

STATE OF SOUTH DAKOTA
DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES
BOARD OF MINERALS AND ENVIRONMENT

IN THE MATTER OF THE PETITION OF)
LUFF EXPLORATION COMPANY, DENVER,)
COLORADO, FOR AN ORDER POOLING)
ALL INTERESTS IN A SPACING UNIT FOR)
THE SOUTH MEDICINE POLE HILLS FIELD)
DESCRIBED AS THE SW/4 OF SECTION 27,)
THE SE/4 OF SECTION 28, THE E/2 OF)
SECTION 33, AND THE W/2 OF SECTION)
34, ALL IN TOWNSHIP 23 NORTH, RANGE)
4 EAST, HARDING COUNTY,)
APPROXIMATELY 22 MILES NORTH-)
NORTHWEST OF BUFFALO, SOUTH)
DAKOTA, AND TO AUTHORIZE THE)
RECOVERY OF RISK COMPENSATION IN)
ADDITION TO THE PRO RATA SHARE OF)
REASONABLE, ACTUAL COSTS FROM)
THE INTEREST OF ANY LESSEE OR)
UNLEASED MINERAL OWNER WHO)
ELECTS NOT TO PARTICIPATE IN THE)
RISK AND COST OF DRILLING AND)
COMPLETING A WELL ON THE SPACING)
UNIT; AND FOR OTHER RELIEF AS THE)
BOARD DEEMS APPROPRIATE.)

Case No. 12-2012

**FINDINGS OF FACT,
CONCLUSIONS OF LAW,
AND ORDER**

The South Dakota Board of Minerals and Environment, (“Board”), held a hearing in Pierre, South Dakota, pursuant to notice on October 17, 2012, upon the Petition of Luff Exploration Company (“Luff”), in the captioned matter. A quorum of the Board was present at the hearing. The Board, having considered the evidence and arguments offered by Luff, and having afforded other interested parties the opportunity to present evidence and arguments, now makes and enters the following:

FINDINGS OF FACT

1. Luff has petitioned the Board for an order pooling all interests in a spacing unit for the South Medicine Pole Hill Field described as the SW/4 of Section 27, the SE/4 of Section

28, the E/2 of Section 33 and the W/2 of Section 34, Township 23 North, Range 4 East, Black Hills Meridian, Harding County, South Dakota (the “Spacing Unit”) and to authorize the recovery of risk compensation in addition to the pro rata share of reasonable, actual costs from the interest of any lessee or unleased mineral owner who elects not to participate in the risk and cost of drilling and completing a well on said spacing unit.

2. The Department caused proper notice of the time, date and location of the hearing to be timely published pursuant to SDCL 45-9-58.

3. Luff gave proper and timely notice of the time, date and location of the hearing to those persons and entities who own interests in the mineral estate within the proposed spacing unit and whose interests are not already voluntarily pooled. Additionally, a number of the mineral owners of record in the Spacing Unit are deceased and there is nothing of record to indicate the identity or location of their heirs. However, Luff witnesses testified that Luff made a good faith effort to locate the potential heirs (the “Heirs”) of the deceased mineral owners and gave proper and timely notice of the time, date and location of the hearing to those Heirs it was able to identify and locate. A petition to intervene (“Intervention”) was filed by Christine T. Mahoney, Lynn Mahoney Ponce de Leon, Eileen Mahoney, John P. Maher, Denis J. Donoghue, Marianne Boer, Timothy McCarthy, Patrick McCarthy (of Kerry), Hannah McCarthy, Eamon McSweeney, Michael McSweeney, Mary Thompson, Catherine Higgins, Norma Lynch, Daniel Lynch, Neil Lynch, Val Lynch, Patrick McCarthy (of Cork), Birdie Finnegan, Eileen McSparron, Mary Teresa O’Connell, Michael O’ Donoghue, Julia Maher Flynn, Joanne Mahoney, James M. Murray, Marc Rafac, Todd Rafac, and Stephen A. Rafac III (“Intervenors”). The Intervention notes that each of the Intervenors was approached by Luff with a proposed lease for the mineral interests they potentially own, but raises concerns with some of the terms of the proposed lease.

Despite the Intervention, the Interveners did not appear in person or through counsel at the hearing.

4. In Order No.7-2012 the Board established a spacing unit for the South Medicine Pole Hills field consisting of the SW/4 of Section 27, the SE/4 of Section 28, the E/2 of Section 33 and the W/2 of Section 34, Township 23 North, Range 4 East, and authorized the drilling of a horizontal well on such spacing unit.

5. There are four separately owned tracts within the Spacing Unit. There are also separately owned interests within each of these separately owned tracts.

6. There is no voluntary pooling agreement covering all of the interests within the Spacing Unit. While Luff has obtained oil and gas leases from the majority of the owners of mineral interests in the spacing units, and those leases contain pooling clauses authorizing pooling by filing of a declaration of pooling, there are a number of unleased interests within the spacing unit.

7. Approximately 7.692307% of the mineral interest in the SE/4 of Section 28 is owned of record by Peter K. Steiner and Anna Steiner, who are deceased. Luff has identified 5 potential heirs of the Steiners and of these 5 heirs, 4 have agreed to lease whatever interest they may have to Luff pursuant to a standard lease form with customary terms and provisions including a 15% royalty and a \$50 per acre bonus. On September 12, 2012, Luff sent an identical offer to Margaret C. Breese, the fifth potential heir, to either lease her potential interest upon the same terms and conditions as the other potential heirs or to participate in the risk and cost of drilling a well on the spacing unit. Ms. Breese did not agree to lease or participate. The offer was sent by registered or certified mail, and requested that Ms. Breese either sign the proposed lease or return an executed Authority for Expenditure indicating her agreement to

participate within 30 days, and advised Ms. Breese that if she did not lease or agree to participate Luff intended to request the Board to provide risk compensation pursuant to ARSD 74:12:10 and that she could object to risk compensation by responding in opposition.

8. The mineral interests in the SW/4 of Section 27 are owned of record in equal shares by Patrick Donahue, Dennis Donahue, Bridget McCarthy, and Anna Kellher. Each of these individuals is deceased. Luff has identified 27 potential heirs of Patrick Donahue, 14 potential heirs of Dennis Donahue, and 22 potential heirs of Bridget McCarthy. Luff has been unable to identify or locate any potential heirs of Anna Kellher. Luff obtained oil and gas leases from a number of these heirs. Additionally, Luff believed that it had an agreement with 6 of the potential heirs of Patrick Donahue, but those individuals have not yet signed leases.

9. On July 30, 2012 and August 1, 2012, Luff sent invitations to each of the remaining 57 owners it has identified other than those that had already leased to Luff, asking them to either lease their potential interest pursuant to a standard lease form containing customary terms and provisions with a royalty of 15% and a bonus of \$50 per acre. The offer was sent to each of these potential heirs by registered or certified mail, and requested that the potential heir either sign the proposed lease or return an executed Authority for Expenditure indicating the agreement to participate within 30 days, and further advised the potential heir that if the potential heir did not lease or agree to participate Luff intended to request the Board to provide risk compensation pursuant to ARSD 74:12:10 and that the potential heir could object to risk compensation by responding in opposition. Of the remaining 57 heirs, 31 have agreed to lease. The following potential heirs have not agreed to lease or participate (the "Nonparticipating Heirs"):

Michael J. Treacy

Maura O'Connell
Michael O'Donoghue
Denis J. O'Donoghue
Marianne E. Boer
Joanne S. Mahoney
James M. Murray
Michael McSweeney
Hannah McCarthy
Eamon McSweeney
Eileen McSparron
Bridget Finnegan
Patrick McCarthy (Kerry)
Lynn Mahoney Ponce de Leon
Christine T. Mahoney
Eileen B. Mahoney
John P. Maher
Julia Maher Flynn
Patrick McCarthy (Cork)
Timothy McCarthy
Neil Lynch
Norma Mary Lynch
Mary Thompson
Val Lynch

Daniel Lynch

Catherine Higgins

10. Luff has not sent the required notice to Christine R. Rafac, Sara E. Rafac, Samantha L. Dennis, Stephen A. Rafac III, Marc A. Rafac and Todd M. Rafac and does not at this time seek the recovery of risk compensation from any interest that may be owned by these individuals.

11. Additionally, 50% of the minerals underlying the S/2NE/4 of Section 33 and the S/2NW/4 of Section 34 are owned of record by Martha Kopka Bennett, who is deceased. The surface owners of those tracts, Stearns Brothers LLC and Kevin L. Ploszaj, respectively, are attempting to perfect title to this interest through the abandoned mineral interest act and those surface owners have leased any interest they may acquire to Luff.

12. Prima Exploration, Inc. owns a 50.8459% working interest in the SE/4 of Section 28. On August 14, 2012, Luff sent a notice to Prima by certified mail asking Prima to elect to participate in the cost of drilling the Well and advising Prima that if it did not choose to participate, Luff intended to request the Board to provide for the recovery of risk compensation and that Prima may object to the risk compensation by responding in opposition to the application. Prima elected to participate as to a 5% interest in the well which equates to a 30.0001% working interest in the SE/4 of Section 28. Prima did not elect to participate as to the remaining 20.8458% working interest in the SE/4 of Section 28, which is the equivalent of a 3.4743% working interest in the Spacing Unit (the "Nonparticipating Working Interest").

13. None of the potential heirs will be paid royalties or other proceeds of production until such time as the necessary probates have been concluded or other final judgments have been obtained from courts of competent jurisdiction confirming their status as heirs. In the event

any new heirs of any of the deceased mineral owners are determined through such proceedings, Luff will make a good faith attempt to obtain a lease or joinder in the risk and cost of the well from any such persons.

14. ARSD 74:12:10:01 provides that risk compensation may be recovered from any person who elects not to participate in the risk and cost of drilling and operating a well. ARSD 74:12:10:02 provides that risk compensation equal to two hundred percent of the share of reasonable actual costs of drilling, reworking, side-tracking, deepening, plugging, testing, completing and recompleting the well and the costs of newly acquired equipment in the well including the wellhead connection may be recovered out of the share of production attributable to the interest of an owner whose interest is derived from a lease or other contract for development. ARSD 74:12:10:03 provides that risk compensation equal to one hundred percent of the share of reasonable actual costs of drilling, reworking, side-tracking, deepening, plugging, testing, completing and recompleting the well and the costs of newly acquired equipment in the well including the wellhead connection may be recovered out of the share of production attributable to an unleased mineral owner who does not agree to lease or participate in the risk and cost of drilling a well, exclusive of a 1/8 royalty interest. ARSD 74:12:10:01 provides that before an order may be entered providing for the recovery of risk compensation, the applicant must (1) provide proof that an unsuccessful, good faith attempt was made to have the nonparticipating owner execute a lease or participate in the risk and cost of drilling and operating the well and (2) notify the nonparticipating owner with proof of service that the applicant intends to request the board to provide for the recovery of risk compensation and that the nonparticipating owner may object to the risk compensation provision by responding in opposition to the application for the compulsory pooling order.

15. Luff's invitation to lease or participate constituted a good faith attempt to have the Nonparticipating Heirs execute a lease or participate in the risk and cost of drilling and operating the well.

16. Luff has drilled the McKitrick I-28H well (the "Well") as a horizontal well on the Spacing Unit and the well is currently awaiting the installation of surface equipment.

CONCLUSIONS OF LAW

1. The Board has the authority to hear and decide this matter pursuant to SDCL Chapter 45-9 and ARSD Chapter 74:09:01.

2. All notices of the petition and the hearing were properly and timely given.

3. The petition is complete in all respects and contains all required and requested information.

4. Pursuant to SDCL Section 45-9-31, the Board is required to enter an order pooling all interests in a spacing unit for the development and operation thereof, and for the sharing of production therefrom. The Board has jurisdiction pursuant to SDCL Section 45-9-33 and ASRD Chapter 74:12:10 to include provisions whereby an owner who does not elect to participate in the risk and cost of drilling and operating a well may elect to participate in the drilling and operation of the well on a limited or carried basis, and has the jurisdiction to authorize the recovery of risk compensation from the interest of a lessee or unleased mineral owner who does not elect to participate in the drilling and operation of a well.

5. Providing that each tract in the spacing unit will be allocated a proportionate share of production from the well proposed to be drilled on the spacing unit equal to a fraction of the production from the spacing unit equal to the number of acres contained in each such tract divided by the total number of acres in the spacing unit will ensure that each owner will have an

opportunity to recover or receive, without unnecessary expense, a just and reasonable share of the production from the spacing unit.

6. Allowing the recovery of risk compensation equal to one-hundred percent of the reasonable actual costs of drilling and completing the well and the costs of newly acquired equipment in addition to the pro rata share of such costs from the interest of any unleased owner who does not agree to lease or participate in the risk and cost of drilling, equipping and operating the well, and two-hundred percent of the same costs for any lessee who does not agree to participate, is just and reasonable.

7. By mailing the invitation to lease or participate in the risk and cost of drilling the Well, Luff made an unsuccessful, good-faith attempt to have the Nonparticipating Heirs execute a lease or participate in the risk and cost of drilling and operating the Well. Luff also gave notice to the Nonparticipating Heirs of its intention to seek risk compensation and of their right to oppose such a request.

ORDER

Based upon the foregoing Findings of Fact and Conclusions of Law, the Board does hereby order:

1. That the Petition of Luff as set forth above is granted and approved.
2. All interests in a spacing unit for the South Medicine Pole Hills Field described as the SW/4 of Section 27, the SE/4 of Section 28, the E/2 of Section 33 and the W/2 of Section 34, Township 23 North, Range 4 East, Black Hills Meridian, Harding County, South Dakota, including the interests of the Nonparticipating Heirs, are pooled for purposes of the drilling and operation of, and production from, the Well drilled in accordance with Order No. 7-2012. Luff is hereby designated the operator and is authorized to drill and operate said Well on the Spacing

Unit. All expenses incurred in drilling, equipping and operating said wells on the Spacing Unit, and all production from such wells, shall be allocated to the various tracts within the Spacing Unit on the basis of the ratio the number of acres contained in each separately owned tract bears to the number of acres in the Spacing Unit. Operations incident to the drilling of said wells on any portion of the Spacing Unit shall be deemed for all purposes the conduct of such operations upon each separately owned tract in the spacing unit, and production allocated to each tract shall, when produced, be deemed for all purposes to have been produced from each tract by a well drilled thereon.

3. Luff, on behalf of other working interest owners within the Spacing Unit who do share in the risk and cost of drilling and completing the Well, may recover from the Nonparticipating Heirs' respective share of production from then Spacing Unit, exclusive of a one-eighth royalty, and from Prima's Nonparticipating Working Interest's share of production from the Spacing Unit, their proportionate share of the reasonable actual costs of drilling, equipping and operating the Well until the market value of those shares of production, exclusive of the one-eighth royalty as to the Nonparticipating Heirs' interest, equals the sums payable by or charged to the respective interests of Nonparticipating Heirs and Prima's Nonparticipating Working Interest.

4. Luff, on behalf of other working interest owners within the Spacing Unit who do share in the risk and cost of drilling and completing the Well, may recover from Nonparticipating Heirs' respective shares of production from the Spacing Unit, exclusive of a one-eighth royalty, risk compensation equal to an additional 100% of the reasonable actual costs of drilling, reworking, side-tracking, deepening, plugging back, testing, completing and recompleting the Well and the costs of newly acquired equipment in the Well including the wellhead connection.

Such risk compensation may be recovered only out of production from the Spacing Unit, exclusive of a one-eighth royalty. Additionally, Luff, on behalf of the other working interest owners within the Spacing Unit who do share in the risk and cost of drilling and completing the Well, may recover from Prima's Nonparticipating Working Interest's share of production from the Spacing Unit risk compensation equal to an additional 200% of the reasonable actual costs of drilling, reworking, side-tracking, deepening, plugging back, testing, completing and recompleting the Well and the costs of newly acquired equipment in the Well including the wellhead connection.

5. In the event of a dispute as to the costs of drilling, equipping, or operating the Well, the South Dakota Board of Minerals and Environment shall determine the costs in accordance with SDCL 45-9-35.

Dated at Pierre, South Dakota, this 17th day of October, 2012.

SOUTH DAKOTA BOARD OF
MINERALS AND ENVIRONMENT

By 
Its Hearing Chairman