

Attorney for Mack Energy Corporation

cc: J. Scott Hall w/encl.

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

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

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

Case No. 14763 (*de novo*)
Order No. R-13519-E

PROPOSED ORDER
OF
MACK ENERGY CORPORATION

This case came on for hearing at 9:00 a.m. on September 13, 2012, at Santa Fe, New Mexico, before the Oil Conservation Commission (the "Commission").

NOW, on this _____ day of October, 2012, the Commission, having considered the testimony, the evidence, and other materials submitted by the parties,

FINDS THAT:

(1) Due public notice has been given, and the Commission has jurisdiction of this case and of the 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/4NW/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) Applicant appeared at hearing through counsel and presented evidence that:

(a) The well was drilled in 1978 as a deep gas well. At some point in time OXY WTP Limited Partnership ("OXY") acquired 100% working interest ownership in the well.

(b) Siana Oil and Gas LLP ("Siana"), an affiliate of Tom M. Ragsdale ("Ragsdale"), acquired the well from OXY in 1998. Caza Energy LLC ("Caza"), an affiliate of Applicant, acquired the entire working interest in the well from Siana in 2004. Since Siana had never been designated operator of record, operation of the well, in the Division's files, was changed directly from OXY to Applicant, who operated wells on behalf of Caza.

(c) Pursuant to the agreement by which Caza acquired its interest from Siana, Caza assigned a 6.25% working interest, as well as an overriding royalty interest, to Ragsdale.

(d) Applicant re-completed the well in the Abo, and the well has been producing since 2004.

(e) No joint operating agreement exists with respect to the well or the Unit. Applicant was unaware that no operating agreement existed until August 2011.

(f) Ragsdale has received his share of proceeds of production from the well. Ragsdale paid his share of operating expenses until October 2010, at which time he ceased paying joint interest billings.

(g) The timeline of recent contacts between the parties is as follows:

(i) On August 30, 2011, Applicant's landman sent a proposed Authorization for Expenditures (AFE) to Ragsdale, proposing a fracture stimulation ("fracing") of the Abo in order to increase production.

(ii) Lee Livingston, Applicant's engineer, had two telephone calls concerning this matter with a representative of Ragsdale. However, Ragsdale never asked for any significant information about the AFE or the frac, and ultimately Rasgdale's representative conveyed to Mr. Livingston that Ragsdale did not agree to participate in the proposed operation.

(iii) Applicant filed its pooling application on November 1, 2011.

(iv) In late November 2011 Ragsdale's Texas attorney called Applicant and requested that Applicant send a Joint Operating Agreement to Ragsdale.

(v) On December 7, 2011 Applicant sent Ragsdale a proposed form of Joint Operating Agreement for the Unit, and sent follow-up letters

requesting that he sign the agreement. However, Ragsdale has not commented on, requested changes to, or signed a Joint Operating Agreement.

(h) Over the last several years Applicant has provided all information regarding the well which Ragsdale requested.

(i) Applicant's engineering witnesses testified that, although there is risk involved in the frac, it is a reasonable risk which will (i) increase the reserves of the well in excess of 10,000 barrels of oil, and (2) will accelerate recovery, thereby reducing operating costs during the life of the well by $400,000.

(5) Ragsdale appeared at the hearing through counsel and testified in opposition to the application. However, Ragsdale's testimony concerning pertinent facts did not differ materially from the evidence presented by Applicant. In fact, Ragsdale testified that he had extensive frac experience, and knew what questions to ask Applicant about the proposed procedure. Ragsdale testified that he believes some costs charged by Applicant for operation of the well were excessive and unreasonable, but he did not elucidate on his claims.

(6) Ragsdale's counsel filed a Motion to Dismiss this case before the Division, on the ground that Applicant had not made a good faith effort to secure a voluntary agreement. The motion was denied by the Division. At the conclusion of the Commission hearing, Ragsdale's attorney verbally requested that Applicant's application for compulsory pooling be dismissed.

Conclusions Regarding Motion to Dismiss

(7) By sending Ragsdale an AFE proposing its intended operation two months before filing its compulsory pooling Application, sending a proposed JOA when requested, and contacting Ragsdale or his representative on several occasions to follow up, Applicant complied with the requirements for good faith negotiation delineated in Division Orders No. R-13155 and R-13165.

(8) There is no evidence that Applicant ever refused to discuss its proposal with Ragsdale or refused any request for information, or that Ragsdale made any proposal that Applicant rejected or did not consider.

(9) NMSA 1978 §70-2-17.C states that if no voluntary agreement is reached the Division (or Commission) "shall" pool the well unit, and the statute expressly allows pooling before or after a well is drilled.

(10) Accordingly, Ragsdale's Motion to Dismiss should be denied.

Findings and Conclusions Regarding Compulsory Pooling

(11) There are undivided interests in oil and gas minerals in the Unit that are separately owned.

(12) 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.

(13) 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.

(14) 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 Ragsdale, 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.

(15) 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.

(16) Applicant should be designated the operator of the well and of the Unit.

(17) Both Applicant's expert witnesses and Ragsdale testified that Applicant's fracing 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.

(18) 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.

(19) 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) The motion to dismiss filed in this case by Respondents, Siana Oil and Gas LLP and Tom M. Ragsdale, is denied.

(2) Pursuant to the application of Mack Energy Corporation, all uncommitted mineral interests, whatever they may be, in the oil and gas from the surface to the base of the Abo formation in the SE/4NW/4 of Section 32, Township 17 South, Range 35 East, NMPM, Lea County, New Mexico, are pooled to form a standard 40-acre oil spacing and proration unit for all pools or formations developed on 40-acre spacing within that 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 from the well described in Finding Paragraph 3.

(3) 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, NMPM, Lea County, New Mexico.

(4) 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.

(5) Mack Energy Corporation (OGRID No. 13837) is hereby designated the operator of the well and of the Unit.

(6) 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 re-completion operation ("fracing costs").

(7) 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."

(8) 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.

(9) 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.

(10) 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.

(11) 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.

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

(13) 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.

(14) 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.

(15) The operator of the well and Unit shall notify the Commission in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

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

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

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

ROBERT BALCH, Member

SCOTT DAWSON, Member

JAMI BAILEY, Chair

SEAL