

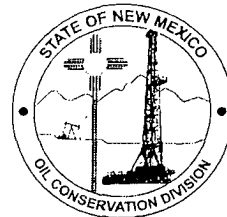
New Mexico Energy, Minerals and Natural Resources Department

Bill Richardson
Governor

Jim Noel
Cabinet Secretary

Karen W. Garcia
Deputy Cabinet Secretary

Mark Fesmire
Division Director
Oil Conservation Division



September 7, 2010

Paladin Energy Corp.
10290 Monroe Dr., Suite 301
Dallas, TX 75229

DENIAL OF APPLICATION FOR PERMIT TO DRILL, DEEPEN OR PLUG BACK

Re: Paladin Energy Corp., OGRID #164070

- South Vacuum #275, H-27-T18S-R35E, API #30-025-37299, Lea County, New Mexico

Dear Operator:

The Oil Conservation Division (OCD) **denies** your application(s) for permit(s) to drill, deepen or plug back the wells identified above because your company is out of compliance with 19.15.5.9(A) NMAC [Part 5.9(A)]. See 19.15.14.10(A) NMAC.

Your company is out of compliance with Part 5.9(A) on the following ground(s):

_____ **Financial assurances.** Your company is in violation of the financial assurance requirements for well plugging set out in 19.15.8.9 NMAC. See 19.15.5.9(A)(1) NMAC. Specifically, your company [has not posted the required blanket financial assurance] [has not posted the single-well financial assurances required for state or fee wells which have been inactive for more than two years. The wells requiring single-well financial assurances are identified in the attached sheet.]

_____ **Corrective action.** Order _____, issued on _____ after notice and hearing, found your company to be in violation of an order requiring corrective action. See 19.15.5.9(A)(2) NMAC.

_____ **Unpaid penalties.** Your company has not paid the penalties assessed against your company in _____, issued on _____. More than 70 days have passed since the issuance of the order assessing the penalty. See 19.15.5.9(A)(3) NMAC.

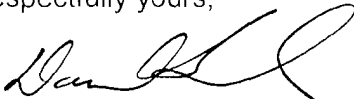
XX Inactive wells. According to the attached inactive well list, your company has too many wells in violation of the inactive well rule (19.15.25.8



NMAC) that are not subject to an inactive well agreed compliance order.
See 19.15.5.9(A)(4) NMAC. As an operator of 55 wells, your company
may have no more than 2 wells in violation of the inactive well rule.
Your company has 6 wells in violation of the inactive well rule.

I have enclosed an information sheet explaining the requirements of Part 5.9. You may re-submit your request after your company has returned to compliance with Part 5.9.

Respectfully yours,

A handwritten signature in black ink, appearing to read 'Dan Sanchez', with a long, sweeping underline that extends across the signature block.

Daniel Sanchez, Compliance and Enforcement Manager

Ec: Mark Fesmire, Division Director, Santa Fe
Theresa Duran-Saenz, Legal Assistant, Santa Fe
Larry "Buddy" Hill, District 1 Supervisor
Randy Dade, District 2 Supervisor
Charlie Perrin, District 3 Supervisor
Ed Martin, District 4 Supervisor
Donna Mull, District 1 Compliance Officer

Inactive Well List

Total Well Count: 55 Inactive Well Count: 6 Since: 6/14/2009

Printed On: Tuesday, September 07 2010

District	API	Well	ULSTR	OCD Unit	OGRID	Operator	Lease Type	Well Type	Last Production	Formation/Notes	Status	TA Exp Date
1	30-025-00103	H C POSEY A #006	H-11-12S-32E	H	164070	PALADIN ENERGY CORP	P	O	03/2009	PENN		
1	30-025-08007	NEW MEXICO BH STATE #001	C-11-12S-32E	C	164070	PALADIN ENERGY CORP	S	O	02/2009	WC RETURN TO PROD 08/23/07		
1	30-025-08008	NEW MEXICO BH STATE #002	F-11-12S-32E	F	164070	PALADIN ENERGY CORP	S	O	10/2008	04/02/2008 PLUGBACK		
1	30-025-37091	STATE BT C #006	F-35-11S-33E	F	164070	PALADIN ENERGY CORP	S	O	02/2009	DEVONIAN		
1	30-025-01020	STATE BT D #002	J-35-11S-33E	J	164070	PALADIN ENERGY CORP	S	O	12/2008	DEVONIAN 07/29/08 PLUGBACK TO WOLFCAMP		
1	30-025-01047	W E MATHERS A #001	2-3 -12S-33E	B	164070	PALADIN ENERGY CORP	P	O	03/2009	LOWER PENN		

WHERE Ogrid:164070, County:All, District:All, Township:All, Range:All, Section:All, Production(months):15, Excludes Wells Under ACOI, Excludes Wells in Approved TA Period

INFORMATION SHEET FOR PART 5.9

Oil Conservation Division (OCD) Rule 19.15.5.9 NMAC, commonly known as “Part 5.9,” requires operators to meet certain minimum compliance standards for the wells they already operate before they can drill, acquire, produce or inject into additional wells. If an operator is out of compliance as defined by Part 5.9, the OCD:

- May deny registration by the operator or certain related entities. *See* 19.15.9.8(B) NMAC.
- May deny applications for change of operator that would transfer wells to the operator. *See* 19.15.9.9(C) NMAC.
- Must deny injection permits. *See* 19.15.26.8(A) NMAC.
- May deny APDs. *See* 19.15.14.10(A) NMAC.
- Must deny allowable and authorizations to transport. *See* 19.15.16.19(A) NMAC.

In addition, the OCD may, after notice and hearing, revoke previously issued injection permits if the operator is out of compliance with Part 5.9. *See* 19.15.26.8(A) NMAC.

To stay in compliance with Part 5.9, an operator must:

- Keep current with the financial assurance requirements for well plugging. *See* 19.15.5.9(A)(1) NMAC.
- Comply with orders requiring corrective action. *See* 19.15.5.9(A)(2) NMAC.
- Pay properly assessed penalties. *See* 19.15.5.9(A)(3) NMAC.
- Have no more than a certain number of wells out of compliance with the inactive well rule. *See* 19.15.5.9(A)(4) NMAC.

FINANCIAL ASSURANCE REQUIREMENTS: The OCD’s financial assurance requirements for well plugging are set out in 19.15.8.9 NMAC. The OCD requires all state or fee wells to be covered by a financial assurance. The OCD does not require financial assurances for Federal or Indian wells.

The operator must either post a blanket financial assurance in the amount of \$50,000 to cover its state or fee wells, or post single-well financial assurances for each state or fee well in the amount set by the rule.

If the operator chooses to post a blanket financial assurance, it must also post single-well financial assurances for each state or fee well that has been inactive for more than two years that has not been plugged and released. Note that a single-well financial assurance is required even if the well is on approved temporary abandonment status, and even if the wellbore of the well has been plugged. To check compliance with this requirement, go to www.emnrd.state.nm.us/OCD, OCD Online, E-Permitting, Financial Assurance. Insert the operator name or OGRID, and hit “Get Report.” The report will list all the wells for that operator that have not been plugged and released. Wells currently in violation of the single-well financial assurance requirement will have a “Y” in the far right column, titled “In Violation.”

For information on how to post financial assurances, please contact OCD Financial Assurance Administrator Dorothy Phillips, (505) 476-3461, Dorothy.phillips@state.nm.us.

CORRECTIVE ACTION REQUIREMENTS: If an operator fails to take an action required by a hearing order or an agreed compliance order, the OCD may go to hearing to obtain a formal order finding the operator “in violation of an order requiring corrective action.” Once such an order is issued and becomes final, the operator will be out of compliance with Part 5.9 until that order is lifted. To lift the order, the operator must

complete the corrective action required, and file a motion to declare the order satisfied. The Oil Conservation Division or the Oil Conservation Commission, as appropriate, may grant the motion without hearing or may set the matter for hearing.

UNPAID PENALTIES: An operator with a penalty assessment unpaid more than 70 days after issuance of the order assessing the penalty will be in violation of Part 5.9 until that penalty is paid. Penalties may be assessed by the district court, or may be agreed to by the operator under an agreed compliance order entered into to resolve a compliance action.

INACTIVE WELLS: The inactive well rule, 19.15.25.8 NMAC, requires any well that has been inactive for a period of more than 15 months to be plugged and abandoned, placed on approved temporary abandonment status, or returned to production or other beneficial use. An operator will be out of compliance with Part 5.9 if it has too many wells in violation of the inactive well rule; the number of non-compliant wells allowed depends on the size of the operator. Under Part 5.9, if an operator operates:

- 1 well, it may have no wells out of compliance;
- 2 or 3 wells, it may have no more than 1 well out of compliance;
- 4 to 100 wells, it may have no more than 2 wells out of compliance;
- 101 to 500 wells, it may have no more than 5 wells out of compliance;
- 501 to 1000 wells, it may have no more than 7 wells out of compliance; and
- 1000 or more wells, it may have no more than 10 wells out of compliance.

To check compliance with 5.9 as to inactive wells, go to www.emnrd.state.nm.us/OCD, OCD Online, E-Permitting, Inactive Well List. Do not change the default search terms. Insert the operator name or OGRID, and hit "Get Report." The report will identify the wells that -- according to OCD records -- have been inactive for 15 months, are not on approved temporary abandonment status, do not have a plugged wellbore, and are not subject to an inactive well agreed compliance order. For purposes of Part 5.9, if a well appears on this list, there is a rebuttable presumption that the well is in violation of the inactive well rule. The heading of the list will also identify the total well count for the operator, and the total number of non-compliant inactive wells, so you can determine if the operator is in compliance with Part 5.9.

If your company has more non-compliant wells than allowed under Part 5.9, you will need to return wells to compliance by returning them to production or other beneficial use, placing them on approved temporary abandonment status, or plugging the wellbore. In some limited circumstances, the OCD may be willing to enter into an inactive well agreed compliance order setting a schedule for returning the wells to compliance and imposing sanctions if that schedule is not met. Wells covered by an inactive well agreed compliance order are not included when calculating Part 5.9 compliance. For information on inactive well agreed compliance orders, contact OCD Attorney Sonny Swazo at (505) 476-3463, Sonny.swazo@state.nm.us.