Hilcorp San Juan

September 10, 2019

Dear Revenue Owner:

You are receiving this letter because you own a Working Interest (WI), Royalty Interest (RI) and/or Overriding Royalty Interest (ORRI) in one or more Federal Units or Communitized Areas operated by Hilcorp San Juan throughout the San Juan Basin.

We are pleased to announce that going forward, the details that accompany your monthly revenue check have been abridged in an effort to improve and simplify check details and our internal processing. Specifically, we have modified our process to now report revenue on a "**unit basis**" rather than at the "**tract level**." This will not change the revenue amounts you are otherwise due from a particular Federal Unit or Communitized Area.

We hope we have anticipated any questions you may have regarding the "new look" to your revenue checks. If you have any questions, please call the Hilcorp Owner Hotline at 713.209.2457. Attached we have provided some additional background and an illustration showing an example of a tract to unit calculation.

Sincerely,

Hilcorp Owner Relations

Background:

Federal Units are comprised of multiple oil and gas leases that have been combined under a single operating agreement for the purpose of jointly developing and producing common reservoirs. Each Federal Unit has one or more Participating Areas (PA's). Each PA is specific to a particular reservoir (*e.g*., Fruitland Coal, Mesaverde, Dakota, *etc*.). That portion of an individual lease that contributes to the overall PA is referred to as a "tract." Costs and production from each PA are allocated on a surface-acreage basis, whereby the sum of all separate PA tracts are proportionate to the total PA's acreage.

Likewise, the term "communitization" refers to a process by which all or part of a State, Federal or Indian oil and gas lease is combined with other leased acreage to form a spacing/proration unit. Similar to Federal Units, Communitized Areas allocate production from the overall spacing/proration unit in proportion to the individual lease acreage. That portion of an individual lease that contributes to the overall spacing/proration unit is also referred to as a "tract."

Illustration:

For example, if a Federal Unit PA is 100 acres in size, and there are ten (10) separate lease tracts within the PA, and each lease tract is comprised of ten (10) acres, then each PA tract is deemed to contribute 10% to the PA's overall costs and production. The percentage each lease tract contributes to the overall PA (or Communitized Area) is referred to as the **Tract Participation Factor** (TPF).

The Tract Participation Factor is then used to calculate the royalty or overrides associated with each lease tract within the PA. Previously, Hilcorp reported monthly revenue on the "tract level," which required a two-step calculation, whereby the overall unit production's value (in dollars) was multiplied by each tract's TPF to obtain the percentage of unit revenue due to each tract. Then, the tract's percentage of unit revenue was multiplied by the Royalty (or ORRI) burden, to determine the royalty burden for each tract.

Please note example below is using general numbers to illustrate the calculation.

$$\$100 \qquad 50\% \quad = \quad \$50$$

(Overall unit production value) X (Tract Factor %) = Tract's % of unit revenue

and then

$$\$50 \qquad .125\% \qquad - \qquad \$6.25$$

(Tract's % of unit revenue X Owner's Royalty interest in tract) = Owner's unit revenue for the tract

There is an alternate method of distributing unit revenue, and that is to pay at the unit level rather than at a tract level. ***Please note the example below is using general numbers to illustrate the calculation.***

$$\underset{\text{(Tract's participation \% in unit}}{\textbf{50\%}} \text{ X } \underset{\text{Owner's Royalty interest \% in tract)}}{\textbf{.125\%}} = \underset{\text{Owner's unit interest \%}}{\textbf{.0625 \%}}$$

and then

$$\underset{\text{(Owner's unit \% derived from that tract}}{\textbf{.0625\%}} \text{ X } \underset{\text{Overall unit production value)}}{\textbf{\$100}} = \underset{\text{Owner's unit revenue for tract}}{\textbf{\$6.25}}$$

If an owner has interests in more than one tract, the owner's unit interests by tract can simply be added together to get the owner's total unit interest. Once the owner's unit interest has been calculated revenue and expenses will be disbursed at the unit level on a monthly basis going forward. The owner's unit interest multiplied by the unit production for the month will yield the owner's unit revenue for the month.