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SECRETARY, BOARD OF
OIL, GAS & MINING

BEFORE THE BOARD OF OIL, GAS AND MINING
DEPARTMENT OF NATURAL RESOURCES
STATE OF UTAH

IN THE MATTER OF THE REQUEST FOR AGENCY ACTION OF KERR-MCGEE OIL & GAS ONSHORE LP FOR AN ORDER SUSPENDING APPLICATION OF CERTAIN OF THE BOARD'S ORDERS IN THE CAUSE NO. 179 SERIES AND UTAH ADMIN. CODE RULES R649-3-2, R649-3-10 AND R649-3-11 (1) AND (2) INSOFAR AS THEY PERTAIN TO LANDS WITHIN THE PONDEROSA FEDERAL EXPLORATORY UNIT COVERING PORTIONS OF TOWNSHIPS 9 AND 10 SOUTH, RANGE 23 EAST, SLM, UINTAH COUNTY, UTAH	**FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER** Docket No. 2012-016 Cause No. 179-17

This Cause came on for hearing before the Utah Board of Oil, Gas and Mining (the "Board") on Wednesday, April 25, 2012, at approximately 1:30 p.m., in the Commission Chambers of the Sevier County Administration Building in Richfield. The following Board members were present and participated at the hearing: Chairman James T. Jensen, Ruland J. Gill, Jr., Jake Y. Harouny, Kelly L. Payne, Carl F. Kendel and Chris D. Hansen. Board Member Jean Semborski was unable to attend. The Board was represented by Michael S. Johnson, Esq., Assistant Attorney General.

Testifying on behalf of Petitioner Kerr-McGee Oil & Gas Onshore LP ("KMG") was Joe Johnson, Landman, whom the Board recognized as an expert in petroleum land management. Also present and available for testimony on behalf of KMG were Eric Schullenberger – Development Geologist, and Stephanie Bormann – Reservoir Engineer. Relma M. Miller, Esq. of Beatty & Wozniak, P.C. appeared as attorney for KMG on the

pleadings filed in this Cause but, due to a family emergency was unable to attend the hearing. Frederick M. MacDonald, Esq., also of Beatty & Wozniak, P.C., appeared in her stead as attorney for KMG at the hearing.

Upon Motion by Mr. MacDonald, without objection and unanimously approved, the Board authorized Mr. MacDonald to proffer the testimony of Mr. Schullenberger and Ms. Bormann in a summary fashion and accepted the geologic and engineering exhibits they had prepared and/or would testify about into evidence based on such proffered testimony. In light of the facts that the Board had previously authorized the equivalent of 10-acre well density for Wasatch and Mesaverde Group production for nearly all of the lands at issue in this Cause in its Order entered in Cause No. 179-14 and that, with the exception of Replacement Exhibit "Q" and the economic assumptions reflected therein, all of the geologic and engineering exhibits and testimony would be identical to that admitted into evidence at the hearing in Cause No. 179-14, and that this matter was uncontested, and in the interest of time and brevity, the Board deemed the proffer of said testimony to be reasonable and appropriate.

The Division of Oil, Gas and Mining (the "Division") did not file a staff memorandum in this Cause but nevertheless participated in the hearing. Steven F. Alder, Esq., Assistant Attorney General, appeared as attorney for the Division. At the conclusion of KMG's presentation–in–chief, Mr. Alder expressed the Division's support

for the granting of KMG's Request for Agency Action dated March 12, 2012 (the "Request"), as conformed to the testimony and other evidence provided at the hearing.

No other party filed a response to the Request and no other party appeared or participated at the hearing.

The Board, having considered the testimony presented and the exhibits received into evidence at the hearing, being fully advised, and for good cause, hereby makes the following findings of fact, conclusions of law and order in this Cause.

FINDINGS OF FACT

1. KMG is a Delaware limited partnership in good standing and authorized to conduct business in the State of Utah. It is duly bonded with all appropriate State of Utah and Federal agencies relevant to this cause.

2. The following Uintah County, Utah lands comprise the Ponderosa Federal Exploratory Unit (the "Unit"):

Township 9 South, Range 23 East, SLM

Section 31: Lots 1 (39.01), 2 (38.95), E½W½, E½

Township 10 South, Range 23 East, SLM

Section 1: Lots 1 (40.61), 2 (40.60), 3 (40.58) and 4 (40.57), S½N½, S½ [All]
Section 2: Lots 1 (40.56), 2 (40.58), 3 (40.58) and 4 (40.60), S½N½, S½ [All]
Section 4: Lots 1 (40.64), 2 (40.63), 3 (40.63) and 4 (40.62), S½N½, S½ [All]

Section 5:	Lots 1 (40.62), 2 (40.60), 3 (40.60) and 4 (40.58), S½N½, S½ [All]
Section 6:	Lots 1 (40.59), 2 (40.59), 3 (40.61), 4 (39.42), 5 (38.87), 6 (38.93) and 7 (38.97), S½NE¼, SE¼NW¼, E½SW¼, SE¼ [All]
Section 7:	Lots 1 (39.04), 2 (39.11), 3 (39.19) and 4 (39.26), E½W½, E½ [All]
Section 8:	All
Section 9:	All
Section 10:	W½
Section 11:	All
Section 12:	Lot 1 (34.43), SE¼SE¼, N½SE¼, SW¼, N½
Section 13:	Lots 2 (35.48), and 3 (39.12), W½NW¼
Section 14:	N½
Section 15:	All
Section 16:	E½
Section 17:	All
Section 18:	Lots 1 (39.31), 2 (39.34), 3 (39.36) and 4 (39.39), E½W½, E½ [All]
Section 22:	NE¼NW¼

(hereinafter the "Subject Lands"). The Unit was approved by the United States Bureau of Land Management ("BLM") to be effective as of May 1, 2012. All oil and gas underlying said lands are unitized. KMG is the named operator of the Unit. There are no uncommitted tracts within the Unit.

3. The gas and associated oil and hydrocarbons underlying the Subject Lands are primarily under Federal ownership, with the exceptions of Sections 2 and the E½ of 16, which are owned by the State of Utah in trust for the benefit of its schools and institutions. All of the Subject Lands are subject to Federal or State of Utah oil and gas leases, under which KMG is the sole lessee and operating rights owner.

4. Effective as of May 1, 2012, a participating area for Wasatch and Mesaverde Group production, comprised of the entire Unit area, will be established.

5. The NE¼NW¼ of Section 22 is not currently subject to any orders of the Board and is therefore ostensibly subject to the general statewide well siting rule set forth in Utah Admin. Code R649-3-2, and the general directional drilling well rules set forth in Utah Admin. Code R649-3-10 and R649-3-11. Under Utah Admin. Code Rule R649-3-2, each well is to be located within a 400-foot "window" surrounding the center of each governmental quarter-quarter section, or a substantially equivalent lot or tract or combination of lots or tracts, and no well may be located closer than 920 feet from an existing well drilling to or capable of producing from the same pool. The result of the application of this Rule is to allow one well on said lands.

6. The remaining Subject Lands have been the subject of a series of previous Board Orders, entered in Causes with the prefix "179," namely:

a) by Order entered on October 24, 1978 in Cause No. 179-1 (the "179-1 Order"), the Board established 320-acre stand-up drilling units for the development and production of oil, gas and associated hydrocarbons "from the interval described as commencing at the surface down to the top of the Mancos formation," which interval is inclusive of the Wasatch Formation and Mesaverde Group, for all of said lands within Township 10 South, Range 23 East, SLM, except for Sections 13 and 14 for which lay-

down units were instead established. The Board additionally ruled only one well on each drilling unit producing from said interval would be allowed;

b) by Order entered on May 24, 1994 in Cause No. 179-6 (the "179-6 Order"), the Board modified the 179-1 Order to allow the drilling of a second production well within the drilling units created under the 179-1 Order;

c) by Order entered on February 3, 1995 in Cause No. 179-7 (the "179-7 Order"), the Board established 80-acre stand-up drilling units for the production of oil, gas and associated hydrocarbons from the interval between "the top of the Wasatch formation down to the base of the Mesaverde formation" for the Section 31 lands, and ruled only one well on each such drilling unit producing in said interval would be allowed. The permitted wells for each unit were to be located in the NW¼ and SE¼ within a drilling window 400 foot square on the center location; provided, however, that the Division may grant administrative approval for exception well locations for topographic, environmental and archaeological consideration and when "no surface occupancy" stipulations imposed by the lessors prohibited drilling at a legal location, without the necessity of a full hearing before the Board;

d) by Order entered on December 28, 1999 in Cause No. 179-9 (the "179-9 Order"), the Board modified the 179-1 and 179-6 Orders to allow the drilling of up to four production wells on each of the drilling units created under the 179-1 Order. The additional authorized wells were to be located no closer than 920 feet from an existing

well producing from the spaced interval and 460 feet from the exterior boundary of each drilling unit; provided, however, that administrative approval may be granted for exception well locations for topographical, environmental and archaeological consideration and when "no surface occupancy" stipulations imposed by the lessors prohibited drilling at a legal location, without the necessity of a full hearing before the Board;

e) by Order entered on July 5, 2005 in Cause No. 179-12 (the "179-12 Order"), the Board modified the 179-1, 179-6, 179-7 and 179-9 Orders to allow the drilling of additional wells thereon to achieve the equivalent of an approximate 40-acre well density pattern, *i.e.* to allow up to eight producing wells on the 320-acre or substantial equivalent drilling units established under the 179-1 Order and two producing wells on the 80-acre or substantial equivalent drilling units established under the 179-7 Order, for the production of oil, gas and associated hydrocarbons from the Wasatch Formation and that part of the Mesaverde Group to the top of the Castlegate Sandstone as referenced by R.D. Hettinger and M.A. Kirschbaum in 2002 as pamphlet to Geologic Investigations Series I-2764, U.S. Department of the Interior, U.S. Geologic Survey, "Stratigraphy of the Upper Cretaceous Mancos Shale (Upper Part) and Mesaverde Group in the Southern Part of the Uintah and Piceance Basins, Utah and Colorado," defined as:

> that interval from the stratigraphic equivalent of 4,298 feet down to the stratigraphic equivalent of 8,726 feet, as shown on the Gamma and Caliper logs, Dual Laterologs and Compensated Neutron-Formation Density log of

the Southman Canyon Federal 1-5 well located in the SE¼NW¼ of Section 5, T10S, R23E, SLM.

(the "Subject Formations"). The Board further ruled that the additional wells so authorized may be located no closer than 920 feet from an existing well producing from the Subject Formations and no closer than 460 feet from the exterior boundary of each drilling unit; provided, however, that administrative approval by the Division may be granted in accordance with Utah Admin. Code Rule R649-3-3 for exception well locations for topographical, geological, environmental, and archaeological considerations and when "no surface occupancy" stipulations imposed by the lessors prohibit drilling at a legal location, without the necessity of a full hearing before the Board; and

f) by Order entered on June 12, 2008 in Cause No. 179-14 (the "179-14 Order"), the Board modified the 179-12 to allow the drilling of additional wells thereon to achieve the equivalent of an approximate 10-acre well density pattern, *i.e.* to allow up to 32 producing wells on the 320-acre or substantial equivalent drilling units established under the 179-1 Order and eight producing wells on the 80-acre or substantial equivalent drilling units established under the 179-7 Order, with the proviso that the additional wells so authorized may be located no closer that 460 feet from the exterior boundary of each unit unless an exception is granted by the Division in accordance with Utah Admin. Code Rule R649-3-3 for topographical, geological, environmental, and archaeological considerations and when "no surface occupancy" stipulations imposed by the lessors

prohibit drilling at a legal location, and the elimination of any offset limitations as between wells within each such drilling unit and the suspension of Utah Admin. Code Rules R649-3-10 and R649-3-11 (1) and (2), with the proviso that no well may be directionally drilled if any portion of a 460-foot radius along the projected well intersects with a drilling unit boundary without approval of the Division or Board, and the operator provides to the Division a plat or sketch showing the distance to the drilling unit boundary and the target location within the Subject Formation.

The 179-1, 179-6, 179-7, 179-12 and 179-14 Orders are collectively hereafter referred to as the "179 Series Orders."

7. There are communitization agreements already in place covering portions of the Subject Lands, which were executed and approved by the requisite agencies in order to establish proration units in conformance with the 179-1 and 179-7 Orders. However, the Unit Agreement provides that, as of the effective date thereof, the communitization agreements shall be deemed to be terminated and merged into the Unit Agreement.

8. Paragraph 16 of the Unit Agreement expressly requires the Unit Operator to produce Unitized Substances, and conduct all operations to provide for the most economical and efficient recovery of said substances, without waste, as defined by or pursuant to State or Federal law or regulation.

9. Well location and density patterns within the Unit Area are determined in accordance with the terms of the Unit Agreement and, in particular, the annual plan of Unit development approved by the BLM. Drilling applications are approved by both the BLM and the Division.

10. The Board confirms and adopts all of its technical Findings of Fact contained in the 179-14 Order as relating to the Subject Formations justifying an equivalent 10-acre well density pattern as to all of the Subject Lands.

11. Drilling on a 10-acre density pattern, given the setback requirements under the 179-14 Order, and especially as to the NE¼NW¼ of Section 22 which is not currently subject to a Board order, under current circumstances may clash with Unit development patterns and, in some instances, will always prohibit location within the allowed "window" under the general well siting regulation (Utah Admin Code Rule R649-3-2) and conversely always require an exception location approval (in accordance with Utah Admin. Code Rule R649-3-3). Additionally, wells may need to be directionally drilled from existing pads to minimize surface disturbance and alleviate certain environmental concerns.

12. A copy of the Request was mailed, postage pre-paid, certified with return receipt requested, and properly addressed, to the governmental agencies owning the oil and gas and having jurisdiction over the minerals underlying the Subject Lands. Copies of the return receipts, evidencing receipt of all such mailings, were filed with the Board.

13. Notice of the filing of the Request and of the hearing thereon was duly published in the Salt Lake Tribune and the Deseret Morning News on April 8, 2012 and in the Uintah Basin Standard on April 3, 2012, and in the Vernal Express on April 4, 2012.

14. The vote of the Board members present and participating in the hearing on this Cause was unanimous (6-0) in favor of granting the Request.

CONCLUSIONS OF LAW

1. Due and regular notice of the time, place and purpose of the hearing was properly given to all parties whose legally protected interests are affected by the Request in the form and manner as required by law and the rules and regulations of the Board and Division.

2. The Board has jurisdiction over all matter covered by the Request and all interested parties therein, and has the power and authority to render the order herein set forth pursuant to Utah Code Ann. §§ 40-6-5(3)(b) and Utah Admin. Code Rule R649-2-3.

3. The conservation of oil and gas and the prevention of waste are accomplished by operations conducted in accordance with the terms of the Unit Agreement.

4. The NE¼NW¼ of Section 22 is subject to the general statewide well siting and directional drilling rules (Utah Admin. Code Rules R649-3-2, R649-3-10 and R649-3-11 (1) and (2)).

5. The currently existing 10-acre density drilling program for Subject Formation production from the Subject Lands appears reasonable, justified and economic.

6. To account for KMG's 10-acre density drilling program for the Subject Lands, including associated directional drilling, suspension of the 179 Series Orders and Utah Admin. Code Rules R649-3-2, R649-3-10 and R649-3-11 (1) and (2) as to the Subject Lands is fair, reasonably and justified with the following provisions:

(a) no future well within the Unit may be located closer than 460 feet from a Unit boundary without administrative approval of the Division in accordance with Utah Admin. Code Rule R649-3-3;

(b) no future well may be directionally drilled if any portion of a 460-foot radius along the projected wellbore intersects a Unit boundary without approval of the Division or Board in accordance with Utah Admin. Code Rules R649-3-3 and R649-3-11;

(c) the operator provides to the Division (1) a plat or sketch showing the distance from the surface location to section and lease lines and the target location within the intended producing interval with any application for permit to drill filed for a well to be directionally drilled in the Unit Area; and (2) copies of the annual plan of Unit development for the Unit filed with the BLM, if required by the BLM; and

(d) this suspension shall remain in effect only for committed lands which remain part of the Unit. Upon Unit contraction or termination, lands eliminated from the Unit shall once again become subject to the applicable 179 Series Orders or rules.

7. The relief granted hereby will result in the orderly development and greatest recovery of Unitized oil and gas, prevent waste and adequately protect the correlative rights of all affected parties.

8. KMG has sustained its burden of proof, demonstrated good cause, and satisfied all legal requirements, including those set forth in Utah Admin. Code Rule R649-2-3, for the granting of its Request.

ORDER

Based upon the Request, testimony and evidence submitted, and the findings of fact and conclusions of law stated above, the Board hereby orders:

1. The Request in this cause is granted.

2. The 179 Series Orders and Utah Admin. Code Rules R649-3-2, R649-3-10 and R649-3-11 (1) and (2) are suspended insofar as they apply to the Subject Lands as described above; provided, however, that:

> (a) no future well within the Unit may be located closer than 460 feet from a Unit boundary without administrative approval of the Division in accordance with Utah Admin. Code Rule R649-3-3;
>
> (b) no future well may be directionally drilled if any portion of a 460 foot radius along the projected wellbore intersects a Unit boundary without approval of the Division or Board in accordance with Utah Admin. Code Rules R649-3-3 and R649-3-11.
>
> (c) KMG and any successor Unit Operator shall provide the Division: (1) a plat or sketch showing the distance from the surface location to section and lease lines and the target location within the intended producing interval with any application for permit to drill filed for a well to be

directionally drilled in the Unit; and (2) copies of the annual plan of Unit development for the Unit filed with the BLM, if required by the BLM; and

(d) this suspension shall remain in effect only for the Subject Lands which remain part of the Unit. Upon Unit contraction or termination, any of the Subject Lands eliminated from the Unit shall once again become subject to the applicable 179 Series Orders or rules.

3. If the Division should determine that operations within the Unit area are not being conducted in a manner which is intended to maximize recovery of oil and gas, promotes conservation, is protective of correlative rights, and/or prevents waste, it may initiate a Notice of Agency Action in accordance with Utah Admin. Code Rule R641-104-100 for the Board to reconsider the suspension of the relevant rules granted hereby.

4. Pursuant to Utah Admin. Code Rules R641 and Utah Code Ann. § 63G-4-204 to 208, the Board has considered and decided this matter as a formal adjudication.

5. This Order is based exclusively on evidence of record in the adjudicative proceeding or on facts officially noted, and constitutes the signed written order stating the Board's decision and the reasons for the decision, all as required by the Administrative Procedures Act, Utah Code Ann. § 63G-4-208 and Utah Administrative Code Rule R641-109.

6. Notice re: Right to Seek Judicial Review by the Utah Supreme Court or to Request Board Reconsideration: As required by Utah Code Ann. § 63G-4-208(e) - (g), the Board hereby notifies all parties in interest that they have the right to seek judicial review of this final Board Order in this formal adjudication by filing a timely appeal with

the Utah Supreme Court within 30 days after the date that this Order issued. Utah Code Ann. §§ 63G-4-401(3)(a) and 403. As an alternative to seeking immediate judicial review, and not as a prerequisite to seeking judicial review, the Board also hereby notifies parties that they may elect to request that the Board reconsider this Order, which constitutes a final agency action of the Board. Utah Code Ann. § 63G-4-302, entitled, "Agency Review - Reconsideration," states:

> (1)(a) Within 20 days after the date that an order is issued for which review by the agency or by a superior agency under Section 63G-4-301 is unavailable, and if the order would otherwise constitute final agency action, any party may file a written request for reconsideration with the agency, stating the specific grounds upon which relief is requested.
>
> (b) Unless otherwise provided by statute, the filing of the request is not a prerequisite for seeking judicial review of the order.
>
> (2) The request for reconsideration shall be filed with the agency and one copy shall be sent by mail to each party by the person making the request.
>
> (3)(a) The agency head, or a person designated for that purpose, shall issue a written order granting the request or denying the request.
>
> (b) If the agency head or the person designated for that purpose does not issue an order within 20 days after the filing of the request, the request for reconsideration shall be considered to be denied.

Id. The Board also hereby notifies the parties that Utah Admin. Code Rule R641-110-100, which is part of a group of Board rules entitled, "Rehearing and Modification of Existing Orders," states:

> Any person affected by a final order or decision of the Board may file a petition for rehearing. Unless otherwise provided, a petition for rehearing

> must be filed no later than the 10th day of the month following the date of signing of the final order or decision for which the rehearing is sought. A copy of such petition will be served on each other party to the proceeding no later than the 15th day of the month.

Id. See Utah Admin. Code Rule R641-110-200 for the required contents of a petition for Rehearing. If there is any conflict between the deadline in Utah Code Ann. § 63G-4-302 and the deadline in Utah Admin. Code Rule R641-110-100 for moving to rehear this matter, the Board hereby rules that the later of the two deadlines shall be available to any party moving to rehear this matter. If the Board later denies a timely petition for rehearing, the party may still seek judicial review of the Order by perfecting a timely appeal with the Utah Supreme Court within 30 days thereafter.

7. The Board retains continuing jurisdiction over all the parties and over the subject matter of this cause, except to the extent said jurisdiction may be divested by the filing of a timely appeal to seek judicial review of this order by the Utah Supreme Court.

8. For all purposes, the Chairman's signature on a faxed copy of this Order shall be deemed the equivalent of a signed original.

DATED this 9th day of May, 2012.

STATE OF UTAH
BOARD OF OIL, GAS AND MINING

By: James T. Jensen
James T. Jensen, Chairman

CERTIFICATE OF SERVICE

I hereby certify that I caused a true and correct copy of the foregoing **FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER** for Docket No. 2012-016, Cause No. 179-17 to be mailed with postage prepaid, this 9th day of May, 2012, to the following:

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