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

IN THE MATTER OF THE APPLICATION OF NEARBURG EXPLORATION COMPANY, L.L.C., SRO2 LLC AND SRO3 LLC FOR AN ACCOUNTING AND LIMITATION ON RECOVERY OF WELL COSTS, AND FOR CANCELLATION OF APPLICATION FOR PERMIT TO DRILL, EDDY COUNTY, NEW MEXICO

CASE NO. 15441

NEX'S RESPONSE TO MOTION TO DISMISS APPLICATION AND QUASH SUBPOENA

Nearburg Exploration Company, L.L.C., SRO2 LLC and SRO3 LLC, (together, "Nearburg" or "NEX") hereby respond to the Motion to Dismiss and Quash Subpoena[1] filed on behalf of COG Operating LLC ("COG") as follows:

BACKGROUND FACTS

1. NEX corrects the following facts alleged by COG:[2]

2. NEX signed a document entitled "Ratification and Joinder of Unit Agreement and Unit Operating Agreement" on June 26, 2009. However, that document did not ratify a Unit Operating Agreement. The document, instead, states, "the undersigned hereby expressly ratifies, approves and adopts said Unit Agreement as fully as though the undersigned had executed the original agreement." *See* Motion to Dismiss, Exhibit 2. Moreover, the disputed wells were not proposed or drilled under the Unit Operating Agreement.

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[1] NEX will provide a separate response to the motion to quash.
[2] NEX makes these corrections without waiver of any objections the Applicants may have to the facts alleged by COG in its Motion to Dismiss Application.

3. NEX did not review, ratify, or even receive Marbob Energy's 2009 transmission letter. Marbob's transmission letter could not commit NEX to any more than NEX actually agreed to.

4. Despite the recital found in the Unit Agreement, NEX never agreed to be bound by the Unit Operating Agreement and never "subscribed" to it for the reason, among others, that NEX assigned its lease. *See* Application, Exhibit 1. NEX never executed the operating agreement. *See* Operating Agreement (excerpted), Exhibit A. As COG has been informed by its title examining attorneys, the operating agreement is given effect only as to those parties who executed it. *See* Title opinion (excerpted), Exhibit B.

5. The Communitization Agreements signed by NEX were not provided until June 10, 2015. Along with those Communitization Agreements, NEX asserted and COG agreed that it was without waiver to NEX's rights "held by it as owner and holder of Lease and that Nearburg specifically reserve[d] all rights relating to this situation." *See* transmittal letter, Exhibit C.

POINTS AND AUTHORITIES

A. The Division has jurisdiction to grant the relief sought by NEX.

By its Motion COG seeks the dismissal of certain, but not all, requests for relief sought by NEX. COG then misstates the requests for relief set forth in the NEX Application. Correctly stated, they are as follow:

(A) Determining that COG did not have the right to drill 043H and 044H on the unconsolidated, uncommunitized, and unpooled lease acreage owned by NEX;

(B) Determining that COG violated Section 70-2-17.C and 70-2-18.A of the New Mexico Oil and Gas Act, as well as Rules 19.15.14.8.B, 19.15.16.15.A, and 19.15.16.15.F of the Division's rules;

(C) Requiring COG to account and pay to Applicants the amount they are entitled in the absence of pooling without recovery of well costs or expenses;

(D) Cancelling the drilling permit for 069H; and

(E) Making such other and further provisions as may be proper in the premises, which may include removing COG as Operator of 016H. (Application at 9).

COG does not seek the dismissal of Requests for Relief (B) and (D) and the Division's jurisdiction is not disputed. As to Requests for Relief (A), (C) and (E), COG contends that the Division may not exercise jurisdiction over these matters because of related litigation in the First Judicial District Court.

The exercise of jurisdiction by the Division and the Commission during the pendency of related court litigation is not new and is supported by agency precedent involving analogous factual circumstances. The *TMBR/Sharp* line of cases involved four consolidated competing compulsory pooling applications[3] and two consolidated applications seeking a cessation of operations and appealing the denial of two APDs.[4] Simultaneously, the parties to those cases filed a lawsuit in the Fifth Judicial District Court in Lea County which related to the oil and gas lease interests that were the subject of the six applications pending before the

[3] Case No. 12816, *Application of TMBR/Sharp Drilling, Inc. for Compulsory Pooling, Lea County, New Mexico;* Case No. 12841, *Application of Ocean Energy, Inc. for Compulsory Pooling, Lea County, New Mexico;* Case No. 12859, *Application of David H. Arrington Oil and Gas Inc. for Compulsory Pooling, Lea County, New Mexico;* Case No. 12860, *Application of Ocean Energy, Inc. for Compulsory Pooling, Lea County, New Mexico*

[4] Case No. 12731, *Application of TMBR/Sharp Drilling, Inc. for an Order Staying David H. Arrington, Inc. from Commencing Operations, Lea County, New Mexico;* Case No. 12744, *Application of TMBR/Sharp Drilling, Inc. Appealing the Hobbs District Supervisor's Decision Denying Approval of Two Applications for Permit To Drill, Lea County, New Mexico. These cases resulted in Orders No. R-11700 through R-11700-D. Orders R-11700-C and R-11700-D were compulsory pooling orders.*

NMOCC. The Commission specifically noted the pendency of the lawsuit in court and the likelihood of an appeal, but the Commission affirmatively elected to retain concurrent jurisdiction over the administrative applications and proceeded to conduct hearings on them to their conclusion. Order No. R-11700-B, Order ¶ 30 (April 26, 2002). Exhibit D.

In 2007, the Commission cited to the precedent of the *TMBR/Sharp* case in the adjudicatory order it issued in the *Samson Resources/Chesapeake* case.[5] In that matter, the unlawful drilling of a well off-lease, cancellation of APDs, and the operator's false certification of the right to drill on a C-102 form were involved, ultimately leading the Commission to remove Chesapeake as operator of a prolific Morrow gas well. Order No. R-12343-E, Conclusions Regarding Legal Issues ¶¶ 31-33, Order ¶2 (March 16, 2007). Exhibit E. There, too, the Commission was undeterred from exercising jurisdiction because of the pendency of contemporaneous litigation in the Lea County District Court. *Samson Resources Company v. Chesapeake Operating, Inc., Fifth Judicial District Cause No. D-506-CV-2005-00275.* Both of the orders from the *TMBR/Sharp* and *Samson Resources* cases demonstrate the fundamental interest and resolve of the Division and the Commission to act as necessary to enforce the integrity of the agency's rules and regulations.

The invocation of Division and Commission jurisdiction in the *TMBR/Sharp* and *Samson Resources* involved requests for relief similar to those stated in Requests for Relief (A) and (E) in NEX's Application. With respect to Request for Relief (C), Order No. R-1960-B[6] establishes

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[5] Case No. 13492, *Application of Samson Resources Company, Kaiser-Francis Oil Company and Mewbourne Oil Company for Cancellation of Two Drilling Permits and Approval of a Drilling Permit, Lea County, New Mexico* consolidated with Case No. 13493, *Application of Chesapeake Operating, Inc. for Compulsory Pooling, Lea County, New Mexico.*

[6] Case No. 13957, *Application of Energen Resources Corporation to Amend the Cost Recovery Provisions of Compulsory Pooling Order No. R-1960, to Determine Reasonable Costs, and for Authorization to Recover Costs from Production of Pooled Mineral Interest, Rio Arriba County, New Mexico.*

clearly that directing an operator to render an accounting and pay for production is well within the agency's jurisdiction. Order No. R-1960-B, Order ¶¶ (a)-(e) (August 13, 2009). Exhibit F.

B. NEX did not ratify the operating agreement, therefore COG violated the Division Rules in submitting applications for SRO 43H, 44H, and 69H.

COG's reliance on a document title, rather than the agreement of the parties is fatal to its argument. COG's argument is based on the document titled "Ratification and Joinder of Unit Agreement and Unit Operating Agreement." However, that document did not ratify a Unit Operating Agreement. The document, instead, states, "the undersigned hereby expressly ratifies, approves and adopts said ***Unit Agreement*** as fully as though the undersigned had executed the original agreement." *See* Motion to Dismiss, Exhibit 2.

Contract titles do not constitute controlling evidence of a contract's substantive meaning and cannot be used to alter or replace the text of a contractual provision. *See In re G-I Holdings, Inc.*, 755 F.3d 195, 203 (3d Cir. 2014) (applying Delaware law) ("Contract headings do not constitute controlling evidence of a contract's substantive meaning."); *Imation Corp. v. Koninklijke Philips Electronics N.V.*, 586 F.3d 980, 987 n. 3 (Fed.Cir.2009) (applying New York law) (court unwilling to resolve contract interpretation question based on section headings "where doing so would conflict with the plain reading of operative language elsewhere in the contract"); *Canada v. Am. Airlines, Inc. Pilot Ret. Ben. Program*, 3:09-0127, 2010 WL 4877280 at *14 (M.D. Tenn. Aug. 10, 2010) *aff'd as modified*, 10-6131, 2014 WL 3320892 (6th Cir. July 9, 2014) ("[T]he descriptive heading, though clumsily drafted, is not part of the contract and its meaning is not controlling." (quoting *Swiss Bank Corp. v. Dresser Indus., Inc.*, 942 F.Supp. 398, 401 (N.D.Ill.1996)); *Liberty Ins. Corp. v. J&A Gen. Contractors, Inc.*, 2014 IL App (1st) 132693-U ¶ 33, 2014 WL 2619077 at *7 (Ill. App. Ct. June 11, 2014) ("[H]eadings in insurance contracts do not expand, or otherwise alter the scope of the policy's text."); *McEwan v. Mt.*

Land Support Corp., 116 P.3d 955, 959 (Utah Ct. App. 2005) (contract heading was not substantive part of contract that created ambiguity with casualty insurance requirements in text of provision).

Contract headings are organizational tools – not substantive contract provisions. While there is conflict between the Ratification's title and the substantive language beneath it, the substance of the contract is what NEX agreed to and can be bound by.

The Communitization Agreements do not support COG's assertions. While those documents state that COG shall be the Operator – NEX never affirmed or agreed to be bound by the Operating Agreement (indeed, COG obviously did not believe it was bound by the Operating Agreement because it never sent the notices required under Article VI.B.1. for 43H, 44H, or 69H). COG specifically acknowledged that NEX was not waiving any rights held by it as owner and holder of the Lease by executing the 2nd Bone Spring Communitization Agreements. By this letter agreement, COG agreed that NEX was specifically reserving all rights relating to the situation created by COG when it, among other things, drilled 043H and 044H through NEX's mineral estate without authority.

NEX requests that the Division enter its Order providing as follows: (A) Determining that COG did not have the right to drill 043H and 044H on the unconsolidated, uncommunitized, and unpooled lease acreage owned by NEX; (B) Determining that COG violated Section 70-2-17.C and 70-2-18.A of the New Mexico Oil and Gas Act, as well as Rules 19.15.14.8.B, 19.15.16.15.A, and 19.15.16.15.F of the Division's rules; (C) Requiring COG to account and pay to Applicants the amount they are entitled in the absence of pooling without recovery of well costs or expenses; (D) Cancelling the drilling permit for 069H; and (E) Making such other and further provisions as may be proper in the premises, which may include removing COG as operator of 016H.

For all the reasons set forth above, Nearburg Exploration Company, L.L.C., SRO2 LLC and SRO3 LLC request that COG's Motion Dismiss be denied.

Respectfully submitted,

/s/ J. Scott Hall

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ATTORNEYS FOR NEARBURG EXPLORATION COMPANY, L.L.C., SRO 2 LLC, and SRO3 LLC

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served on counsel of record by electronic mail on January 29, 2016:

Michael H. Feldewert
Jordan L. Kessler
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/s/ J. Scott Hall
J. Scott Hall

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

MODEL FORM OPERATING AGREEMENT

SRO STATE EXPLORATORY UNIT

OPERATING AGREEMENT

DATED

May 8, 2009
(year)

OPERATOR Marbob Energy Corporation

CONTRACT AREA SEE ATTACHED EXHIBIT "A"

COUNTY OR PARISH OF Eddy STATE OF New Mexico

EXHIBIT A

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of 8th day of May, (year) 2009.

OPERATOR

MARBOB ENERGY CORPORATION

Ray Mills RD

NON-OPERATORS

PITCH ENERGY CORPORATION

Ray Mills RD

THE ALLAR COMPANY

YATES PETROLEUM CORPORATION

EG3, INC

YATES DRILLING COMPANY

ABO PETROLEUM CORPORATION

MYCO INDUSTRIES, INC.

CHESAPEAKE EXPLORATION, LLC

NEARBURG EXPLORATION COMPANY, LLC

LEGEND NATURAL GAS III L.P.

DEVON ENERGY PRODUCTION COMPANY LP

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of 1th day of May, (year) 2007.

OPERATOR

MARBOB ENERGY CORPORATION

Ray Miller RD

NON-OPERATORS

PITCH ENERGY CORPORATION

Ray Miller RD

THE ALLAR COMPANY

YATES PETROLEUM CORPORATION

EOG, INC.

YATES DRILLING COMPANY

ABO PETROLEUM CORPORATION

MYCO INDUSTRIES, INC.

CHESAPEAKE EXPLORATION, LLC

NEARBURG EXPLORATION COMPANY, LLC

LEGEND NATURAL GAS III L.P.

DEVON ENERGY PRODUCTION COMPANY LP

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of the 8th day of May, 1995.

OPERATOR

MARBOB ENERGY CORPORATION

Ray Mills RD

NON-OPERATORS

PYCO ENERGY CORPORATION

Ray Mills RD

THE ALLAR COMPANY

YATES PETROLEUM CORPORATION

BCO, INC

YATES DRILLING COMPANY

ABO PETROLEUM CORPORATION

MYCO INDUSTRIES, INC.

Chesapeake Exploration, L.L.C.
An Oklahoma Limited Liability Company
By:
Henry J. Hood, Senior Vice President -
Land and Legal & General Counsel

HEARBURG EXPLORATION COMPANY, LLC

LEGEND NATURAL GAS III L.P.

DEVON ENERGY PRODUCTION COMPANY LP

EXHIBIT "A"

Attached to & made a part of that certain Joint Operating Agreement dated May 8, 2009, by and between Marbob Energy Corporation, as Operator, and Pitch Energy Corporation, et al, as Non-Operators.

I. CONTRACT AREA/DEPTH RESTRICTIONS:

Township 25 South, Range 28 East, N.M.P.M.
Section 32: E/2E/2
Section 33: ALL
Section 34: S/2

Township 26 South, Range 28 East, N.M.P.M.
ALL OF SECTIONS 3-4, 9-10, 15, 17, 20
Section 2 : W/2
Section 5 : W/2
Section 7 : E/2
Section 8 : E/2
Section 16: E/2E/2
Section 18: E/2
Containing 7,360 acres, more or less

CONTRACT AREA IS LIMITED IN DEPTH FROM THE SURFACE TO THE BASE OF THE BONE SPRING FORMATION

II. NAME, WORKING INTEREST PERCENTAGES, AND ADDRESSES OF THE PARTIES FOR NOTICE PURPOSES:

Marbob Energy Corporation P.O. Box 227 Artesia, NM 88211-0227	19.477715%
Pitch Energy Corporation P.O. Box 304 Artesia, NM 88211-0304	16.856606%
Yates Petroleum Corporation 105 South 4th Street Artesia, NM 88210	13.028650%
Abo Petroleum Corporation 105 South 4th Street Artesia, NM 88210	6.663396%
Yates Drilling Company 105 South 4th Street Artesia, NM 88210	6.663396%
Myco Industries, Inc 105 South 4th Street Artesia, NM 88210	6.663396%
The Allar Company P. O. Box 1567 Graham, TX 76450	20.162395%
Chesapeake Exploration LLC PO Box 18496 Oklahoma City, OK 73154	10.484446%
TOTAL	100%

III. OIL AND GAS LEASES SUBJECT TO THE AGREEMENT:
SEE ATTACHED EXHIBIT A-1

Exhibit A-1

TRACT NUMBER	DESCRIPTION OF LANDS	ACRES	SERIAL NUMBER	EXPIRATION DATE	BASIC ROYALTY AND PERCENTAGE	LESSEE OF RECORD	WORKING INTEREST OWNERS	WI Decimal	Net Acres
	TOWNSHIP 25 SOUTH, RANGE 28 EAST								
1	Section 32: E/2E/2	160	VB-0575	8/1/2009	0.1875	YATES PETROLEUM CORPORATION	Yates Petroleum Corp.	0.18322480	29.315968
							ABO Petroleum Corp	0.04257430	6.811888
							Yates Drilling Company	0.04257430	6.811888
							MYCO Industries, Inc.	0.04257430	6.811888
							Marbob Energy Corp	0.11959360	19.134976
							Pitch Energy Corp	0.11959360	19.134976
							Legend Natural Gas	0.21045550	33.67288
							Devon Energy Production Company LP	0.23940960	38.305536
2	Section 33: N/2	320	VB-0576	8/1/2009	0.1875	YATES PETROLEUM CORPORATION	Yates Petroleum Corp.	0.18322480	58.631936
							ABO Petroleum Corp	0.04257430	13.623776
							Yates Drilling Company	0.04257430	13.623776
							MYCO Industries, Inc.	0.04257430	13.623776
							Marbob Energy Corp	0.11959360	38.269952
							Pitch Energy Corp	0.11959360	38.269952
							Legend Natural Gas	0.21045550	67.34576
							Devon Energy Production Company LP	0.23940960	76.611072
3	Section 33: S/2	320	VB-0569	8/1/2009	0.1875	YATES PETROLEUM CORPORATION	Yates Petroleum Corp.	0.18322480	58.631936
							ABO Petroleum Corp	0.04257430	13.623776
							Yates Drilling Company	0.04257430	13.623776
							MYCO Industries, Inc.	0.04257430	13.623776
							Marbob Energy Corp	0.11959360	38.269952
							Pitch Energy Corp	0.11959360	38.269952
							Legend Natural Gas	0.21045550	67.34576
							Devon Energy Production Company LP	0.23940960	76.611072

Exhibit A-1

4	Section 34: S/2	320	V-7085	7/1/2009 - Prod	0.16667	MARBOB ENERGY CORPORATION	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536
	TOWNSHIP 26 SOUTH, RANGE 28 EAST								
5	Section 2: W/2	320	VB-0694	7/1/2010	0.1875	YATES PETROLEUM CORPORATION	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536
6	Section 3: E/2	320	V-7438	7/1/2010	0.16667	The Allar Company	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536
7	Section 3: W/2	320	V-7461	7/1/2010	0.16667	Yates Petroleum Corporation	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536

Exhibit A-1

8	Section 4: E/2	320	V-7439	7/1/2010	0.16667	The Allar Company	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536
9	Section 4: W/2	320	V-7462	7/1/2010	0.16667	Yates Petroleum Corporation	Yates Petroleum Corp.	0.18322480	58.631936
							ABO Petroleum Corp	0.04257430	13.623776
							Yates Drilling Company	0.04257430	13.623776
							MYCO Industries, Inc.	0.04257430	13.623776
							Marbob Energy Corp	0.11959360	38.269952
							Pitch Energy Corp	0.11959360	38.269952
							Legend Natural Gas	0.21045550	67.34576
							Devon Energy Production Company LP	0.23940960	76.611072
10	Section 5: E/2	320	V-7440	7/1/2010	0.16667	Legend Natural Gas III LP	Yates Petroleum Corp.	0.18322480	58.631936
UNCOMMITTED							ABO Petroleum Corp	0.04257430	13.623776
							Yates Drilling Company	0.04257430	13.623776
							MYCO Industries, Inc.	0.04257430	13.623776
							Marbob Energy Corp	0.11959360	38.269952
							Pitch Energy Corp	0.11959360	38.269952
							Legend Natural Gas	0.21045550	67.34576
							Devon Energy Production Company LP	0.23940960	76.611072
11	Section 5: W/2	320	V-7463	7/1/2010	0.16667	Yates Petroleum Corporation	Yates Petroleum Corp.	0.18322480	58.631936
							ABO Petroleum Corp	0.04257430	13.623776
							Yates Drilling Company	0.04257430	13.623776
							MYCO Industries, Inc.	0.04257430	13.623776
							Marbob Energy Corp	0.11959360	38.269952
							Pitch Energy Corp	0.11959360	38.269952
							Legend Natural Gas	0.21045550	67.34576
							Devon Energy Production Company LP	0.23940960	76.611072

Exhibit A-1

12	Section 6: E/2	320	V-7441	7/1/2010	0.16667	Legend Natural Gas III LP	Yates Petroleum Corp.	0.18322480	58.631936
UNCOMMITTED							ABO Petroleum Corp	0.04257430	13.623776
							Yates Drilling Company	0.04257430	13.623776
							MYCO Industries, Inc.	0.04257430	13.623776
							Marbob Energy Corp	0.11959360	38.269952
							Pitch Energy Corp	0.11959360	38.269952
							Legend Natural Gas	0.21045550	67.34576
							Devon Energy Production Company LP	0.23940960	76.611072
13	Section 7: E/2	320	V-7465	7/1/2010	0.16667	Yates Petroleum Corporation	Yates Petroleum Corp.	0.18322480	58.631936
							ABO Petroleum Corp	0.04257430	13.623776
							Yates Drilling Company	0.04257430	13.623776
							MYCO Industries, Inc.	0.04257430	13.623776
							Marbob Energy Corp	0.11959360	38.269952
							Pitch Energy Corp	0.11959360	38.269952
							Legend Natural Gas	0.21045550	67.34576
							Devon Energy Production Company LP	0.23940960	76.611072
14	Section 8: W/2	320	V-7443	7/1/2010	0.16667	Legend Natural Gas III LP	Yates Petroleum Corp.	0.18322480	58.631936
UNCOMMITTED							ABO Petroleum Corp	0.04257430	13.623776
							Yates Drilling Company	0.04257430	13.623776
							MYCO Industries, Inc.	0.04257430	13.623776
							Marbob Energy Corp	0.11959360	38.269952
							Pitch Energy Corp	0.11959360	38.269952
							Legend Natural Gas	0.21045550	67.34576
							Devon Energy Production Company LP	0.23940960	76.611072

Exhibit A-1

15	Section 8: E/2	320	V-7466	7/1/2010	0.16667	Marbob Energy Corporation	Yates Petroleum Corp.	0.18322480	58.631936
							ABO Petroleum Corp	0.04257430	13.623776
							Yates Drilling Company	0.04257430	13.623776
							MYCO Industries, Inc.	0.04257430	13.623776
							Marbob Energy Corp	0.11959360	38.269952
							Pitch Energy Corp	0.11959360	38.269952
							Legend Natural Gas	0.21045550	67.34576
							Devon Energy Production Company LP	0.23940960	76.611072
16	Section 9: W/2	320	V-7444	7/1/2010- Prod	0.16667	The Allar Company	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536
17	Section 9: E/2	320	V-7467	7/1/2010 - Prod	0.16667	Yates Petroleum Corporation	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536
18	Section 10: W/2	320	VB-0677	7/1/2010	0.1875	The Allar Company	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536

Exhibit A-1

19	Section 10: E/2	320	VB-0695	7/1/2010	0.1875	Yates Petroleum Corporation	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536
20	Section 15: E/2	320	V-7445	7/1/2010	0.16667	The Allar Company	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536
21	Section 15: W/2	320	V-7468	7/1/2010	0.16667	Yates Petroleum Corporation	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536
22	Section 16: E/2E/2	160	V-7446	7/1/2010	0.16667	The Allar Company	Marbob Energy Corp	0.19505495	31.208792
							Pitch Energy Corp	0.19505495	31.208792
							Yates Petroleum Corp.	0.07554945	12.087912
							ABO Petroleum Corp	0.07554945	12.087912
							Yates Drilling Company	0.07554945	12.087912
							MYCO Industries, Inc.	0.07554945	12.087912
							The Allar Company	0.30769230	49.230768
23	Section 17: E/2	320	V-7447	7/1/2010	0.16667	Chesapeake Exploration LP	Chesapeake Exploration Limited Partnership	1.00000000	320

Exhibit A-1

24	Section 17: W/2	320	V-7470	7/1/2010	0.16667	Yates Petroleum Corporation	Yates Petroleum Corp.	0.35000000	112
							ABO Petroleum Corp	0.05000000	16
							Yates Drilling Company	0.05000000	16
							MYCO Industries, Inc.	0.05000000	16
							Marbob Energy Corp	0.50000000	160
25	Section 18: E/2	320	V-7448	7/1/2010	0.16667	Chesapeake Exploration LP	Chesapeake Exploration Limited Partnership	1.00000000	320
26	Section 20: W/2	320	V-7450	7/1/2010	0.16667	Nearburg Exploration Company, LLC	Nearburg Exploration Company, LLC	1.00000000	320
27	Section 20: E/2	320	V-7473	7/1/2010	0.16667	Marbob Energy Corporation	Marbob Energy Corp	0.19505495	62.417584
							Pitch Energy Corp	0.19505495	62.417584
							Yates Petroleum Corp.	0.07554945	24.175824
							ABO Petroleum Corp	0.07554945	24.175824
							Yates Drilling Company	0.07554945	24.175824
							MYCO Industries, Inc.	0.07554945	24.175824
							The Allar Company	0.30769230	98.461536

Exhibit A-1

RECAPITULATION

Acres of State of New Mexico Lands = 100%
Acres of Fee Lands = 0%
100%

LEASE BASIS	
TOTAL COMMITTED ACRES	7360
TOTAL UNCOMMITTED ACRES	960
TOTAL ACRES	8320

Unit Working Interest		
Marbob Energy Corp	0.18507511	1188.974488
Pitch Energy Corp	0.16016961	1028.974488
Yates Petroleum Corp.	0.12379680	795.305384
ABO Petroleum Corp	0.06331485	406.752344
Yates Drilling Company	0.06331485	406.752344
MYCO Industries, Inc.	0.06331485	406.752344
The Allar Company	0.19158086	1230.7692
Chesapeake Exploration LLC	0.09962205	640
Nearburg Exploration Company LLC	0.04981102	320
TOTAL	1.00000000	6424.280592

Nearburg ORI	0.00415092

Nearburg TA'd to all parties proportionately making new WI:	
Unit Working Interest	
Marbob Energy Corp	0.19477715
Pitch Energy Corp	0.16856606
Yates Petroleum Corp.	0.13028650
ABO Petroleum Corp	0.06663396
Yates Drilling Company	0.06663396
MYCO Industries, Inc.	0.06663396
The Allar Company	0.20162395
Chesapeake Exploration LLC	0.10484446
Nearburg Exploration Company LLC	
TOTAL	1.00000000

HINKLE SHANOR LLP
ATTORNEYS AT LAW
119 SOUTH ROSELAWN
SUITE 308
P.O. BOX 1720
ARTESIA, NEW MEXICO 88210
575-622-6510 (FAX) 575-746-6316

WRITER:

Scott S. Morgan
smorgan@hinklelawfirm.com

January 9, 2015

IN RE: FIRST CUMULATIVE SUPPLEMENTAL DRILLING AND DIVISION ORDER OPINION OF TITLE TO:

The State of New Mexico Oil and Gas Leases more particularly identified on Exhibit "A" hereto, which cover the following described lands situated in Eddy County, New Mexico:

Township 25 South, Range 28 East, N.M.P.M.
Section 32: E½E½
Section 33: All
Section 34: S½

Township 26 South, Range 28 East, N.M.P.M.
Section 2: W½
Section 3: All
Section 4: All
Section 5: All
Section 6: E½
Section 7: E½
Section 8: All
Section 9: All
Section 10: All
Section 15: All
Section 16: E½E½
Section 17: All
Section 18: E½
Section 20: All

containing 8,320 acres, more or less.

The depths reported herein are limited to all depths from the surface down to the base of the Bone Spring Formation. The lands are referred to herein by their respective Unit Tract numbers under the terms of the SRO State Exploratory Unit which terminated March 1, 2014 and which are reflected on Exhibit "A hereto."

SRO State Unit Well No. 9H
SRO State Unit Well No. 15H
SRO State Unit Well No. 16H
SRO State Unit Well No. 20H
SRO State Unit Well No. 53H
SRO State Unit Well No. 12H

No. 32,348

COG Operating LLC
One Concho Center
600 West Illinois Avenue
Midland, Texas 79701

Attention: Mr. Aaron Myers, Senior Landman

EXHIBIT B

Article XV, Other Provisions, include a priority of operations provision and a provision regarding required operations that provides as follows:

> Notwithstanding any other provisions herein, if during the term of this agreement, a well is required to be drilled, deepened, reworked, plugged back, sidetracked, or recompleted, or any other operation that may be required in order to (1) continue a lease or leases in force and effect, or (2) maintain a unitized area or any portion thereof in force and effect, or (3) earn or preserve and [sic] interest in and to oil and/or gas and other minerals which may be owned by a third party or which, failing in such operation may revert to a third party, or (4) comply with an order issued by regulatory body having jurisdiction in the premises, failing in which certain rights would terminate, the following shall apply. Should less than all parties hereto elect to participate and pay their proportionate part of the costs to be incurred in such operation, those parties desiring to participate shall have the right to do so at their sole cost, risk, and expense. Promptly following the conclusion of such operation, each of those parties not participating agree to execute and deliver an appropriate assignment to the total interest of each non-participating party in and to the lease, leases, or rights, LIMITED TO THE SRO UNIT DEPTHS, which would have terminated or which otherwise may have been preserved by virtue of such operation, and in and to the lease, leases, or rights LIMITED TO THE SRO UNIT DEPTHS, within the balance of the drilling unit upon which the well was drilled, excepting, however, wells therefore completed and capable of producing in paying quantities. Such assignment shall be delivered to the participating parties in the proportion that they bore the expense attributable to the non-participating parties' interest. The purposes of defining a required operation under this provision, such operation will be deemed required if proposed within thirteen (13) months prior to the date such rights would terminate.

Article XV C states that the operating agreement supersedes and replaces any other current operating agreements covering and concerning the contract area. We have given effect to this provision only as to those parties who executed the Operating Agreement.

The interests of the parties set forth in the agreement are as follows:

Marbob Energy Corporation	19.477715%
Pitch Energy Corporation	16.856606%
Yates Petroleum Corporation	13.028650%
Abo Petroleum Corporation	6.663396%
Yates Drilling Company	6.663396%
Myco Industries, Inc.	6.663396%
The Allar Company	20.162395%
Chesapeake Exploration LLC	10.484446%

The leases subject to the Operating Agreement are attached as Exhibit A-1. Exhibit C is a COPAS 1984-1 Onshore Accounting Form; Exhibit D contains the insurance provisions and that the operator may be self insured; Exhibit E is a Gas Balancing Agreement; and Exhibit F is an equal employment opportunity provision. As the SRO State Exploratory Unit was terminated effective March 1, 2014, this Operating Agreement is no longer a unit operating agreement and is now a working interest unit operating agreement. We know you are familiar with the terms of this Agreement so we do not analyze it further.

2. **Myox Operating Agreement:** You submitted a copy of the Myox Operating Agreement dated November 1, 2005, which names Marbob Energy Corporation as operator, and the following as nonoperators: Pitch Energy Corporation; Yates Petroleum Corporation; Yates Drilling Company; Abo Petroleum Corporation; Myco Industries, Inc; OGX Resources LLC; and Devon Energy Production Company, L.P. This Operating Agreement was prepared on AAPL Form 610-1977 Model Form Operating Agreement and the contract area covers the following described lands:

Township 25 South, Range 28 East, N.M.P.M.
Sections 16, 19 - 21, 28 - 33: All

Township 26 South, Range 28 East, N.M.P.M.
Section 4: W½
Sections 5 - 8: All

Nearburg Exploration Company, L.L.C.

Oil and Gas Exploration
3300 North "A" Street
Building 2, Suite 120
Midland, TX 79705-5421
432-686-8235
FAX 432-686-7806

June 10, 2015

COG Operating LLC
Attn: Mr. Aaron Myers
One Concho Center
600 W. Illinois Avenue
Midland, Texas 79701

Hand Delivery

Re: Communitization Agreements
SRO State Comm #43H & 44H Wells
Eddy County, New Mexico
Sections 17 & 20, T-26-S, R-28-E, N.M.P.M.

Dear Aaron:

Pursuant to our correspondence to you dated May 28, 2015, Nearburg Exploration Company, L.L.C. ("Nearburg") is in receipt of revised Communitization Agreements for the SRO State Com #43H and the SRO State Com #44H, (collectively the "Agreements").

Nearburg owns an interest in the SRO State Com #43 H and SRO State Com #44H wells (collectively the "Wells") by way of Nearburg's State of New Mexico Lease #VO-7450-0001 covering the W/2 of Section 20, T-26-S, R-28-E, N.M.P.M., Eddy County, New Mexico (the "Lease"). The Lease was subject to a Term Assignment of Oil and Gas Lease from Nearburg in favor of Marbob Energy Corporation (now COG) recorded in Book 790, Page 530 of the records of Eddy County, New Mexico (the "Term Assignment"). The Term Assignment has expired by its own terms and has not been extended.

Nearburg requested and COG has advised us that we have been furnished with all emails and other written communications between COG and the New Mexico State Land Office (the "Office") regarding Nearburg and the Agreements. In addition COG has agreed to amend the Communitization Agreements on the above wells to be restricted to the 2nd Bone Spring interval as Nearburg proposed.

In an effort to further evaluate our working interest in the Wells, Nearburg requests it be provided with the following 8/8ths information for the Wells:

a) Daily production (including any FTP or FCP pressure data that is available) through the date Nearburg and COG resolve ownership of the Wells;

EXHIBIT C

b) Daily reports, when applicable, for any well repairs, workovers, etc. through the date Nearburg and COG resolve ownership of the Wells;

c) A detailed accounting of the actual costs to drill, complete and equip the Wells;

d) Actual lease operating expenses billed through your monthly joint interest billings;

e) Actual revenues received through April 2015;

f) Itemized revenue deductions for any transportation, taxes or other deductions.

We understand this information will be provided to Nearburg on or before June 17, 2015. In addition, Nearburg requests that going forward you furnish monthly lease operating expenses and monthly production and revenues/itemized revenue deductions received at the same time this information is provided to other working interest owners in the Wells.

Please acknowledge as provided below that Nearburg's execution and delivery of the enclosed Agreements does not extend or ratify the Term Assignment and Nearburg does not waive any rights held by it as owner and holder of the Lease and that Nearburg specifically reserves all rights relating to this situation.

We ask that you please provide the documentation requested above as soon as possible in order to expedite resolution of this matter.

If you have any questions or comments, or should you need anything further in regard to this matter, please do not hesitate to contact the undersigned at (432) 818-2914 or via email at rhoward@nearburg.com.

Sincerely,

Nearburg Exploration Company, L.L.C.

Randy Howard
Land Manager

Enclosures

Acknowledged this 10th day of June, 2015

COG Operating LLC

By: Aaron L. Myers

Its: Senior Landman

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

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

APPLICATION OF TMBR/SHARP DRILLING, INC. FOR AN ORDER STAYING DAVID H. ARRINGTON OIL & GAS, INC. FROM COMMENCING OPERATIONS, LEA COUNTY, NEW MEXICO. — CASE NO. 12731

APPLICATION OF TMBR/SHARP DRILLING, INC. APPEALING THE HOBBS DISTRICT SUPERVISOR'S DECISION DENYING APPROVAL OF TWO APPLICATIONS FOR PERMIT TO DRILL FILED BY TMBR/SHARP DRILLING, INC., LEA COUNTY, NEW MEXICO. — CASE NO. 12744

ORDER NO. R-11700-B

ORDER OF THE OIL CONSERVATION COMMISSION

BY THE COMMISSION:

THIS MATTER came before the Oil Conservation Commission (hereinafter referred to as "the Commission") on March 26, 2002, at Santa Fe, New Mexico, on application of TMBR/Sharp Drilling Inc. (hereinafter referred to as "TMBR/Sharp"), *de novo*, and opposed by David H. Arrington Oil and Gas Inc. (hereinafter referred to as "Arrington") and Ocean Energy Inc. (hereinafter referred to as "Ocean Energy") and the Commission, having carefully considered the evidence, the pleadings and other materials submitted by the parties hereto, now, on this 26th day of April, 2002,

FINDS,

1. Notice has been given of the application and the hearing on this matter, and the Commission has jurisdiction of the parties and the subject matter herein.

2. In Case No. 12731, TMBR/Sharp seeks an order voiding permits to drill obtained by Arrington and awarding or confirming permits to drill to TMBR/Sharp concerning the same property.

3. In Case No. 12744, TMBR/Sharp appeals the action of the Supervisor of District I of the Oil Conservation Division denying two applications for permit to drill.

EXHIBIT D

4. Arrington and Ocean Energy oppose[1] both applications.

5. The cases were consolidated by the Division for purposes of hearing and remain so before the Commission.

6. Still pending before the Division are two applications for compulsory pooling. They are: Case No. 12816, Application of TMBR/Sharp for compulsory pooling, Lea County, and Case No. 12841, Application of Ocean Energy Inc. for compulsory pooling, Lea County.

7. The Commission conducted an evidentiary hearing on March 26, 2002, heard testimony from witnesses called by TMBR/Sharp, and accepted exhibits. The Commission also accepted pre-hearing statements from TMBR/Sharp and Arrington and heard opening statements from TMBR/Sharp, Arrington and Ocean Energy and accepted brief closing statements from TMBR/Sharp and Arrington.

8. Following the hearing, TMBR/Sharp filed a Motion to Supplement the Record to include the April 10, 2002 letter of Arrington to the Oil Conservation Division's Hobbs District Office and a portion of Arrington's Supplemental Response to Plaintiff's Motion for Reconsideration in Lea County Cause No. CV-2001-315C. Ocean filed a response to that motion that argued the items add nothing to the record, and Arrington filed a response arguing that the supplemental material is not new or inconsistent. The Motion to Supplement the Record should be granted as no party seems to object to review of the documents; the objections seem to relate only to the significance of the documents to this matter.

9. Applications for permit to drill were filed with the Division in Sections 23 and 25 by Arrington and TMBR/Sharp. The applications filed by TMBR/Sharp and Arrington both proposed a well in the NW/4 of in Section 25. In Section 23, the application for permit to drill filed by TMBR/Sharp proposed a well in the NE/4, and the application of Arrington proposed a well in the SE/4.

10. Arrington's application in Section 25 was filed on July 17, 2001 and sought a permit to drill its proposed "Triple-Hackle Dragon "25" Well No. 1." This application was approved on July 17. On or about August 7, 2001, TMBR/Sharp filed its application for a permit to drill its proposed "Blue Fin "25" Well No. 1" in the same section. That application was denied on August 8, 2001.

11. Arrington's application in Section 23 was filed on July 25, 2001 and sought a permit to drill its proposed "Blue Drake "23" Well No. 1." This application was

[1] On April 10, 2002 Arrington agreed to release its permit to drill to TMBR/Sharp. A dispute may no longer therefore exist concerning Section 23 although the parties apparently do not agree with this assessment.

approved on July 30, 2001. On or about August 6, 2001, TMBR/Sharp filed its application for a permit to drill its proposed "Leavelle "23" Well No. 1" in the same section. That application was denied on August 8, 2001.[2]

12. TMBR/Sharp's applications in Sections 23 and 25 were denied on the grounds of the permits previously issued to Arrington for the "Triple-Hackle Dragon "25" Well No. 1" and the "Blue Drake "23" Well No. 1." The Townsend Mississippian North Gas Pool, the pool from which the wells are to produce, is governed by the spacing and well density requirements of Rule 104.C(2) [19 NMAC 15.C.104.C(2)]. That rule imposes 320-acre spacing on wells producing from that pool. TMBR/Sharp's applications were denied because, if granted, more than one well would be present within a 320-acre spacing unit, in violation of Rule 104.C(2).

13. Before an oil or natural gas well may be drilled within the State of New Mexico, a permit to drill must be obtained. See NMAC 19.15.3.102.A, 19 NMAC 15.M.1101.A. Only an "operator" may obtain a permit to drill, 19 NMAC 15.M.1101.A, and an "operator" is a person who is "duly authorized" and "is in charge of the development of a lease or the operation of a producing property." NMAC 19.15.1.7.O(8).

14. The central issue in this case is whether Arrington was eligible to become the operator of the wells in question. If not, Arrington should not have received the permits to drill. If Arrington was eligible to become the operator, then the permits were properly issued to Arrington.

15. A dispute exists concerning the validity of Arrington and TMBR/Sharp's mineral leases in Sections 23 and 25. As will be seen below, resolution of this dispute in favor of Arrington or TMBR/Sharp determines which party is eligible to be the operator and thus, who should receive the permits to drill.

16. TMBR/Sharp is the owner of oil and gas leases comprising the NW/4 of Section 25 and the SE/4 of Section 23 (along with other lands) pursuant to leases dated August 25, 1997 granted by Madeline Stokes and Erma Stokes Hamilton. TMBR/Sharp Exhibit 6. The leases were granted to Ameristate Oil & Gas, Inc. (hereinafter referred to as "Ameristate") and were recorded respectively in Book 827 at Page 127 and in Book 827 at Page 124 in Lea County, New Mexico.

17. TMBR/Sharp and Ameristate entered into a Joint Operating Agreement along with other parties on July 1, 1998 and TMBR/Sharp was designated as the operator in Section 25. See TMBR/Sharp Exhibit 7.

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[2] Apparently TMBR/Sharp reapplied for the permits to drill that were previously denied, and the Division approved those permits on March 20, 2002.

18. Although the primary terms of the TMBR/Sharp leases have apparently expired, TMBR/Sharp alleges that the leases were preserved by the drilling of the "Blue Fin 24 Well No. 1" and subsequent production from that well. The Blue Fin 24 Well No. 1 is located in the offsetting section 24.

19. Subsequent to Stokes and Hamilton's execution of leases in favor of Ameristate Oil & Gas Inc., they granted leases in the same property to James D. Huff on March 27, 2001. See TMBR/Sharp Exhibit 9. The leases to Mr. Huff were recorded in Book 1084 at Page 282 and in Book 1084 at Page 285 in Lea County, New Mexico. The parties referred to these leases as "top leases," meaning that according to their terms, they would not take effect until the prior or "bottom" leases became ineffective. See TMBR/Sharp Exhibit 9, ¶ 15.

20. Arrington alleges Mr. Huff is an agent of Arrington but presented nothing to support that contention.

21. In July and August 2001, Ocean acquired a number of farm-out agreements in Section 25. See TMBR/Sharp Exhibit 10, Schedule 1. By an assignment dated September 10, 2001, Ocean assigned a percentage of the farm out agreements to Arrington under terms that require Arrington to drill a test well in Section 25 known as the Triple Hackle Dragon "25" Well No. 1 in the NW/4 of that section.

22. On August 21, 2001, after receiving the denials of the applied-for permits to drill from the District office, TMBR/Sharp filed suit against Arrington and the lessors of its mineral interests in the Fifth Judicial District Court of Lea County, New Mexico. In that case, styled "TMBR/Sharp Drilling, Inc. v. David H. Arrington Oil & Gas, Inc., *et al.*", TMBR/Sharp alleged that its leases were still effective and the Arrington top leases were ineffective. The District Court, in its Order Granting Partial Summary Judgment, dated December 24, 2001, agreed with TMBR/Sharp's contention. See TMBR/Sharp's Exhibit No. 12,

23. During the hearing of this matter, TMBR/Sharp argued that because the Fifth Judicial District Court found that Arrington's "top leases" had failed, TMBR/Sharp was entitled to permits to drill in Sections 23 and 25 and Arrington was not entitled to permits to drill and its permits should be rescinded. TMBR/Sharp also argued that Arrington had filed applications to prevent TMBR/Sharp from being able to drill and to place its obligations under the continuous drilling clauses of the oil and gas leases in jeopardy. TMBR/Sharp argued that Ocean Energy's letter agreement with Arrington could not revive Arrington's claim of title and that Ocean Energy's pending pooling application with the Division is essentially irrelevant to the question of whether TMBR/Sharp should have been granted a permit to drill.

24. Arrington argued in response that the title issue ruled upon by the District Court with respect to section 25 is irrelevant because Arrington acquired an independent

interest in that section by virtue of a farm out agreement in September of 2001. Arrington also argued it was willing to assign the disputed acreage in Section 23 to TMBR/Sharp in order to resolve the present controversy. Arrington also argued that it doesn't intend to actually drill at the present time under either approved permit to drill and argued, citing Order No. R-10731-B, that the Commission's practice has not been to rely on "first in time, first in right" principles in deciding competing applications on compulsory pooling, but instead on geological evidence. Arrington seemed to argue that a compulsory pooling proceeding is the place to present such geologic evidence. Arrington argues that these proceedings are unnecessary and that the Commission should rely upon the Division's pending pooling cases to decide who of the various parties should properly possess the permit to drill.

25. Ocean Energy argued that since its farm out agreement terminates on July 1, 2002 time is of the essence and that the matters at issue here should be resolved in the pending compulsory pooling proceeding instead of this proceeding. Ocean Energy argued that the permit to drill is meaningless in this context, that TMBR/Sharp is essentially asking the Commission to determine pooling in the context of the permit to drill, and that the dedication of acreage on the acreage dedication plat should not determine what acreage would be pooled to the well. If the Commission were to adopt this approach, Ocean Energy argues, the compulsory pooling statutes would be written out of existence.

26. The parties seem to agree that in a situation where the bottom lease has not failed, a person owning a top lease is not a person duly authorized to be in charge of the development of a lease or the operation of a producing property, and is therefore not entitled to a permit to drill. NMAC 19.15.1.7(O)(8). See also 1 Kramer & Martin, The Law of Pooling and Unitization, 3rd ed., § 11.04 at 11-10 (2001). Moreover, because only an "owner" may seek compulsory pooling, it seems that a person owning a top lease where the bottom lease has not failed might not be entitled to compulsory pooling either. See NMSA 1978, § 70-2-17(C).

27. When an application for permit to drill is filed, the Division does not determine whether an applicant can validly claim a real property interest in the property subject to the application, and therefore whether the applicant is "duly authorized" and "is in charge of the development of a lease or the operation of a producing property." The Division has no jurisdiction to determine the validity of any title, or the validity or continuation in force and effect of any oil and gas lease. Exclusive jurisdiction of such matters resides in the courts of the State of New Mexico. The Division so concluded in its Order in this matter. See Order No. R-11700 (December 13, 2001).

28. It is the responsibility of the operator filing an application for a permit to drill to do so under a good faith claim to title and a good faith belief that it is authorized to drill the well applied for. It appears to this body that Arrington had such a good faith belief when it filed its application, but subsequently the District Court found otherwise.

It is not within the purview of this body to question that decision and it should not do so in this case.

29. As of the date of this order, TMBR/Sharp, by Court declaration, is the owner of an oil and gas lease in both Section 23 and Section 25, and Arrington, also by Court declaration, is not an owner in those sections. Therefore, Arrington, who the Court has now decreed has no authority over the property, should not have been granted permits to drill in those sections and TMBR/Sharp should have been granted a permit.

30. Both Arrington and Ocean Energy imply that an appeal will be filed of the District Court's decision. Until the issue of title in Sections 23 and 25 is finally resolved by the courts or by agreement of the parties, the outcome of this proceeding is therefore uncertain. As of the present time, TMBR/Sharp has prevailed on the title question and this Order reflects that (present) reality. However, as an appeal could change that conclusion, jurisdiction of this matter should therefore be retained until matters are finally resolved.

31. The permits to drill issued by the Division in July 2001 to Arrington were issued erroneously and should be rescinded *ab initio*. The applications to drill submitted by TMBR/Sharp in August 2001 should have been processed within a few days of receipt. Arrington's later acquisition of an interest in section 23 and 25 through a farm out agreement doesn't change this analysis; Arrington had no interest by virtue of farm out as of the date of TMBR/Sharp's applications.

32. On another issue, Arrington and Ocean Energy have both urged this body to stay these proceedings pending the resolution of the applications for compulsory pooling, arguing that a decision on those matters will effectively resolve the issues surrounding the permits to drill.

33. Arrington and Ocean Energy's conclusion does not necessarily follow. An application for a permit to drill serves different objectives than an application for compulsory pooling and the two proceedings should not be confused. The application for a permit to drill is required to verify that requirements for a permit are satisfied. For example, on receipt of an application, the Division will verify whether an operator has financial assurance on file, identify which pool is the objective of the well so as to identify the proper well spacing and other applicable requirements, ensure that the casing and cementing program meets Division requirements and check the information provided to identify any other relevant issues. The acreage dedication plat that accompanies the application (form C-102) permits verification of the spacing requirements under the applicable pool rules or statewide rules. Compulsory pooling is related to these objectives in that compulsory pooling would not be needed in the absence of spacing requirements. 1 Kramer & Martin, The Law of Pooling and Unitization, § 10.01 (2001) at 10-2. But its primary objectives are to avoid the drilling of unnecessary wells and to protect correlative rights. NMSA 1978, § 70-2-17(C).

34. It has long been the practice in New Mexico that the operator is free to choose whether to drill first, whether to pool first, or whether to pursue both contemporaneously. The Oil and Gas Act explicitly permits an operator to apply for compulsory pooling after the well is already drilled. See NMSA 1978, § 70-2-17(C) (the compulsory pooling powers of the Division may be invoked by an owner or owners "... who has the right to drill *has drilled* or proposes to drill a well [sic] ..."). Issuance of the permit to drill does not prejudge the results of a compulsory pooling proceeding, and any suggestion that the acreage dedication plat attached to an application to drill somehow "pools" acreage is expressly disavowed. If acreage included on an acreage dedication plat is not owned in common, it is the obligation of the operator to seek voluntary pooling of the acreage pursuant to NMSA 1978, § 70-2-18(A) and, if unsuccessful, to seek compulsory pooling pursuant to NMSA 1978, § 70-2-17(C).

35. Thus, where compulsory pooling is not required because of voluntary agreement or because of common ownership of the dedicated acreage, the practice of designating the acreage to be dedicated to the well on the application for a permit to drill furthers administrative expedience. Once the application is approved, no further proceedings are necessary. An operator may first apply for a permit to drill a well and may thereafter pool (on a voluntary or compulsory basis) separately owned tracts to the well. Alternatively, the operator may first pool and later seek a permit to drill. The two are not mutually exclusive, and there is no preferred methodology.

36. Thus, the process fosters efficiency by permitting a simple approach in cases where ownership is common and pooling, voluntary or compulsory, is not necessary.

37. Ocean's expiring farm-outs present a difficult problem because the delay occasioned by this proceeding and any delay that might occur in the pending compulsory pooling cases may place Ocean's interests in jeopardy. It is worth noting that Ocean's interests seem to be free of the title issues plaguing the other parties, but since Ocean Energy intended that Arrington drill and become operator, Ocean isn't planning on preserving its rights by drilling a well itself and hasn't applied for a permit to drill. Unfortunately, this body is without authority to stay expiration of the farm-outs; Ocean should petition the District Court for relief if the expiring farm-outs are a concern.

CONCLUSION OF LAW:

The Oil Conservation Commission has no jurisdiction to determine the validity of any title, or the validity or continuation in force and effect of any oil and gas lease. Exclusive jurisdiction of such matters resides in the courts of the State of New Mexico.

IT IS THEREFORE ORDERED:

1. The portion of TMBR/Sharp's application in Case No. 12731 seeking to void permits to drill obtained by Arrington is granted. The permits to drill awarded to

Arrington shall be and hereby are rescinded *ab initio* and the applications originally filed by TMBR/Sharp in August, 2001 shall be and hereby are remanded to the District Office for approval consistent with this Order provided the applications otherwise meet applicable Division requirements.

2. TMBR/Sharp's application in Case No. 12744, appealing the decision of the Supervisor of District I of the Oil Conservation Division, is granted and the decision shall be and hereby is overruled.

3. The motions of Arrington and Ocean to continue this proceeding until after the decision in Cases No. 12816 and No. 12841 shall be and hereby are denied.

4. The motion of TMBR/Sharp to Supplement the Record is hereby granted.

5. Jurisdiction of this case is retained for the entry of such further orders as may be necessary given subsequent proceedings in TMBR/Sharp Drilling, Inc. v. David H. Arrington Oil & Gas, Inc., *et al.*

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

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

LORI WROTENBERY, CHAIR

JAMI BAILEY, MEMBER

ROBERT LEE, MEMBER

S E A L

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

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

APPLICATION OF SAMSON RESOURCES COMPANY, KAISER-FRANCIS OIL COMPANY AND MEWBOURNE OIL COMPANY FOR CANCELLATION OF TWO DRILLING PERMITS AND APPROVAL OF A DRILLING PERMIT, LEA COUNTY, NEW MEXICO — CASE NO. 13492 (De Novo)

APPLICATION OF CHESAPEAKE OPERATING, INC. FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO — CASE NO. 13493 (De Novo)

ORDER NO. R-12343-E

ORDER OF THE COMMISSION

THIS MATTER, having come before the New Mexico Oil Conservation Commission (Commission) on January 11, 2007 at Santa Fe, New Mexico, on application of Samson Resources Company (Samson), Kaiser-Francis Oil Company (Kaiser-Francis) and Mewbourne Oil Company (Mewboume) (Samson et al) for cancellation of two drilling permits and approval of a drilling permit and application of Chesapeake Operating, Inc. (Chesapeake) for compulsory pooling, Lea County, New Mexico, and the Commission, having carefully considered the evidence, the pleadings and other materials the parties submitted, now, on this 16th day of March, 2007,

FINDS THAT:

PRELIMINARY MATTERS

1. Notice has been given of the applications and the hearing on this matter, and the Commission has jurisdiction of the parties and the subject matter.

2. The New Mexico Oil and Gas Act, NMSA 1978, Section 70-2-17, provides that "Where, however, such owner or owners have not agreed to pool their interests, and where one such separate owner, or owners, who has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply, the division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent

EXHIBIT E

waste, shall pool all or any part of such lands, or interest or both in the spacing unit or proration unit as a unit".

3. NMSA 1978, Section 70-2-17, also provides that "For purposes of determining the portion of production owned by persons owning interests in the pooled oil or gas, or both, such production shall be allocated to the respective tracts within the unit in the proportion that the number of surface acres included within each tract bears to the number of surface acres included in the entire unit. The portion of production allocated to the owner or owners of each tract or interest included in a well spacing or proration unit formed by a pooling order shall, when produced, be considered as if produced from the separately owned tract or interest by a well drilled thereon. Such pooling order of the division shall make definite provision as to any owner, or owners, who elects not to pay his proportionate share in advance for the prorated reimbursement solely out of production to the parties advancing the costs of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, but which shall include a reasonable charge for supervision and may include a charge for the risk involved in the drilling of such well . . "

4. Case No. 13492 concerns Samson et al's application before the Oil Conservation Division (Division) seeking cancellation of the Division's approval of an application for permit to drill filed on March 10, 2005 by Chesapeake for the KF 4 State Well No. 1 and an application for permit to drill filed on March 18, 2005 by Chesapeake for the Cattlemen 4 State Com Well No. 1. The Division permitted the KF 4 State Well No. 1 (KF 4 well) for a location in the southeast quarter, 660 feet from the South line and 990 feet from the East line of irregular Section 4, Township 21 South, Range 35 East, NMPM, in Lea County. The Division permitted the Cattleman 4 State Com Well No. 1 for a location 3300 feet from the South line and 990 feet from the Rast line in the east half of the geographical middle third of irregular Section 4, Township 21 South, Range 35 East, NMPM.

5. Samson et al sought cancellation of the applications for permit to drill (APD) for the KF 4 well and the Cattleman 4 State Com Well No. 1 on the ground that they own the entire working interest in the quarter sections containing the KF 4 well and the Cattleman 4 State Com Well No. 1.

6. Case No. 13493 concerns Chesapeake's application to create a compulsory pooled lay-down unit consisting of the south half (geographical south third) of irregular Section 4, Township 21 South, Range 35 East, NMPM and dedicate it to Chesapeake's KF 4 well.

7. As a result of the factual relationship between the two cases, the Division and subsequently the Commission combined the two cases for hearing purposes.

8. The parties appeared at the hearing and presented evidence. Samson et al presented evidence in support of its application in Case No, 13492 and in opposition to

Chesapeake's application in Case No. 13493. Chesapeake presented evidence in support of its application and in opposition to Samson et al's application.

UNDISPUTED EVIDENCE

9. Section 4 of Township 21 South, Range 35 East, NMPM, in Lea County, is an irregular section consisting of approximately 950.8 acres, more or less, and is approximately one mile wide from east to west, and one and one-half miles long from north to south. The subdivisions of Section 4 are as follows:

a. the southeast quarter (geographically, the east half of the south one-third), consisting of lots 17, 18, 23 and 24;

b. the southwest quarter (geographically, the west half of the south one-third), consisting of lots 19 through 22;

c. Lots 9, 10, 15 and 16, being the quarter section immediately north of the southeast quarter, hereinafter called "the east half of the middle one-third";

d. Lots 11 through 14, being the quarter section immediately north of the southwest quarter, hereinafter called "the west half of the middle one-third";

e. Lots 1 through 8, consisting of 310.8 acres, more or less, being the two northern most quarter sections. Stipulation by the Parties as to Undisputed Evidence to be Considered by the Commission filed August 9, 2006 (Stipulation), pages 1 and 2.

10. The State of New Mexico owns the oil and gas minerals within the entire Section 4, Township 21 South, Range 35 East, NMPM (as well as the surface), and all acres have been leased. Lease status and ownership are as follows:

a. The southeast quarter is leased under State of New Mexico Lease No. BO-1481-14. Kaiser-Francis, Samson, and Mewbourne own all the working interest.

b. The southwest quarter is leased under State of New Mexico Lease No. VO-7063-2. Chesapeake owns all the working interest.

c. The middle one-third is leased under State of New Mexico Lease No. VO-7054. Samson owns all the working interest.

d. The northern one-third is leased under State of New Mexico Lease No. VO-7062-2. Chesapeake owns all the working interest. Stipulation, page 2.

11. Chesapeake does not own an interest in the southeast quarter of Section 4, Township 21 South, Range 35 East and has not owned such interest at any time relevant to this case. Chesapeake has no contractual right with respect to the mineral estate in the

southeast quarter of Section 4, Township 21 South, Range 35 East, NMPM. Stipulation, page 2.

12. On February 27, 2005, Mewbourne ran electric logs showing over 40 feet of Morrow porosity on its Osudo 9 State Com. Well No. 1 (Osudo 9 well) located in the southeast quarter of the northeast quarter of Section 9, Township 21 South, Range 35 East, NMPM, being the quarter section immediately south of the southeast quarter of Section 4, Township 21 South, Range 35 East, NMPM. On March 8, 2005, Mewbourne placed that well on line and began selling natural gas. The Osudo 9 well is a prolific producer of natural gas from the Morrow formation and is owned by Mewbourne, Chesapeake, and Finley Resources. Stipulation, page 2.

13. On March 9, 2005, Chesapeake sent a letter to Samson (received on March 11, 2005) proposing the drilling of the KF 4 well "in the south half of Section 4" and requesting the recipient to elect whether or not to participate. The letter also invited Samson to enter into negotiations for sale of its interest to Chesapeake, but stated, "be advised that entering into negotiations to sell Samson's interest does not excuse or allow Samson to delay the required election under this well proposal". Chesapeake also sent a similar proposal letter to Kaiser-Francis. Chesapeake did not send a proposal letter to Mewbourne because Mewbourne had not yet obtained an interest in the proposed spacing unit. Stipulation, pages 2 and 3.

14. On March 10, 2005, Chesapeake Operating, Inc. filed an APD for the KF 4 well, designating a lay-down spacing unit consisting of the southeast and southwest quarters of Section 4, Township 21 South, Range 35 East, NMPM. Stipulation, page 2.

15. The Division approved Chesapeake's APD on March 11, 2005. Stipulation, page 2.

16. There was no operating agreement between Chesapeake and Samson or Kaiser-Francis that would require an election, and Chesapeake knew that there was no such agreement. Stipulation, page 3.

17. On March 22, 2005, Samson signed and returned Chesapeake's election letter and authorization for expenditures, indicating that it elected to participate in the proposed KF 4 well, but did not send its portion of the dry hole costs as requested in the letter. Stipulation, page 3.

18. On March 28, 2005, Mewbourne, as operator on behalf of Samson et al., filed an APD for its proposed Osudo 4 State Com. No. 1. The Mewbourne APD proposed a location in the southeast quarter and the east half of the middle third of Section 4, Township 21 South, Range 35 East, NMPM. The Division rejected Mewbourne's APD on March 30, 2005 because of its earlier approval of Chesapeake's APD. Stipulation, page 3.

19. On March 30, 2005, Samson sent a letter and fax to Chesapeake stating that "Samson hereby rescinds and revokes its invalid election to participate in [the KF 4 well]". Stipulation, page 3.

20. On April 15, 2005, Chesapeake began site construction for the KF 4 well. Stipulation, page 3.

21. On April 20, 2005, Mewbourne, as the last of the designated parties (Kaiser-Francis, Samson, and Mewbourne) signed a communitization agreement providing for a communitized unit in the Morrow consisting of the southeast quarter and the east half of the middle third of Section 4, Township 21 South, Range 35 East, NMPM. Stipulation, page 3.

22. On April 26, 2005, the applications in Case No. 13492 and Case No. 19493 were filed with the Division. Stipulation, page 3. In Case No. 13492 Samson et al sought cancellation of two drilling permits and approval of a drilling permit and in Case No. 193493 Chesapeake applied for compulsory pooling, Lea County, New Mexico.

23. On April 27, 2005, the New Mexico State Land Office approved the communitization agreement described above in paragraph 20, noting that, "[t]he effective date of this approval is April 1, 2005".

24. On April 27, 2005, Chesapeake spudded the KF 4 well. Stipulation, page 3.

25. Chesapeake completed the KF 4 well and placed it in production in January 2006. Stipulation, page 3.

26. As of April 2006, the KF 4 well had produced 270, 279 Mcf of gas and 2, 286 barrels of oil. Stipulation, page 3.

CONCLUSIONS REGARDING LEGAL ISSUES

27. It is undisputed that Chesapeake did not own, and does not own, title to the minerals or surface of the southeast quarter of Section 4, Township 21 South, Range 35 East, NMPM where it drilled the KF 4 well.

28. If Chesapeake had any contractual right in the southeast quarter of Section 4, Township 21 South, Range 35 East, NMPM, it arose by virtue of Samson's election letter and authorization for expenditures approval. Samson rescinded those prior to Chesapeake drilling the KF 4 well.

29. The facts existing at the time of the Division's approval of Chesapeake's SPD were materially distinguishable from the facts in Case No. 13153, *Application of Pride Energy Company, etc.*

30. In *Application of Pride Energy Company, etc.* the Commission found that an operator could file an application for permit to drill before it filed a pooling application. It did not find that an operator could actually drill a well on acreage in which it had no interest before the Division or Commission decided a pooling application.

31. In this matter Chesapeake drilled a well on acreage it did not have an interest in before the Division or Commission decided on the pooling application.

32. As such, since it is within the Commission's discretion whether to allow a risk charge for drilling the well, the Commission finds that Chesapeake should not be allowed a risk charge for drilling the KF 4 well on acreage it did not have an interest in prior to the Division or Commission deciding on the pooling application.

33. To prevent further misunderstandings in the interpretation of the Commission's orders, particularly in Case No. 13153, *Application of Pride Energy Company, etc.*, Order No. R-12108-C and *Application of TMBR/Sharp, Inc.*, Order R-11700-B, the Commission approves of the language on Division Form C-102, field 17, concerning the operator's certification and asks the Division to continue its use and to notify the Commission if it plans to discontinue its use. That certification states "I hereby certify that the information contained herein is true and correct to the best of my knowledge and belief and that the organization either owns a working interest or unleased mineral interest in the land, including the proposed bottomhole location, or has a right to drill this well at this location pursuant to a contract with an owner of such mineral or working interests or in a voluntary pooling agreement or compulsory pooling order hereto entered by the Division".

34. Chesapeake indicated that it no longer intends to drill a well at the location of its proposed Cattlemen 4 State Com Well No. 1. See Order No. R-12343-B, page 20.

35. Accordingly, the application of Samson et al, in Case No. 13492, for cancellation of the permit to drill for the Cattleman 4 State Com Well No. 1 should be approved.

CONCLUSIONS REGARDING TECHNICAL ISSUES

36. The isopach maps (maps of the oil and gas producing layers that estimate the location and depth of those layers) created by the geologists of each party support their respective positions on what should be the correct orientation of the spacing unit. Each was bound by his interpretation of the existing well control (other existing wells in the vicinity that are drilled in the same formation that have production from that formation or did not have production) and was free to project contours into areas void of data based on an overall interpretation of general trends,

37. Both Chesapeake and Samson et al presented logical interpretations of the data in these cases. No effective well control exists either to the north or to the west that could preclude projection of the Osudo 9/KF 4 reservoir in either of those directions.

38. The parties interpreted the thickness of the Morrow sands (oil and gas producing layers) of several wells differently. Some of the older wells have only sonic logs, which are sometimes difficult to relate to neutron-density logs. In addition, a lime matrix was used to scale the neutron-density logs. These differences significantly affected the way the geologists drew the contours for the Morrow. The interpretations seemed to agree on the western edge of the maps (three to four miles west of the subject area) but disagreed locally over the area in question.

39. Both parties agree that the Central Basin Platform (CBP) exists to the east. Chesapeake's geologist testified that the CBP was a local source of Morrow sediments and influenced the local flow direction of the Morrow channels. Samson et al's geologist testified the Morrow sands originated from the Pedernal highlands to the north, and the CBP was too low and swampy in Morrowan times to contribute to the Morrow sands.

40. The Chesapeake geologist attempted to separate the Middle Morrow sands into layers and mapped each of these lenses using existing well control. Chesapeake did not relate the direction of the Morrow sand channels with the mapped top-of-Morrow structure or the north-south faulting and pointed out that one of the best Morrow wells, a well in Section 5, exists on a structural high (an elevated area within the geologic layer).

41. The Delaware Basin began forming in the late Mississippian period into the early Pennsylvanian period. Samson Exhibit 12, page 38.

42. The Delaware Basin's axis lies west of the KF 4 well area and trends in a north/northwest-south/southeast lineation. Samson Exhibit 12, pages 39 and 42.

43. Pennsylvanian age Morrowan sediments are fine-grained sandstone and shale that eroded from areas north, east and northwest of the Delaware Basin. See Chesapeake Rebuttal Exhibit 9.

44. The Pedernal highlands located northwest of the KF 4 well area were the primary source for Morrowan sediments. See Samson Exhibit 12, page 39.

45. The erosion of the Mississippian section off the exposed CBP provided additional sediments. See Samson Exhibit 12, page 39; Transcript, pages 761 through 767 and 788.

46. The Barnett shale, which consists of partly silty, brown shale and contains very fine-grained sandstone and siltstone, overlies the Mississippian limestone. See Sampson Exhibit 12, page 38 and Samson Exhibit 10, page 414.

47. The Midland Basin had not yet formed during the Morrowan period and was therefore an area of non-deposition. Transcript, page 724.

48. In addition, the CBP's western boundary contained greater structural relief and vertical separation than the eastern boundary so erosion would be to the west. See Samson Exhibit 16, page 163.

49. During lowstands during the Pennsylvanian period fluvial systems would have trended in an east-west direction with a possible southwesterly component. Transcript, page 785. Samson Exhibit 18, page 149.

50. In addition, fluvial systems from the Pedernal highlands would have been in a northwest to southeast direction and the two would have converged. Transcript, page 785; Samson Exhibit 18, page 149.

51. Both the Pedernal highlands and the CBP provided sediments to the subject area, and as a result the sands in the reservoir area are a coalescence of sands that are oriented both north-south/northwest-southeast and east-west. As a result the Commission should create a 640-acre proration unit consisting of the south two-thirds of Section 4, Township 21 South, Range 35 East, NMPM, in order to prevent waste and protect correlative rights.

52. The Commission also takes administrative notice that the special rules and regulations for the North Osudo-Morrow Gas Pool provide for a standard unit containing 640 acres.

IT IS THEREFORE ORDERED THAT:

1. All uncommitted mineral interests, whatever they may be, in the oil and gas from the top of the Wolfcamp formation to the base of the Morrow formation underlying the south two-thirds of irregular Section 4, Township 21 South, Range 35 East, NMPM, Lea County, New Mexico are hereby pooled forming a 640-acre, more or less, spacing unit in all pools or formations within that vertical extent, including but not limited to the South Osudo-Morrow Gas Pool (82200) (the Unit).

2. There may be up to four total wells drilled in the Unit including the KF 4 well. Future wells shall be located at standard locations.

3. While the Commission will not cancel the APD for the KF 4 well, effective on the date of this order, Samson is hereby designated the operator of the Unit, the KF 4 well and any subsequent wells in the Unit.

4. 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, including un-leased mineral interests, who are not parties to an operating agreement governing the unit as established by this order)

5. Chesapeake shall furnish the Commission and each known pooled working interest owner (including non-consenting working interest owners) an itemized

schedule of actual well costs for the KF 4 well, including invoices and other documentation, as well as sales documents within 30 days following this order. Pooled working interest owners shall file any objections to the documentation or well costs with the Commission within 30 days following receipt of the documentation. If there is an objection to actual well costs, the Commission will determine reasonable well costs at a regularly scheduled meeting after public notice and hearing.

6. Pursuant to NMSA 1978, Section 70-2-17, the well costs for the KF 4 well shall be divided according to the pooled working interest owners in the Unit, with all pooled working interest owners paying their pro rata share of the reasonable, actual well costs. Such costs shall not include a risk charge, but shall include reasonable, actually incurred charges for supervision. Pooled working interest owners shall offset costs and proceeds from production shall be credited to the parties from the date of first production of the KF 4 well.

7. Reasonable charges for supervision for the KF 4 well (combined fixed rates) shall not exceed $7,000 per month while drilling and $750 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III. LA. of the COPAS form titled *"AccountingProcedure-Joint Operations"*.

8. Except as provided above, all proceeds from the production from the KF 4 well that are not disbursed for any reason shall be placed in escrow in Lea County, New Mexico, to be paid to the true owner upon demand and proof of ownership. The operator shall notify the Commission of the name and address of the escrow agent within 30 days from the date of first deposit with the escrow agent.

9. For any additional wells that the operator may drill in the Unit (wells other than the KF 4 well), the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of drilling, completing and equipping the well ("well costs").

10. For additional wells, within 30 days from the date the operator furnishes the schedule of estimated well costs, a pooled working interest owner may pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production. Pooled working interest owners who elect to pay their share of estimated well costs 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 well costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners".

11. For additional wells, the operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual wells costs within 90 days following completion of the well. If the Division does not receive an objection within 45 days following receipt of the schedule, the actual well costs shall be deemed to be the reasonable well

costs. If there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

12. For additional wells, within 60 days following determination of reasonable well costs, any pooled working interest owner who has paid its share of estimated costs in advance shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

13. For additional wells, the operator is hereby authorized to withhold the following costs from production:

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

(b) as a charge for the risk involved in drilling the well, 200% of the above costs.

14. For additional wells, the operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the well costs.

15. For additional wells, reasonable charges for supervision (combined fixed rates) are hereby fixed at $7,000 per month while drilling and $750 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.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.

16. Except as provided in Ordering Paragraphs 13 and 15 above, all proceeds from production of additional wells that are not disbursed for any reason shall be placed in escrow in Lea County, New Mexico, to be paid to the true owner upon demand and proof of ownership. The operator shall notify the Division of the name and address of the escrow agent within 30 days from the date of first deposit with the escrow agent,

17. Upon final plugging and abandonment of the KF 4 well and other wells drilled on the unit pursuant to Division rules, the Unit created by this order shall terminate, unless this order has been amended to authorize further operations.

18. The permit to drill issued to Chesapeake for the Cattleman 4 State Com Well No. 1 is cancelled.

19. An operator shall not file an application for permit to drill or drill a well unless it owns an interest in the proposed well location or has a right to drill the well as stated in Division Form C-102.

20. The Commission retains jurisdiction of this matter for entry of such further orders as may be necessary.

DONE at Santa Fe, New Mexico on the 16th day of March 2007.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

JAMI BAILEY, C.P.G., MEMBER

WILLIAM OLSON, MEMBER

MARK E. FESMIRE, P.E., CHAIR

SEAL

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

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

Case No. 13957 (de novo)
Order No. R-1960-B

THE APPLICATION OF ENERGEN RESOURCES CORPORATION TO AMEND THE COST RECOVERY PROVISIONS OF COMPULSORY POOLING ORDER NO. R-1960, TO DETERMINE REASONABLE COSTS, AND FOR AUTHORIZATION TO RECOVER COSTS FROM PRODUCTION OF POOLED MINERAL INTEREST, RIO ARRIBA COUNTY, NEW MEXICO

ORDER OF THE COMMISSION

IN THIS MATTER, having come before the New Mexico Oil Conservation Commission ("Commission") on May 27, 2009 at Santa Fe, New Mexico, on (i) Energen Resources Corporation ("Energen") Application to the New Mexico Oil Conservation Division ("Division") for reformation of compulsory pooling order No. R-1960 and (ii) JAS Oil and Gas Co., LLC's Application for Hearing De Novo, the Commission, having carefully considered the evidence and other materials submitted by the parties, now, on this 13th day of August, 2009:

FINDS THAT:

1. Applicant, Energen Resources Corporation, ("Energen") is the operator of a Pictured Cliffs formation well located in Rio Arriba County. The well at issue is one of a number of properties acquired in 1997 from Energen's predecessor operator, Burlington Resources. The well is subject to a compulsory pooling order issued in 1961 ("Pooling Order"), which pooled certain unleased mineral interests. (Energen Ex.1).

2. The Pooling Order is Order No. R-1960, entered by the Commission in Case No. 2249 on May 5, 1961 ("Pooling Order"). That order established a compulsory pooled unit ("Unit") comprised of SW/4 of Section 2, Township 25 North, Range 3West, NMPM, in Rio Arriba County, New Mexico, as to the Pictured Cliffs formation in the Tapacito-Pictured Cliffs Gas Pool (985920).

3. The Unit was dedicated to the well at issue, the Martinez Well No. 1 (API No. 30-039-06124), located 790 feet from the South line and 790 feet from the West line (Unit M) of Section 2 ("Well No. 1"). Southern Union Production Company ("Supron"),

EXHIBIT F

the applicant in the original pooling case, was designated operator. (Comp. Energen Exs. 2 and 6).

4. Well No. 1 was drilled and completed by Supron in 1961. Initially, the well was operated by Supron. (Tr., p. 20).[1]

5. Through a series of transfers and acquisitions, in August 1997 Taurus Exploration USA, Inc. acquired Supron's interests in Well No. 1 and became the operator.

6. Subsequently, on October 1, 1998, through a corporate change of name, Taurus Exploration USA, Inc. became Energen Resources Corporation. Energen continues to operate Well No. 1. (Tr., pp. 20, 93).

7. At the time Well No. 1 was drilled, Joseph A. Sommer ("Sommer") was the owner of an unleased mineral interest in the S/2 SW/4 of Section 2 comprising approximately 8.33333% of the Unit. Pursuant to NMSA 1978, § 70-2-17, one-eighth of Sommer's interest is treated as a royalty interest, and seven-eighths of Sommer's interest is treated as a working interest. Tr., p. 22; Energen Ex. 6).

8. Sommer did not contractually commit his interest to Well No. 1 and did not otherwise elect to participate under the Pooling Order. Accordingly he became a nonconsenting party, as to his working interest. Tr., p. 22).

9. Sommer's interest was subsequently conveyed to the Joseph A. Sommer Trust and currently is owned by JAS Oil and Gas Co., LLC's (collectively the Sommer's/Trust/JAS interest will be referred to herein as "JAS." (Energen Ex. 7); Tr., p. 97).

10. By letter dated March 17, 1992, Meridian Oil Inc. ("MOI"), a predecessor in Energen's interest, advised all of the working interest owners in the properties it operated, including the Martinez No. 1, that it would discontinue selling gas on behalf of the other working interest owners beginning on May 1, 1992 (Energen Ex. 4). By that same letter MOI advised the non-marketing interest owners to make arrangements for marketing their gas.

11. By letter dated September 28, 1995, MOI notified JAS that MOI's affiliate, Meridian Oil Trading Inc. would no longer purchase gas from the working interest owners in Well No. 1. (Energen Ex. 5).

12. When Energen took over operation of Well No. 1, in August 1997, JAS was overproduced in the amount of 1031 mcf of gas. (Tr., p. 23).

13. At least since August 1997, JAS has not made arrangements for the sale of its share of gas from Well No. 1, and it has not authorized Energen to market gas on its

[1] References to the transcript of the May 27, 2009, hearing of this matter are denoted by a "Tr." followed by the cited page number.

behalf. ("... Energen commenced and continued to sell my 8.3333% of the total gas produced to which it had no title and for which sale it had no authorization. ... Nothing in the Pooling Order of May 1961 purports to authorize Southern Union Production Company as owner of a 50% operating interest to produce and sell more gas than is required for the payment of reasonable costs of its production.") (Energen Ex. 14).

14. The Pooling Order is silent as to the sale of a nonoperating interest owner's share of production. (Energen Ex. 1).

15. If it is the case that JAS' gas has not been marketed, as of January 2009, JAS was underproduced in the amount of 8,378 mcf of gas. (Energen Ex. 25).

16. Evidence was not tendered to show whether Energen received a credit for JAS's overproduction when Energen purchased its predecessor's interest in Well No. 1.

17. It is a custom and practice of the oil and gas industry to implement gas balancing when less than all interest owners in a well have their gas sold. (Tr., pp. 24, 26).] Doing so allows gas for marketing parties in a well to be sold and avoids the shut-in of the well when less than 100% of the interest owners have made arrangements for the disposition of their share of gas. In such situations, the accounts of selling interest owners become "overproduced" and nonmarketing parties become "underproduced." When an underproduced party sells its gas, the operator often inflates its interest to allow it to "make-up" its underproduced position. If the non-selling interest owner's gas is treated as though it has not been produced by its owner and is not in the ground at depletion of the well, the operator typically will pay the non-selling interest owner at the historical price. (Tr., pp. 24-27)

18. There is no gas balancing agreement between JAS and Energen or any of its predecessors-in-interest with respect to Well No. 1.

19. Energen has suggested that JAS make up its underproduction by taking 40% more gas than it is entitled to for its 8 1/3% working interest. At that rate, it would take JAS 49 years to make up its underproduction. (Energen Ex. 16; Tr., p. 70.

20. Credible evidence was not introduced at the hearing that Well No. 1, drilled in 1961, could be economically produced until 2058.

21. If JAS's gas is treated as though it is underproduced, and if JAS cannot take sufficient amounts of gas to make up for its underproduction before the end of the life of Well No. 1, then, when it is no longer economically feasible to produce Well No. 1, JAS's gas must be left in the ground, which amounts to waste and/or an infringement of JAS's correlative rights.

22. NMSA 1978, § 70-2-2 prohibits "the production or handling of crude petroleum oil or natural gas of any type or in any form, or the handling of products thereof, in such manner or under such conditions or in such amounts as to constitute or result in waste...."

23. NMSA 1978, § 70-2-11 provides that "[t]he division is hereby empowered, and it is its duty, to prevent waste prohibited by this act and to protect correlative rights, as in this act provided. To that end, the division is empowered to make and enforce rules, regulations and orders, and to do whatever may be reasonably necessary to carry out the purpose of this act, whether or not indicated or specified in any section hereof."

24. NMSA 1978 70-2-17(A) provides that "[t]he rules, regulations or orders of the division shall, so far as it is practicable to do so, afford to the owner of each property in a pool the opportunity to produce his just and equitable share of the oil or gas, or both, in the pool, being an amount, so far as can be practically determined, and so far as such can be practicably obtained without waste, substantially in the proportion that the quantity of the recoverable oil or gas, or both, under such property bears to the total recoverable oil or gas, or both, in the pool, and for this purpose to use his just and equitable share of the reservoir energy."

25. If it is uncertain that JAS's share of the gas may be balanced prior to the time that Well No. 1 is no longer capable of being economically produced, and if leaving JAS's gas in the ground results in prohibited waste and/or an infringement of JAS's correlative rights, the Commission must treat JAS's gas as though it has been sold by Energen.

26. NMSA 1978 70-2-17(C) provides that "[a]ll orders effecting such pooling shall be made after notice and hearing, and shall be upon such terms and conditions as are just and reasonable and will afford to the owner or owners of each tract or interest in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil or gas, or both. ... Such pooling order of the division shall make definite provision as to any owner, or owners, who elects not to pay his proportionate share in advance for the pro rata reimbursement solely out of production to the parties advancing the costs of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, but which shall include a reasonable charge for supervision and may include a charge for the risk involved in the drilling of such well, which charge for risk shall not exceed two hundred percent of the nonconsenting working interest owner's or owners' pro rata share of the cost of drilling and completing the well."

27. Supervision charges for Well No. 1 are not specified in the Pooling Order, and it does not provide for escalation of such charges. (Energen Ex. 1).

28. Certain unleased mineral owners in Well No. 1 (excluding JAS) executed a December 12, 1984 operating agreement with Union Texas Petroleum Corporation, an Energen predecessor–in-interest. That operating agreement provided for overhead rates for a producing well of $350/month, subject to escalation under the COPAS accounting procedure. (JAS Ex. 12). Under the cost escalation provision, operating costs for the well would be $866.16/month in 2009. (Energen Ex. 22).

29. Over the years, although JAS did not execute the 1984 operating agreement, Energen has billed JAS for operating expenses, including an overhead charge calculated

pursuant to the 1984 operating agreement. JAS has refused to pay those expenses, and has objected that the overhead rate is not reasonable. (Energen Ex. 14).

30. JAS and Energen are subject to an operating agreement dated March 1, 2006 for the McCroden Well No. 1, a well completed in the Mesa Verde formation located in the W/2 of the same Section 2, Township 25 North, Range 3 West, NMPM. Energen Ex.18. The initial producing well overhead rates in the agreement are $350/month.

31. Energen's list of producing overhead rates for its non-operated Pictured Cliffs wells shows that a majority of the overhead rates are in the $500/month range or lower. Energen Ex. 20.

32. The Ernst & Young overhead rate survey for 2008-2009 reflects a median rate for wells in the San Juan Basin completed at depths of 5000-10000 feet of $550/month. Tr., p. 57.

33. Energen Exhibit 21 reflects the Cumulative COPAS Escalation Percentage as of April 1, 2008.

34. Based on the evidence presented at the hearing, the Commission finds that an overhead rate of $550 for 2009 is a reasonable rate.

CONCLUSIONS

A. The Commission has jurisdiction over this matter and the parties hereto.

B. The Commission must treat JAS's gas as though it has been sold by Energen.

C. Retrospectively, for JAS to obtain its fair share of production, it should receive the price at which gas actually was sold by Energen.

D. Because JAS refused to market its own production, and refused to authorize Energen to market JAS's share of production, Energen is not subject to penalty interest.

E. NMSA 1978, § 70-10-1 *et seq.*, the Oil and Gas Proceeds Payment Act, is instructive on interest rates. Under the Oil and Gas Proceeds Payment Act, if a person entitled to payment may not be located or may not be determined, the operator is obliged to create a suspense account, into which payment is to be made. The person entitled to such payment is required to receive that payment, plus interest that is equal to the discount rate charged by the federal reserve bank of Dallas to member banks plus one and one-half percent ("OGPPA Rate").

F. Additionally, because JAS has paid no expenses to Energen, JAS must account to Energen for reasonable expenses, including overhead charges.

G. If $550 is a reasonable overhead charge for 2009, reasonable annual historic charges may be calculated using the Cumulative COPAS Escalation Percentage that is Energen Exhibit 21.

H. Prospectively, in order to prevent the current situation from arising again, if Energen and/or its successors-in-interest are marketing production from Well No. 1, Energen and its successors in interest will also need to market JAS's share of production from Well No. 1, and pay and account to JAS for same, if JAS does not do so.

IT IS THEREFORE ORDERED THAT:

(a) Energen will select and pay for an independent auditor to audit the JAS account related to Well No. 1. The audit will cover the period of time from the date in 1997 when Energen purchased its predecessor's interest in Well No. 1 to the present ("Audit Period"). The audit will determine for each historic sale by Energen of production from Well No. 1 during the Audit Period (i) the amount of such production that is attributable to JAS's interest in Well No. 1, as though Energen was marketing JAS's interest in production at that time, (ii) the historic price at which Energen sold such production, (iii) the amount that Energen charged working interest owners for the actual operating expenses of Well No. 1, and (iv) assuming that Energen was marketing JAS's share of production from Well No. 1 during the Audit Period, anything else necessary for calculating JAS's share of the historic proceeds received by Energen. The auditor also will calculate the Recalculated Overhead (hereinafter defined) and the Lump Sum Payment (hereinafter defined).

(b) Results of the audit will be used to calculate a Lump Sum Payment by Energen to JAS for the net value of JAS's production, deemed to have been sold by Energen during the Audit Period. In part, the Lump Sum Payment will be the volume of gas produced during the Audit Period that is attributable to JAS's interest in Well No. 1, as though Energen were marketing JAS's gas at the time, sold at the historic prices received by Energen, less the actual operating expenses. Additionally, the payment should be net of an overhead charge. In determining the overhead charges, however, the charges historically levied by Energen shall not be used. For 2009 the overhead charge will be JAS's share of $550 per month. Monthly charges for prior years shall be calculated by using $550 per month in 2009 as a base and deescalating the monthly overhead charge in any given year using the Cumulative COPAS Escalation Percentages that are Energen Exhibit 21. Overhead charges so calculated may be referred to herein as "Recalculated Overhead."

(c) Interest due from Energen to JAS on any historic sale of gas will be calculated from the historic date of payment to Energen to the date that Energen makes payment to JAS. Interest shall be calculated on any given sale at the historic OGPPA Rate.

(d) The Lump Sum Payment, then, shall be, for each sale of Well No. 1 production by Energen: (i) the volume of gas produced during the Audit Period that is attributable to JAS's interest in Well No. 1, as though Energen were marketing JAS's gas at the time, (ii) sold at the historic prices received by Energen, (iii) less the actual operating expenses,

(iv) less Recalculated Overhead, plus interest on the net amount at the historic OGPPA Rate.

(e) The audit shall be completed no later than six months after the date that this Order is entered. Upon completing the audit, the auditor will deliver a complete copy of the audit to Energen and to JAS. Either party, within 30 calendar days of receiving the auditor's report, may appeal all or a portion of the report to the Commission, which retains jurisdiction for that purpose and as otherwise allowed by law.

(f) From the date of this Order forward, if Energen and/or its successors-in-interest are marketing production from Well No. 1, Energen and its successors-in-interest also shall market JAS's share of production from Well No. 1, and pay and account to JAS for same, until 30 days after Energen receives written notice from JAS of arrangements that have been made by JAS to market its own production from Well No. 1. From the date of this Order forward, Energen may deduct from the total sales price of JAS's production, actual operating costs, as well as JAS's working interest share of an overhead charge of $550/month for 2009, escalated annually at the relevant COPAS escalation percentage.

(g) Order No. R-1960-A is hereby vacated and of no further force and effect

(h) Energen will file a division order that accurately sets forth the percentage interest of all interest owners in the Well No. 1 (see, e.g. NMSA 1978, 70-10-3.1(B)) and that is consistent with the terms of the Commission's Order. JAS will execute the Division Order.

DONE at Santa Fe, New Mexico on the 13th of August 2009.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

JAMI BAILEY, CPG, MEMBER

WILLIAM OLSON, MEMBER

MARK E. FESMIRE, P.E., CHAIR

SEAL