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WRITER:

Scott S. Morgan  
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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: E $\frac{1}{2}$ E $\frac{1}{2}$

Section 33: All

Section 34: S $\frac{1}{2}$

**Township 26 South, Range 28 East, N.M.P.M.**

Section 2: W $\frac{1}{2}$

Section 3: All

Section 4: All

Section 5: All

Section 6: E $\frac{1}{2}$

Section 7: E $\frac{1}{2}$

Section 8: All

Section 9: All

Section 10: All

Section 15: All

Section 16: E $\frac{1}{2}$ E $\frac{1}{2}$

Section 17: All

Section 18: E $\frac{1}{2}$

Section 20: All

No. 32,348

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

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

Attention: Mr. Aaron Myers, Senior Landman

PO BOX 10  
ROSWELL, NEW MEXICO 88202  
(575) 822-6510  
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PO BOX 1720  
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NMOCD CASE Nos. 15441, 15481, 15482  
NEX, SRO2 LLC AND SRO3 LLC  
Exhibit No. 22  
May 4, 2016

Township 25 South, Range 28 East  
Sections 16, 19, 20, 21, 28, 29, 30, 31, 32, and 33: All

Township 26 South, Range 28 East  
Section 4: W½  
Sections 5, 6, 7, and 8: All

Township 26 South, Range 27 East  
Sections 1 and 12: All

Neither OGX nor Legend committed Leases V-7440, V-7441, and/or V-7443 to the SRO State Exploratory Unit, and we show these tracts as not committed due to their contractual interest under the Myox Operating Agreement.

**Leases V-7447 and V-7448 (Unit Tracts 23 and 25):**

20. **Chalfant - Chesapeake:** By Assignment of Oil and Gas Leases dated August 4, 2005, approved by the Commissioner of Public Lands on August 23, 2005, Chalfant Properties, Inc. conveyed to Chesapeake Exploration Limited Partnership all of its record title in Leases V-7447 and V-7448 covering Unit Tracts 23 and 25.

21. **Chesapeake - Chesapeake:** An Affidavit of Identity and Corporate Successorship dated August 6, 2007, recorded in Eddy County Records Book 706, page 988, and in Commissioner's Miscellaneous Book 3, Instrument No. 7544, W. Wade Drawley, Vice President of Chesapeake Exploration, LLC, reflects that Chesapeake Exploration Limited Partnership merged into Chesapeake ORC, LLC, which then changed its name to Chesapeake Exploration, LLC.

22. **Chesapeake - Chevron:** By Assignments of Oil and Gas Lease approved by the Commissioner on December 26, 2012, and January 4, 2013, Chesapeake Exploration, LLC conveyed all of the record title in Leases V-7447 and V-7448 to Chevron U.S.A. Inc. By Assignment, Bill of Sale and Conveyance dated effective July 1, 2012, recorded in Eddy County Records Book 912, page 297, Chesapeake Exploration, LLC, among others, conveyed to Chevron U.S.A. Inc. all of its interest in and to the following:

Township 26 South, Range 28 East, N.M.P.M.  
Sections 2 - 5; 7 - 10; 15 - 18; and 20

Township 25 South, Range 28 East, N.M.P.M.  
Sections 32 - 34

and any and all unitization agreements and other agreements associated or related to those properties. This Assignment is subject to a Purchase and Sale Agreement between the parties dated September 6, 2012, and we refer you to Exception to Title No. 5(e) below.

**Lease V-7450 (Unit Tract 26):**

23. **Schutz - Nearburg:** By Assignment of Oil and Gas Lease dated July 8, 2005, approved by the Commissioner on October 4, 2005, recorded in Eddy County Records Book 616, page 593, Doug J. Schutz, a single man, assigned Lease V-7450 to Nearburg Exploration Company, LLC.

24. **Nearburg - Marbob:** By Term Assignment of Oil and Gas Lease dated effective July 1, 2009, recorded in Eddy County Records Book 790, page 530, Nearburg Exploration Company, LLC assigned to Marbob Energy Corporation all of its interest in Lease V-7450 covering Unit Tract 26 for all depths from the surface down to the base of the Bone Spring Formation for a term commensurate with the SRO Exploratory Unit Agreement. Nearburg reserved an override equal to the difference between 25% of 8/8 and the aggregate of all royalty, overriding royalty interest, production payments, and other noncost bearing interests. The override is to be computed and paid at the same time and in the same manner as the royalty payable to the lessor of the lease, and shall bear its proportionate share of taxes and assessments. The override shall be proportionately reduced if the interest assigned is less than a full working interest in the lease. The Assignment provides for a reassignment should unitized substances in paying quantities be discovered and the assignee chooses not to continue drilling operations.

If the lands covered by the lease are eliminated from the unit area after the end of the primary term of the lease but the Unit Agreement remains in effect as to any of the lands embraced therein,



assignor shall still be entitled to an overriding royalty interest in oil and gas produced from the lands remaining subject to the Unit Agreement equal to that which assignee was entitled to before any such elimination. The Assignment is subject to the Unit Agreement for Development and Operation of the SRO Unit Area dated May 8, 2009. Exhibit A to the Term Assignment includes extensive requirements for reporting well information to assignor. The Assignment was made with special warranty covenants.

Exhibit A-1 to the SRO State Exploratory Unit Operating Agreement recites that Nearburg assigned its interest under the Unit Agreement to all of the parties thereto in their proportionate interests, not just Marbob. Nearburg's only interest in the unit was Lease V-7450 covering Unit Tract 26 comprising 320 acres. Therefore, Nearburg owned a .04347826 unit working interest. Exhibit A-1 recites that Nearburg owns an override of .00415092, calculated as the difference between 25% and the 1/6 royalty, proportionately reduced to the acreage owned (which calculation is  $320/6424.280592 \times (.25 - 1/6)$ ). It appears on the exhibit that Nearburg was credited with a .04981102 unit working interest which is then credited to all of the parties to the unit, rather than just Marbob's successors, COG and Concho. We do not know why they calculated the override in this manner. Our calculation is  $(25\% - 1/6) \times 320/7360 = .00362319$ . Marbob's successors should execute an assignment of the other parties' pro rata interests which it acquired from Nearburg, and in this regard we make requirements below.

The term of this Term Assignment has clearly expired, as the SRO State Exploratory Unit was terminated effective March 1, 2014. Pursuant to our discussions with you, we understand you consider this Term Assignment as being in full force and effect. In this regard, we have the following requirement.

**REQUIREMENT D:** COG Operating LLC and Concho Oil & Gas LLC should execute an assignment to the other unit working interest owners of their pro rata share of the Nearburg interest in Lease V-7450 and record the same in the Eddy County records. The assignment should be submitted to us for review, and we reserve possible further requirement and possible revisions to Sections III and IV and our exhibits to this opinion.

**REQUIREMENT E:** Obtain an Amendment to this Term Assignment executed by Nearburg Exploration Company, LLC, COG Operating LLC, Concho Oil & Gas LLC and the other owners in Requirement D, which changes the term of the Term Assignment to be commensurate with the term of the SRO State Exploratory Unit Operating Agreement and sets forth how Nearburg's override is to be calculated. Provide a copy of the recorded Amendment for our review. In the event that you are unable to secure the amendment or the calculation of the override is different from how it is reported herein, resubmit this matter for our review, and we reserve further possible requirement.

**REQUIREMENT F:** If you have not already done so, note in your lease file the extensive reporting requirements under Exhibit A to the Term Assignment and comply with the same. This is advisory.

25. **Marbob - COG and Concho:** By the Assignment and Bill of Sale dated October 6, 2010 identified in Paragraph 5 above, Marbob Energy Corporation conveyed to COG Operating LLC (95%) and Concho Oil & Gas LLC (5%) all of its interest in Lease V-7450.

**Lease V-7473 (Unit Tract 27):**

26. **Marbob - Yates, et al.:** By Assignment of Oil and Gas Lease dated September 1, 2005, effective July 1, 2005, recorded in Eddy County Records Book 610, page 1109, Marbob Energy Corporation assigned an undivided 50% interest in operating rights in Lease V-7473 covering Unit Tract 27 to Yates Petroleum Corporation (12.5%), Yates Drilling Company (12.5%), Abo Petroleum Corporation (12.5%), and Myco Industries, Inc. (12.5%).

27. **Yates Drilling - OXY Y-1:** A Certificate by S. P. Parise, Assistant Secretary of OXY Y-1 Company which is recorded in Eddy County Records Book 835, page 435, reflects that Yates Drilling Company changed its name to OXY Y-1 Company. Attached to the Certificate are the filings with the New Mexico Public Regulation Commission dated October 6, 2010. We have credited the interest of Yates Drilling Company to OXY Y-1 Company.

28. **Marbob - COG and Concho:** By the Assignment and Bill of Sale dated October 6, 2010, identified in Paragraph 5 above, Marbob Energy Corporation conveyed to COG Operating LLC (95%) and Concho Oil & Gas LLC (5%) all of its interest in Lease V-7473.



that each specific override attributable to a tract shall be applicable to production allocated to that tract.

The Override Owners grant to the Working Interest Owners the right and authority to commit the Overriding Royalty Interests, or any of them, to a communitization agreement for purposes of combining the leases to form a spacing unit as required by the rules, regulations or orders of the OCD and to enter into project areas for the drilling of horizontal wells which are approved by the OCD and the allocation of production within the spacing unit and/or project area shall be on an acreage basis. The override shall then be proportionately reduced to the acreage within the tract for which the override is applicable divided by the total acreage within the spacing unit and/or project area as the case may be.

This Agreement provides that the Parties ratify the prior Assignments of Overriding Royalty. The Working Interest Owners succeeded to the interests formerly owned by Marbob and grant and convey to the Override Owners such interests as are necessary to fulfill the express intentions of the Agreement and Disclaimer. Likewise, the Override Owners relinquish and convey such interests to the Working Interest Owners and owners of record to the leases as are necessary to fulfill the express intentions of the Agreement and Disclaimer.

**REQUIREMENT G:** COG Operating LLC and Concho Oil & Gas LLC must execute the Agreement and Disclaimer and record it in the Eddy County Records.

C. **SRO Unit Agreement and Termination:** The Unit Agreement for the Development and Operation of the SRO Unit Area dated May 8, 2009, was approved by the Commissioner of Public Lands on May 29, 2009. The unit area is the captioned lands which is more particularly described on Exhibit "A" hereto and recited to cover 8,320 acres, more or less. This Unit Agreement covers all formations from the surface down to the base of the Bone Spring formation and unitized substances include all oil, gas, natural gasoline, and associated fluid hydrocarbons in any form from those formations. The Marbob Teddy Graham State No. 1 Well in Section 9, T-26-S, R-28-E, indicates that the base of the Bone Spring formation is at 9,333 feet subsurface. Marbob was designated unit operator. This is a state exploratory unit agreement which is a "full participating" unit agreement that calls for the allocation of all production each of the tracts committed thereto on an acreage basis. Paragraph 9 of the Unit Agreement provides that after discovery of unitized substances in paying quantities, the unit operator will proceed with diligence to develop the unitized area and that all undeveloped regular well spacing or proration units within the unit boundaries will be automatically eliminated from the agreement and will no longer be part of the unit unless at the expiration of five years after the first day of the month following the effective date of this agreement, diligent drilling operations are in progress on said tracts. Paragraph 13 of the Unit Agreement provides that all leases, contracts, and agreements concerning the unit area are conformed to the provisions of the Unit Agreement to the degree necessary to coincide with the terms of the Agreement. Each lease committed to the unit, insofar as it applies to lands within the unit area, shall continue in force beyond the term provided as long as the Agreement remains in effect, provided drilling operations on the initial well shall have been commenced. State leases subject to the Unit Agreement are segregated as to any portions of the leases not committed to the unit. This specifically results in the segregation of Leases VB-0575 (Unit Tract 1) and V-7446 (Unit Tract 22). Paragraph 22 provides for subsequent joinder upon approval of the Commissioner of Public Lands, but there will be no retroactive adjustment of revenue upon a subsequent joinder. We know that you are familiar with the terms of this Unit Agreement and will not analyze all of the terms and provisions thereof.

The Unit Agreement was executed by Marbob Energy Corporation as operator, and ratifications and joinders were executed by Yates Petroleum Corporation, Myco Industries, Inc., Abo Petroleum Corporation, Yates Drilling Company, Pitch Energy Corporation, The Allar Company, EG3, Inc., and Nearburg Exploration Company, LLC. Exhibit B to the Unit Agreement indicates that there are 7,360 committed acres and 960 not committed acres to the Unit Agreement, for a total acreage of 8,320 acres. The SRO Unit is completely comprised of state oil and gas leases and 5,600 acres of which are subject to a 1/6 royalty and 1,760 acres are subject to a 3/16 royalty. As a result, the State of New Mexico is credited with a royalty of .17164855 of all unitized substances produced from the unit area.

Section 17 of the SRO State Exploratory Unit Agreement provides that the Agreement may be terminated at any time by not less than 75%, on an acreage basis, of the owners of the working interests who are parties to the Agreement, with the approval of the Commissioner and with notice to the New Mexico Oil Conservation Division. You submitted for our review a Request for Voluntary Termination of the SRO State Exploratory Unit dated October 16, 2013 with an effective



termination date of March 1, 2014 which recites that the parties to the request represent more than the required 75%, on an acreage basis, of the working interest parties to the Agreement.

This Request recites that in conjunction with the approval of voluntary termination, the parties sought the approval of communitization agreements which were enclosed with the Request, each made effective March 1, 2014. The Request has been signed by: COG Operating LLC and Concho Oil & Gas LLC, as successors in interest to Marbob Energy Corporation, and Pitch Energy Corporation; Yates Petroleum Corporation; OXY Y-1 Company, as successor in interest to Yates Drilling Company; Myco Industries, Inc; Abo Petroleum Corporation; The Allar Company; EG3, Inc; and Nearburg Exploration Company, L.L.C.

The SRO State Exploratory Unit Agreement was terminated effective March 1, 2014. You have advised us that the SRO State Exploratory Unit Operating Agreement dated May 8, 2009 remains in full force and effect. We confirm that Article XIII provides for its term to be for as long as there is a well capable of producing plus 180 days after cessation to commence reworking or additional drilling operations.

As the SRO Unit was terminated, communitization agreements are necessary for those leases with wells within the Unit boundaries with project areas that include more than one lease. We refer you to Section VII, paragraph E for a discussion of these Communitization Agreements.

**D. Operating Agreements:** The materials examined reflect that the following Operating Agreements cover the captioned lands, or portions thereof, and appear to remain in force and effect.

1. **SRO State Exploratory Unit Operating Agreement:** The SRO State Exploratory Unit Operating Agreement dated May 8, 2009, names Marbob Energy Corporation as operator. Pitch Energy Corporation; Yates Petroleum Corporation; Yates Drilling Company; Myco Industries, Inc; Abo Petroleum Corporation; The Allar Company; EG3, Inc; Chesapeake Exploration, LLC; and Nearburg Exploration Company LLC are nonoperators. The Operating Agreement was prepared on AAPL Form 610-1982 Model Form Operating Agreement and the contract lands cover the following described lands:

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  
Sections 3 and 4: All  
Section 5: W½  
Section 7: E½  
Section 8: E½  
Sections 9, 10, and 15: All  
Section 16: E½E½  
Section 17: All  
Section 18: E½  
Section 20: All

limited to all depths from the surface down to the base of the Bone Spring formation. Article III B provides for payment of obligations to the extent of 1/6 and each party bears its excess burdens. Article VI A provides that the initial well is to be drilled at a legal location in Section 4 to a depth sufficient to test the Bone Spring formation. Article VI B 2 provides for nonconsent penalties of 200%/500%/500%. Additional typed written provisions on page 6A provide, among other things, that parties who elected to participate in the initial operations on any given well will have the option to participate as to each interval in which the completion is proposed and there will be a separate election as to each specific proposed completion depth. Article VII B provides for lien provisions running in favor of operator. Article VII D provides that no well shall be drilled or deepened without the consent of all parties except and unless done pursuant to Article VI B 2 nonconsent provisions. Article VII D 3 provides for a \$25,000.00 limitation on expenditures. Article VIII D, Maintenance of Uniform Interests, has not been deleted. Article VIII F, Preferential Right to Purchase, has been deleted. Article X provides for a \$15,000.00 settlement of claims provision. Article XIII states that the term of the agreement is for the life of any well drilled under the agreement and for an additional 180 days after cessation of production, with the usual reworking and continuous drilling provisions.



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



ready to produce on June 9, 2011 with a bottom hole location 354 feet FSL and 348 feet FWL Section 17, Township 26 South, Range 28 East, N.M.P.M. First production occurred on June 24, 2011 with a test being conducted on July 3, 2011. This test resulted in the recovery of 112 barrels of oil, 4,000 Mcf of gas and 1,895 barrels of water. The Request for Allowable and Authorization to Transport dated July 6, 2011 reflects that a gas connection was made on July 1, 2011 and that gas delivery was made that same day. You have advised us that the project area for the SRO State Com. No. 43H well is the  $W\frac{1}{2}W\frac{1}{2}$  Section 17 and  $W\frac{1}{2}W\frac{1}{2}$  Section 20, Township 26 South, Range 28 East, and we refer you to Exception to Title No. 1 below.

3. **SRO State Unit Well No. 16H:** You submitted for our review a Well Location and Acreage Dedication Plat dated June 28, 2012 which reflects that the Project Area for the SRO State Unit No. 16H well covers the  $S\frac{1}{2}S\frac{1}{2}$  Section 20, Township 26 South, Range 28 East, N.M.P.M. The Well Completion or Recompletion Report and Log dated July 10, 2012 reflects that the SRO 16H well was spudded on March 4, 2011 with a surface hole location 660 feet FSL and 330 feet FWL Section 20, Township 26 South, Range 28 East, reaching a total measured depth of 10,684 feet on March 25, 2011 with a plug back measured depth of 10,642 feet, being completed ready to produce on June 22, 2012 with a bottom hole location 331 feet FSL and 369 feet FWL Section 20, Township 26 South, Range 28 East, N.M.P.M. First production occurred on July 6, 2012 with a test being conducted on July 7, 2012. This test resulted in the recovery of 176 barrels of oil, 3,810 Mcf of gas and 2,680 barrels of water. The Request for Allowable and Authorization to Transport dated July 10, 2012 reflects that a gas connection was made on July 6, 2012 and that gas delivery was made that same day. You have advised us that the project area for the SRO State Com. No. 43H well is the  $W\frac{1}{2}W\frac{1}{2}$  Section 17 and  $W\frac{1}{2}W\frac{1}{2}$  Section 20, Township 26 South, Range 28 East, and we refer you to Exception to Title No. 1 below.

4. **SRO State Unit Well No. 20H:** You submitted for our review a Well Location and Acreage Dedication Plat dated February 27, 2014 which reflects that the project area for the SRO State Unit Well No. 20H covers the  $E\frac{1}{2}E\frac{1}{2}$  Section 3 and the  $E\frac{1}{2}NE\frac{1}{4}$  Section 10, Township 26 South, Range 28 East, N.M.P.M. The Well Completion or Recompletion Report and Log dated October 4, 2013, reflects that the SRO State Unit No. 20H well was spudded June 29, 2013 with a surface hole location at 190 feet FNL and 109 feet FEL, and reached a total measured depth of 15,303 feet on July 27, 2013, with a plugged back measured depth of 15,256 feet, being completed ready to produce on September 11, 2013 with a bottom hole location 2,296 feet FNL and 642 feet FEL Section 10, Township 26 South, Range 28 East, N.M.P.M. First production occurred on September 13, 2013 with a test being conducted on September 28, 2013. This test resulted in the recovery of 878 barrels of oil, 730 Mcf gas and 1,957 barrels of water. The Request for Allowable and Authorization to Transport dated October 21, 2013 reflects that a gas connection was made on September 24, 2013 and that gas delivery was made on September 25, 2013.

5. **SRO State Unit Well No. 53H:** You submitted for our review a Well Location and Acreage Dedication Plat dated June 27, 2013 which reflects that the project area for the SRO State Unit Well No. 53H covers the  $E\frac{1}{2}E\frac{1}{2}$  Section 16, Township 26 South, Range 28 East, N.M.P.M. The Well Completion Report and Log dated December 18, 2013, reflects that the SRO State Unit No. 53H well was spudded on October 18, 2013 with a surface hole location at 190 feet FNL and 560 feet FEL, and reached a total measured depth of 12,667 feet, with a plugged back measured depth of 12,664 feet being completed ready to produce on November 27, 2013 with a bottom hole location 335 feet FSL and 346 feet FEL Section 16, Township 26 South, Range 28 East, N.M.P.M. First production occurred on December 2, 2013, with a test being conducted on December 9, 2013. This test resulted in recovery of 1,279 bbls oil, 2,665 Mcf gas and 2,586 bbls water. The Request for Allowable and Authorization to Transport dated December 18, 2013 reflects that a gas connection was made on December 5, 2013 and that delivery of gas was made that same day. We again note that a portion of the project area for the SRO State Unit No. 53H well is included in the project area for the SRO State Com. No. 4H well, and we refer you to the Exception to Title No. 1 below.

6. **SRO State Unit Well No. 12H:** You submitted for our review a Well Location and Acreage Dedication Plat dated January 24, 2014 which reflects that the project area for the SRO State Unit Well No. 12H covers the  $E\frac{1}{2}E\frac{1}{2}$  Section 32, Township 25 South, Range 28 East, N.M.P.M. The Well Completion Report and Log dated February 3, 2014, reflects that the SRO State Unit No. 12H well was spudded on November 21, 2013 with a surface hole location at 190 feet FSL and 660 feet FEL, and reached a total measured depth of 12,534 feet, with a plugged back measured depth of 12,512 feet being completed ready to produce on January 13, 2014 with a bottom hole location 343 feet FNL and 626 feet FEL Section 32, Township 25 South, Range 28 East, N.M.P.M. First production occurred on January 19, 2014, with a test being conducted on January 22, 2014. This test resulted in recovery of 409 bbls oil, 1,404 Mcf gas and 1,988 bbls water. The Request for Allowable and Authorization to Transport dated February 21, 2014 reflects that a gas connection was



made on February 17, 2014 and that delivery of gas was made that same day. We again note that a portion of the project area for the SRO State Unit No. 12H well is included in the project area for the SRO State Com. No. 2H well, and we refer you to the Exception to Title No. 1 below.

#### VIII. EXCEPTIONS TO TITLE AND REMARKS:

1. **Overlapping Project Areas:** The project areas for the SRO State Unit Nos. 12H and 53H wells include portions of the project areas for the SRO State Com. Nos. 2H and 4H Wells, respectively. Additionally, the project area for the SRO State Com. No. 43H well covers the combined project areas of the SRO State Unit Nos. 15H and 16H wells. The project area for the SRO State Unit No. 12H well is the E $\frac{1}{2}$ E $\frac{1}{2}$  Section 32. The SE $\frac{1}{4}$ SE $\frac{1}{4}$  Section 32 is also included in the project area for the SRO State Com No. 2H well which covers the S $\frac{1}{2}$ S $\frac{1}{2}$  Section 32. The SRO State Com. No. 2H well was completed on October 22, 2009. We understand that there is no agreement that deals with the allocation of production from the SE $\frac{1}{4}$ SE $\frac{1}{4}$ , which is necessary to properly allocate 1/4 of the production from the SRO State Unit No. 12H well.

The project area for the SRO State Unit No. 53H well is the E $\frac{1}{2}$ E $\frac{1}{2}$  Section 16. The NE $\frac{1}{4}$ NE $\frac{1}{4}$  Section 16 is included in the project area for the SRO State Com No. 4H Well under Communitization Agreement No. 202802 dated January 15, 2010, which communitizes production from the Bone Spring and Delaware formations from Leases V-7446 and V-7469 insofar as they cover the N $\frac{1}{2}$ N $\frac{1}{2}$  Section 16. The SRO State Com. No. 4H well was completed on April 6, 2010. We have not reviewed title to the N $\frac{1}{2}$ NW $\frac{1}{4}$ , SW $\frac{1}{4}$ SE $\frac{1}{4}$  Section 16. We understand that there is no agreement that deals with the allocation of production from the NE $\frac{1}{4}$ NE $\frac{1}{4}$ , which is necessary to properly allocate 1/4 of the production from the SRO State Unit No. 53H well.

The project area for the SRO State Unit No. 15H well is the W $\frac{1}{2}$ W $\frac{1}{2}$  Section 17. The project area for the SRO State Unit No. 16H well is the W $\frac{1}{2}$ W $\frac{1}{2}$  Section 20. The proposed project area for the SRO State Com. No. 43H well is the W $\frac{1}{2}$ W $\frac{1}{2}$  Section 17 and the W $\frac{1}{2}$ W $\frac{1}{2}$  Section 20, and the two state leases involved must be communitized. We understand there is no agreement that deals with the allocation of production from these wells which is necessary to properly allocate production from same.

A well proposed to be completed within the interval of an existing horizontal well project area may only be drilled with the approval of all working interest owners in the project area or by order of the New Mexico Oil Conservation Division after notice to all working interest owners in the project area and an opportunity for hearing. We do not know whether the requisite approval and/or agreement was obtained with regard to the SRO Unit Nos. 12H, 15H, 16H and 53H wells, and in this regard, we have a requirement on point below.

Since no agreement is in place clarifying how production from the respective overlapping 40 acre parcels in the Nos. 12H and 53H wells is to be allocated or as to how production is to be allocated from the 15H, 16H and 43H wells, we discussed this matter with you. You requested us to prepare Exhibits C-1, C-2, D-1, D-2, G-1, G-2, F-1 and F-2, respectively, without considering the existing Communitization Agreements and overlapping project area issues. We have made you aware that the parties to the existing Communitization Agreements and overlapping project areas, including the State of New Mexico, may claim that 25% of production from the Nos. 12H and 53H wells must be allocated pursuant to the existing Communitization Agreements and that the allocation of production from the 15H, 16H and 43H wells may differ from the allocation as reported on our Exhibits C-2 and D-2 hereto. We have not examined title to the lands subject to the two Communitization Agreements that lie outside of the SRO Unit boundaries and therefore we cannot report on who these potential claimants may be, other than the State of New Mexico.

Although we require you to suspend 25% of the proceeds of production from both the 12H and 53H wells, we know that the State's royalty cannot be suspended. For your information Exhibits "F-1" and "G-1" credit the State with the following royalty interest:

$$3/16 \times 1760/7360 + 1/6 \times 5600/7360 = .17164855 \text{ RI}$$

Exhibit "F-2" credits the State with a 1/6 royalty interest. Exhibit "G-2" credits the State with a 3/16 royalty interest.

If 25% of the production from each well were allocated pursuant to the existing applicable Communitization Agreements, the State of New Mexico royalty calculation would be as follows for each well:



SRO State Unit No. 53H Well - Pre Unit Termination:

$$\begin{aligned} &120/160 \times (3/16 \times 1760/7360 + 1/6 \times 5600/7360) \\ &+ 40/160 \times 1/4 \times (3/16 \times 1760/7360 + 1/6 \times 5600/7360) \\ &+ 40/160 \times 3/4 \times 1/6 \\ &= .17071445 \text{ RI} \end{aligned}$$

SRO State Unit No. 53H Well - Post Unit Termination:

$$\begin{aligned} &120/160 \times 1/6 \\ &+ 40/160 \times 1/4 \times 1/6 \\ &+ 40/160 \times 3/4 \times 1/6 \\ &= .16666667 \text{ RI} \end{aligned}$$

SRO State Unit No. 12H Well - Pre Unit Termination:

$$\begin{aligned} &120/160 \times (3/16 \times 1760/7360 + 1/6 \times 5600/7360) \\ &+ 40/160 \times 1/4 \times (3/16 \times 1760/7360 + 1/6 \times 5600/7360) \\ &+ 40/160 \times 1/2 \times 3/16 \\ &= .16290195 \text{ RI} \end{aligned}$$

SRO State Unit No. 12H Well - Post Unit Termination:

$$\begin{aligned} &120/160 \times 3/16 \\ &+ 40/160 \times 1/4 \times 3/16 \\ &+ 40/160 \times 1/2 \times 3/16 \\ &= .17578125 \text{ RI} \end{aligned}$$

Although we require you to suspend the proceeds of production attributable to the 15H, 16H and 43H wells, the State's royalty cannot be suspended. We credit the State with the following royalty interest on our Exhibits C-1 and D-1:

$$3/16 \times 1760/7360 + 1/6 \times 5600/7360 = .17164855 \text{ RI}$$

and the following royalty interest on our Exhibits C-2 and D-2:

$$1/6 \times 160/160 = .16666667 \text{ RI}$$

The royalty interest payable to the State from these wells will not be different although these project areas overlap.

**COMMENT:** As noted above and pursuant to our discussions with you, we have prepared Exhibits "C-1", "C-2", "D-1", "D-2", "F-1", "F-2", "G-1" and "G-2" based on your instructions to credit all proceeds of production from the SRO State Unit Nos. 12H, 15H, 16H and 53H Wells with regard to the overlapping project areas and related communitization agreements. We have not credited any interest therein to the prior Communitization Agreements. You have advised us that you will try to resolve these issues in a manner that will provide for the allocation of proceeds of production as credited on these Exhibits. Although we have credited the proceeds of production in this manner, we make the following requirement.

**REQUIREMENT M:** Suspend the payment of proceeds of production from the SRO State Unit No. 12H well attributable to the SE $\frac{1}{4}$ SE $\frac{1}{4}$  Section 32 and SRO State Unit No. 53H well attributable to the NE $\frac{1}{4}$ NE $\frac{1}{4}$  Section 16 (being 25% from each well), and the SRO State Unit Nos. 15H and 16H except for the payment of royalties due to the State of New Mexico, pending receipt of an agreement or stipulation executed by all parties entitled to production from the respective Communitization Agreements and the SRO Unit and these respective project areas and wells and we reserve further possible requirement and the right to revise Exhibits "C-1", "C-2", "D-1", "D-2", "F-1", "F-2", "G-1" and "G-2" to comport with such agreements or stipulations. In lieu of an agreement or stipulation you could seek to amend the Communitization Agreements and project areas so the production from the SRO No. 2H and SRO Unit No. 12H wells, the SRO Com No. 4H and SRO Unit No. 53H wells and the SRO Unit Nos. 15H, 16H and 43H wells do not overlap with regard to the producing formations.

2. **Possible Adverse Claims:** The materials examined reflect the following instruments that purport to convey interests where we do not credit the grantor with any interest therein or