

NEW YORK STATE DEPARTMENT OF ENVIRONMENTAL CONSERVATION

In the Matter of the Application of Fortuna Energy Inc. for a Well Spacing Order for one gas well known as Reed 1 (API No. 31-101-23055-00) in the Quackenbush Hill Field located in the Town of Corning, Steuben County, pursuant to Environmental Conservation Law Article 23, Mineral Resources.

INTERIM ORDER

(DEC File No. DMN 01-2)

WHEREAS:

1. The Commissioner's Decision and Order, dated January 23, 2002 ("the January 23 Order"), in the matter of the order of field-wide well spacing rules and the integration of interests pursuant to Environmental Conservation Law ("ECL") §§ 23-0501 and 23-0901 for the Quackenbush Hill Field located in Steuben and Chemung Counties, New York, establishes spacing units for four existing wells and procedures for future well spacing and compulsory integration.

2. The Commissioner's Decision and Order, dated December 30, 2002 ("the December 30 Order"), in the matter of the order of field-wide well spacing rules and the integration of interests pursuant to ECL §§ 23-0501 and 23-0901 for the Quackenbush Hill Field located in Steuben and Chemung Counties, New York, establishes a Spacing Unit for one existing well and procedures for future well spacing and compulsory integration.

3. The Director's Order, dated October 22, 2004, in the matter of the order of field-wide well spacing rules and the integration of interests pursuant to ECL §§ 23-0501 and 23-0901 for the Andrews 1 Unit of the Quackenbush Hill Field located in Steuben County, New York, establishes a Spacing Unit for one existing well (Andrews 1) pursuant to the procedures established by the January 23 and December 30 Orders.

4. The January 23 and December 30 Orders incorporated by reference the Stipulation executed by Fortuna Energy Inc. ("Fortuna" or "Applicant") and Department staff, dated November 1, 2001 ("Stipulation"), which provides for the efficient and economical development of the Quackenbush Hill Field. The incorporated Stipulation sets forth the conditions and procedures for future well spacing and compulsory integration in the Quackenbush Hill Field.

5. This Interim Spacing Unit Order ("Interim Order") is made pursuant to ECL Article 23, Title 5, and in accordance with the January 23 and December 30 Orders regarding Quackenbush Hill Field.

6. Compulsory integration, if necessary in the unit established by this Interim Order, will be addressed by further proceedings as provided by the Stipulation, and in accordance with the ECL Article 23, Title 9.

DISCUSSION

Section IV of the Stipulation, entitled "Permit Application Procedures for Future Wells," establishes procedural requirements that both the Applicant and the Department must follow before an extension well or a unit well can be drilled in the Quackenbush Hill Field, before production may proceed from an extension well or a unit well in Quackenbush Hill Field, and before the Department may issue a Well Spacing and Compulsory Integration Order in Quackenbush Hill Field. The Stipulation requires, among other things, that the well be at least 9,000 feet along strike or 5,280 feet perpendicular to strike of the geologic feature shown on Exhibit "D" to the Stipulation from an existing well in Quackenbush Hill Field and that the proposed Spacing Unit be no less than 560 acres and no more than 640 acres in size unless otherwise justified to the satisfaction of Department staff by reasonable geologic and engineering evidence. Prior to production, the Applicant must document its control of at least 75 percent of the oil and gas interests within the proposed Spacing Unit, and must submit engineering and geologic data and analysis in support of the proposed Spacing Unit. Upon Department approval of the Spacing Unit, the Applicant must show proof of notification to all Operators and unleased owners of uncontrolled acreage in accordance with Paragraph IV.F.4 of the Stipulation.

FINDING OF FACTS

1. In accordance with Section IV of the Stipulation, Fortuna has submitted all required information to the Department. Fortuna has demonstrated, among other things, that it controls 98.7 percent of the oil and gas interests within the proposed Reed Spacing Unit. Fortuna is the only operator of record holding leases in the Reed Unit.

2. The Reed Spacing Unit consists of 59 parcels and contains 515.42 acres in the Town of Corning, Steuben County. The breakdown of acreage within the proposed Spacing Unit is shown on the attached map and tabulation labeled Exhibit B7.

3. Fortuna has informed the one unleased owner in the Reed Spacing Unit, John Stephen and Stephen Jeffrey Lawton (“the Lawtons”), consistent with the procedural requirements contained in Paragraph IV.F.4 of the Stipulation, that the unleased owner’s interests are encompassed by the proposed Spacing Unit. Fortuna has provided the Department with copies of notice letters dated March 10, 2004, and April 30, 2004, a return receipt for the letter dated March 10, 2004 and an affidavit of receipt for a letter dated April 30, 2004. The Lawtons have objected to the proposed terms of compulsory integration.

4. The proposed Spacing Unit has been developed by Fortuna and approved by Department staff in accordance with applicable provisions of the ECL and the January 23 and December 30 Orders. Department staff’s approval of the proposed Spacing Unit is based upon a thorough review of the seismic, geologic and engineering data provided by Fortuna, including justification for a unit size smaller than 560 acres, and is consistent with applicable provisions of the ECL and the January 23 and December 30 Orders.

5. In accordance with Paragraph IV.D. of the Stipulation, the Department notified Fortuna by letter dated February 24, 2004 of its approval of the preliminary configuration of the proposed Reed Spacing Unit.

6. No substantive and significant comments regarding configuration of the unit have been submitted to the Department. The ninety day notice period pursuant to section IV.F.4 of the Stipulation concluded June 16, 2004.

NOW, THEREFORE, having considered the matter and been duly advised and having found that the establishment of the Reed Spacing Unit in the Town of Corning, Steuben County, is necessary to carry out the policy provisions of ECL Section 23-0301, it is hereby ORDERED that:

- A. The Reed Spacing Unit is hereby established consisting of 59 parcels and containing 515.42 acres surrounding the Reed 1 Well (API No. 31-101-23055-01) in the Town of Corning, Steuben County, as shown on the attached map labeled Exhibit “B7” which shows the Spacing Unit boundary, parcel boundaries and the top and bottom hole locations of the well.
- B. Only those separately owned tracts or parts thereof listed on the attached Exhibit “B7” tabulation are included in the Reed Spacing Unit.
- C. Production from the Reed 1 Well shall be allocated to each parcel within the Reed Spacing Unit based on the acreage of the parcel within the unit as a percentage of the total acreage in the Spacing Unit.
- D. Effective as of the date of this Order, all operations including, but not limited to, operation of Reed Spacing Unit and future drilling of any infill well in accordance with the terms of the Stipulation upon any portion of this Spacing Unit shall be deemed for all purposes to be the conduct of such operations upon each separately owned tract in this Spacing Unit by the owner or several owners thereof.
- E. That portion of the production allocated to each tract included in the Reed 1 Spacing Unit shall, when produced, be deemed for all purposes to have been produced from such tract by a well drilled thereon.

- F. Fortuna is the operator of the Reed 1 Spacing Unit and the well drilled therein.
- G. Fortuna, as the Spacing Unit Operator, shall file a copy of this Order with the Steuben County Clerk against all parcels in the Reed Spacing Unit and shall submit proof of such filing to the Director of the Bureau of Oil and Gas Regulation, in the Department's Division of Mineral Resources not later than ninety (90) days after the date of this Order.
- H. Fortuna is authorized to immediately release all escrowed royalty payments for the Reed Spacing Unit, including a one-eighth royalty to the Lawtons (Tax Map # 300.00-1-23, 6.56 acres). The release of royalty payments equal to the lowest royalty fraction, but no less than one-eighth, contained in any oil and gas lease within the applicable unit to the Lawtons does not preclude additional royalty payments, or allocation of production, if so provided by further negotiations or by a final Compulsory Integration Order in accordance with Paragraph VII of the Stipulation.
- I. Terms for compulsory integration, if necessary, will be established by a final order, in accordance with Paragraph VII of the Stipulation and subdivision three of ECL 23-0901.
- J. This Order shall apply to, and be binding upon, Fortuna and its subsidiaries, successors and assigns.

IN WITNESS WHEREOF: The Department of Environmental Conservation has caused this Order to be signed and issued and has filed the same in its office in the County of Albany, New York this 14th day of December, 2004.

DIVISION OF MINERAL RESOURCES
DEPARTMENT OF ENVIRONMENTAL CONSERVATION
BRADLEY J. FIELD, DIRECTOR

signed

Albany, New York
December 14, 2004

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