

EMPIRE PETROLEUM CORP  
Form 10-K  
March 03, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

---

**FORM 10-K**

---

**☐ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2013**

**☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**EMPIRE PETROLEUM CORPORATION**

(Exact name of registrant as specified in its charter)

---

**DELAWARE**

(State or Other Jurisdiction  
of Incorporation or Organization)

**001-16653**

(Commission File Number)

**73-1238709**

(I.R.S. Employer  
Identification No.)

**6506 S. Lewis Ave., Suite 112, Tulsa, OK 74316-1020**

---

(Address of principal executive offices) (Zip Code)

**918-488-8068**

(Registrant's telephone number, including area code, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

Title of each class: NONE

Name of each exchange on which registered: N/A

**Securities registered pursuant to 12(g) of the Act:**

Title of each class: Common Stock, \$0.001 par value

Name of each exchange on which registered

---

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

☐ Yes ☒ No

Edgar Filing: EMPIRE PETROLEUM CORP - Form 10-K

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

☐ Yes ☒ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

☒ Yes ☐ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

☐ Yes ☒ No

The aggregate market value of the voting and non-voting common equity held by non-affiliates, based upon the average bid and asked prices of the registrant's Common Stock on the last business day of the registrant's most recently completed second fiscal quarter was \$1,042,484.

**Note.**—If a determination as to whether a particular person or entity is an affiliate cannot be made without involving unreasonable effort and expense, the aggregate market value of the common stock held by non-affiliates may be calculated on the basis of assumptions reasonable under the circumstances, provided that the assumptions are set forth in the Form.

**APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY**

**PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a Plan confirmed by a court.

☐ Yes ☐ No

**(APPLICABLE ONLY TO CORPORATE REGISTRANTS)**

The number of shares of the registrant's common stock, \$0.001 par value, outstanding as of December 31, 2013 was 7,630,609.

**DOCUMENTS INCORPORATED BY REFERENCE**

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) Any annual report to security holders; (2) Any proxy or information statement; and (3) Any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933. The listed documents should be clearly described for identification purposes (e.g., annual report to security holders for fiscal year ended December 24, 1980).

EMPIRE PETROLEUM CORPORATION

FORM 10-K

TABLE OF CONTENTS

ITEM NUMBER AND CAPTION	PAGE NO.
<b>PART I</b>	
Item 1. Business	4-5
Item 1A. Risk Factors	5
Item 1B. Unresolved Staff Comments	5
Item 2. Properties	6-7
Item 3. Legal Proceedings	7
Item 4. Mine Safety Disclosures	7
<b>PART II</b>	
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	7-8
Item 6. Selected Financial Data	8
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	8-13
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	13
Item 8. Financial Statements and Supplementary Data	13
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	13
Item 9A. Controls and Procedures	13
Item 9B. Other Information	13-14
<b>PART III</b>	
Item 10. Directors, Executive Officers and Corporate Governance	14-15
Item 11. Executive Compensation	15
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	15-17
Item 13. Certain Relationships and Related Transactions, and Director Independence	17-18
Item 14. Principal Accounting Fees and Services	18
<b>PART IV</b>	
Item 15. Exhibits, Financial Statement Schedules	19-20
Signatures	21



## PART I

### ITEM 1. BUSINESS.

#### Background

Empire Petroleum Corporation, a Delaware corporation (the "Company" or "Empire"), was incorporated in the State of Utah in August 1983 under the name Chambers Energy Corporation and domesticated in Delaware in March 1985 under the name Americomm Corporation. The Company's name was changed to Americomm Resources Corporation in July 1995. On May 29, 2001, Americomm Resources Corporation acquired Empire Petroleum Corporation, which became a wholly owned subsidiary of Americomm Resources Corporation. On August 15, 2001, Americomm Resources Corporation and Empire Petroleum Corporation merged and the Company's name was changed to Empire Petroleum Corporation. The Company operates from leased office space at 6506 S. Lewis Ave., Suite 112, Tulsa, OK 74136-1020, and its telephone number is (918) 488-8068.

During the past three fiscal years, the Company has focused on the exploration of the Gabbs Valley Prospect and the evaluation of the South Okie Prospect as further described below.

#### Gabbs Valley Prospect

The Company owns a working interest in oil and gas leases in Nye County, Nevada (the "Gabbs Valley Prospect"). As of December 31, 2013, the Company's working interest was 50% on 30,346 gross acres and 88.5% on 3,840 gross acres. The Gabbs Valley Prospect consisted of 34,186 gross acres at December 31, 2013.

In 2006, a test well, the Empire Cobble Cuesta 1-12-12N-34E, Nye County, Nevada was drilled to a depth of 5,195 feet. The well encountered a volcanic formation at 1,760 feet and scattered oil shows from 2,000 feet to total depth. After reaching 5,195 feet, the Company and its partners elected to suspend operations on the well, release the drilling rig, and associated equipment and personnel to evaluate the drilling and logging data. After the study was completed, Empire and its partners decided to conduct a thorough testing program on the well. The Company re-entered the well on April 17, 2007 and conducted a series of drill stem tests and recovered only drilling mud. It was then determined after considerable study that the formation is likely very sensitive to mud and water used in drilling which may have caused clays in the formation to swell preventing any oil that might be present to flow into the wellbore.



In 2008, the Company and its partners engaged W. L. Gore and Associates to carry out an Amplified Geochemical Imaging Survey which covered approximately sixteen square miles. The survey was concentrated along the apex of the large Cobble Cuesta structure which included the areas around the Empire Cobble Cuesta 1-12 exploratory test and another test well drilled in the immediate area by a third party. Both of these tests encountered oil shows and the geochemical survey indicated potential hydrocarbons beyond the two well bores.

During 2010, the Company had a new Federal drilling unit formed and approved by the Bureau of Land Management ("BLM"). This unit was formed according to the Company's plans to drill a second test well on the prospect to be known as the Empire Paradise Unit 2-12. This test well was to be drilled to 6,000 feet, or 500 feet into the Triassic formation or into a zone that establishes commercial production at a lesser depth. Drilling operations were commenced July 19, 2010 and ceased on November 5, 2010. During the drilling phase, the Company had several zones where oil shows were observed. During its test from 3,698' to 3,786' a small amount of oil was recovered. Drilling continued to 4,248', encountering additional oil shows and the decision was made to set 7" production casing to 4,225'. A further attempt to deepen the hole failed when a heavy water flow was encountered at 4,248'. One further test through the pipe at 4,140' to 4,167' tested water. It was then decided to test the area between 3,700' to 3,782'. Oil was recovered from this interval and was swabbed at the rate of three (3) to five (5) barrels of oil per day. The recovered oil contained a significant amount of paraffin, which could have restricted the oil production. The Company then made the decision to plug the well, considering it to be non-commercial. One of the parties that had farmed out their interest to Empire for drilling the 2-12 test well asked for an assignment of the lease on which the well was drilled. Empire agreed to this assignment subject to such party's assumption of the plugging liabilities of both the 1-12 and 2-12 wells, plus the reclaiming and seeding of the two well sites and replacing Empire's \$25,000 drilling bond. The acquiring party conducted additional testing of the well. The Company has been provided with such additional well data. Although the Company is not optimistic that further testing will improve the 2-12 well, it believes there is producible oil in the very large Cobble Cuesta Structure, which is located 150 miles from the nearest oil production. As a result, the Company has conducted additional geological studies with the expectation it will likely attempt to promote the drilling of another test on the prospect.

Other than a small refinery located approximately 100 miles from the Gabbs Valley Prospect, and a six inch gas pipeline crossing our prospect, there are no service networks located near the prospect.

#### South Okie Prospect

On August 4, 2009, the Company purchased, for \$25,000 and payment of lease rentals of \$4,680, a nine month option to purchase oil and gas leases known as the South Okie Prospect in Natrona County, Wyoming.

The option allowed the Company to purchase the leasehold interests for \$35,000. The Tensleep Sand at depths from 3,300 feet to 4,500 feet is the primary target. As of December 31, 2009, the Company acquired 11 miles of seismic data and studies of this data were completed in early January 2010. An additional geological study was also completed early January 2010. Based on these studies, the Company exercised its option in 2010.

In October, 2012 the Company allowed one of the leases to terminate on the South Okie Prospect, Wyoming. As of December 31, 2013, the Company's interest in the South Okie Prospect consisted of approximately 110 net acres of leases.

## Competition

The oil and gas business is extremely competitive. The Company must compete with many long-established companies with greater financial resources and technical capabilities. The Company is not a significant participant in the oil and gas industry.

## Markets; Price Volatility

The market price of oil and gas is volatile, subject to speculative movement and depends upon numerous factors beyond the control of the Company, including expectations regarding inflation, global and regional demand, political and economic conditions and production costs. Future profitability, if any, will depend substantially upon the prevailing prices for oil and gas. If the market price for oil and gas is significantly depressed in the future, it could have a material adverse effect on the Company's ability to raise additional capital necessary to finance operations and to explore the Gabbs Valley and South Okie Prospects. Lower oil and gas prices may also reduce the amount of oil and gas, if any, that can be produced economically from the Company's properties. While the prices of oil and gas remain volatile, the oil and gas industry has recently experienced historically high prices for oil and gas. The Company anticipates that the prices of oil and gas will fluctuate somewhat in the near future.

## Regulation

The oil and gas industry is subject to extensive federal, state and local laws and regulations governing the production, transportation and sale of hydrocarbons as well as the taxation of income resulting therefrom.

Legislation affecting the oil and gas industry is constantly changing. Numerous federal and state departments and agencies have issued rules and regulations applicable to the oil and gas industry. In general, these rules and regulations regulate, among other things, the extent to which acreage may be acquired or relinquished; spacing of wells; measures required for preventing waste of oil and gas resources; and, in some cases, rates of production. The heavy and increasing regulatory burdens on the oil and gas industry increase the Company's cost of doing business and, consequently, affect profitability.

A substantial portion of the leases, which constitute the South Okie and Gabbs Valley Prospects are granted by the federal government and administered by the BLM and the Minerals Management Service ("MMS") of the U.S. Department of the Interior, both of which are federal agencies. Such leases are issued through competitive bidding, contain relatively standardized terms and require compliance with detailed BLM and MMS regulations and orders (which are subject to change by the BLM and the MMS). Leases are also accompanied by stipulations imposing restrictions on surface use and operations. Operations to be conducted by the Company on federal oil and gas leases must comply with numerous regulatory restrictions, including various nondiscrimination statutes. Federal leases also generally require a complete archaeology and environmental impact assessment prior to the authorization of an exploration or development plan.

The Company's oil and gas properties and operations are also subject to numerous federal, state and local laws and regulations relating to environmental protection. These laws govern, among other things, the amounts and types of substances and materials that may be released into the environment, the issuance of permits in connection with exploration, drilling and production activities, the reclamation and abandonment of wells and facility sites and the remediation of contaminated sites. These laws and regulations may impose substantial liabilities if the Company fails to comply or if any contamination results from the Company's operations.

#### Employees

As of December 31, 2013, the Company had one employee, a full-time secretary. Mr. Albert E. Whitehead, Chairman and Chief Executive Officer, devotes a considerable amount of time to the affairs of the Company and receives no compensation. For financial statement purposes, Mr. Whitehead's services have been recorded as contributed capital and expense in the amount of \$50,000 for the years ended December 31, 2013 and 2012.

#### ITEM 1A. RISK FACTORS

Not applicable.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

#### ITEM 2. PROPERTIES.

## Gabbs Valley Prospect

As of December 31, 2013, the Gabbs Valley Prospect consisted of approximately 34,186 gross acres of federal leases located in Nye County, Nevada, of which the Company owns a 50% working interest in 30,346 gross acres and 88.5% in 3,840 gross acres.

As of December 31, 2013, two wells, the Empire Cobble Cuesta 1-12 and the Empire Paradise 2-12, had been drilled and tested on this prospect, but the wells were not completed. For more information regarding the Gabbs Valley Prospect, see "Gabbs Valley Prospect" under Item 1 of this Form 10-K.

**COMPANY UNDEVELOPED ACREAGE (LEASES)****GABBS VALLEY PROSPECT, NYE COUNTY, NEVADA****AS OF DECEMBER 31, 2013**

<b>Federal Lease Number</b>	<b>Undeveloped Gross Acres</b>	<b>Acreage Net Acres</b>	<b>Productive Gross Acres</b>	<b>Acreage Net Acres</b>	<b>Effective Date</b>	<b>Remaining Term (Years)</b>
N-82185	1,927.00	963.50	-	-	9/1/2006	3
N-82186	2,355.00	1,177.50	-	-	9/1/2006	3
N-82187	760.00	380.00	-	-	9/1/2006	3
N-82195	2,560.00	1,280.00	-	-	9/1/2006	3
N-82196	2,560.00	1,280.00	-	-	9/1/2006	3
N-82197	1,920.00	960.00	-	-	9/1/2006	3
N-85867	2,538.67	1,269.34	-	-	11/1/2006	5
N-85871	2,544.24	1,272.12	-	-	11/1/2006	5
N-85873	2,400.00	1,200.00	-	-	11/1/2006	5
N-85876	2,461.00	1,230.50	-	-	11/1/2006	5
N-86998	2,560.00	1,280.00	-	-	11/1/2006	5
N-86999	2,560.00	1,280.00	-	-	11/1/2006	5
N-87000	2,560.00	1,280.00	-	-	11/1/2006	5
N-89136	640.00	320.00	-	-	12/1/2011	7
N-90505	1,920.00	1,699.20	-	-	2/1/2012	8
N-90506	1,920.00	1,699.20	-	-	2/1/2012	8
<b>TOTALS</b>	<b>34,185.91</b>	<b>18,571.36</b>				

During the last three years, the Company has drilled one well, the Empire Paradise Unit 2-12, which is in the Gabbs Valley Prospect. For additional information regarding this well, see Item 1 of this Form 10-K.

As of December 31, 2013, the Company's interest in the South Okie Prospect consisted of approximately 110 net acres of leases.

# **COMPANY UNDEVELOPED ACREAGE (LEASES)**

## **SOUTH OKIE PROSPECT, NATRONA COUNTY, WYOMING**

### **AS OF DECEMBER 31, 2013**

<b>Federal Lease Number</b>	<b>Undeveloped Gross Acres</b>	<b>Acreage Net Acres</b>	<b>Productive Gross Acres</b>	<b>Acreage Net Acres</b>	<b>Effective Date</b>	<b>Remaining Term (Years)</b>
WYW-0323746	240.00	30.00	-	-	11/1/1972	HBP
WYW-036587	320.00	40.00	-	-	11/1/1972	HBP
WYW-036587	40.00	40.00	-	-	11/1/1972	HBP
<b>TOTALS</b>	<b>600.00</b>	<b>110.00</b>				

### **ITEM 3. LEGAL PROCEEDINGS.**

As of December 31, 2013, neither the Company nor its properties were subject to any legal proceedings.

### **ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable.

## **PART II**

### **ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

Market Information

The Company's Common Stock is traded on the OTCQB under the symbol "EMPR".

The following table sets forth the high and low bid information for the Company's common stock during the time periods indicated.

Year ending December 31, 2012:

**Quarter HighLow**

03/31/12	.467	.21
06/30/12	.420	.21
09/30/12	.420	.12
12/31/12	.306	.119

Year ending December 31, 2013:

**Quarter HighLow**

03/31/13	.292	.061
06/30/13	.252	.120
09/30/13	.240	.015
12/31/13	.135	.05

Quotations reflect inter-dealer prices, without retail mark-up, markdown or commission and may not represent actual transactions.

At December 31, 2013, there were approximately 197 stockholders of record of the Company's Common Stock.

**Dividends**

The Company has never paid cash dividends on its Common Stock. The Company intends to retain future earnings for use in its business and, therefore, does not anticipate paying cash dividends on its Common Stock in the foreseeable future.

**Recent Sales of Unregistered Securities**

In August 2011, the Company issued 166,667 shares (2,000,000 pre-split shares) of its common stock to Albert E. Whitehead, its Chief Executive Officer, for a purchase price of \$0.60 per share post-split, which resulted in a total investment of \$100,000. In this Form 10-K, references to “pre-split” are references to the period prior to the reverse stock split of the Company’s common stock which occurred in 2013, and references to “post-split” are references to the period after the reverse stock split. Additional information about the reverse stock split is in Item 7 of this Form 10-K.

On December 11, 2012, the Company entered in a note conversion agreement with the Albert E. Whitehead Living Trust (the “Whitehead Trust”). Pursuant to the note conversion agreement, on December 11, 2012, the Company converted \$300,013 in debt owed by the Company to the Whitehead Trust into shares of Common Stock at a conversion rate of \$0.60 per share (post-split), resulting in the issuance of 500,021 shares (6,000,250 pre-split shares) of Common Stock to the Whitehead Trust. Upon the issuance of such shares, such debt owed by the Company to the Whitehead Trust was deemed paid in full and certain notes issued by the Company and the other obligations relating to such debt were terminated. Albert E. Whitehead, the Chief Executive Officer of the Company and Chairman of its Board of Directors, is the trustee of the Whitehead Trust.

For information about additional private equity placements conducted by the Company, see “Private Equity Placements” in Item 7 of this Form 10-K.

The offers and sales related to the securities described above were not registered under the Securities Act of 1933, as amended, in reliance upon the exemption from the registration requirements of that act provided by Section 4(2) thereof. The recipient of the securities is a sophisticated investor with the experience and expertise necessary to evaluate the merits and risks of an investment in the Company's stock and the financial means to bear the risks of such an investment.

#### ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

#### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

##### **Cautionary Note Regarding Forward-Looking Statements.**

All statements, other than statements of historical fact, contained in this report are forward-looking statements. Forward-looking statements generally are accompanied by words such as "anticipate", "believe", "estimate", "expect",

"may", "might", "potential", "project" or similar statements.

Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, no assurance can be given that such expectations will prove to be correct. Factors that could cause results to differ materially from the results discussed in such forward-looking statements include:

- \* the need for additional capital,
- \* the costs expected to be incurred in exploration and development,
- \* unforeseen engineering, mechanical or technological difficulties in drilling wells,
- \* uncertainty of exploration results,
- \* operating hazards,
- \* competition from other natural resource companies,
- \* the fluctuations of prices for oil and gas,
- \* the effects of governmental and environmental regulation, and
- \* general economic conditions and other risks described in the Company's filings with the Securities and Exchange Commission (the "SEC").

Information on these and other risk factors are discussed under "Factors That May Affect Future Results" below. Accordingly, the actual results of operations in the future may vary widely from the forward-looking statements included herein, and all forward-looking statements in this Form 10-K are expressly qualified in their entirety by the



cautionary statements in this paragraph.

Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis, judgment, belief and expectations only as of the date hereof. The Company undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof.

#### **Factors That May Affect Future Results.**

The Company does not have any significant on-going income producing oil and gas properties and has limited financial resources.

For the past three fiscal years, the Company has financed its operations primarily from sales of its equity securities and from loans made to the Company by Albert E. Whitehead, the Company's Chief Executive Officer. There is no assurance that the Company will be able to continue to finance its operations through the sale of its equity securities, or through loans or advances by third parties. In addition, Mr. Whitehead has no obligation to advance the Company any additional money, and there is no assurance that he will do so.

The Company reported losses of \$(227,823) and \$(253,348) for the years ended December 31, 2013 and 2012, respectively. The Company also had an accumulated deficit of \$(14,487,724) as of December 31, 2013. The Company can provide no assurance that it will be profitable in the future and, if the Company does not become profitable, it may have to suspend its operations. As a result of the foregoing, the audit report of the Company's independent registered public accounting firm relating to the Company's financial statements has been modified because of a going concern uncertainty. If the Company is able to raise the funds necessary to continue its operations, its future performance will be dependent on the successful drilling results of its inventory of unproved locations in Wyoming and Nevada. The failure of drilling activities to achieve sufficient quantities of economically attractive reserves and production would have a material adverse effect on the Company's liquidity, operations and financial results.

#### **The Company could be adversely affected by fluctuations in oil and gas prices.**

Even if the Company's drilling activities achieve commercial quantities of economically attractive reserves and production revenue, the Company will remain subject to prevailing prices for oil, natural gas and natural gas liquids, which are dependent upon numerous factors such as weather, economic, political and regulatory developments and competition from other sources of energy. The volatile nature of the energy markets makes it particularly difficult to estimate future prices of oil, natural gas and natural gas liquids. Prices of oil, natural gas and natural gas liquids are subject to wide fluctuations in response to relatively minor changes in circumstances,

and there can be no assurance that future prolonged decreases in such prices will not occur. All of these factors are beyond the control of the Company. Any significant decline in oil and gas prices could have a material adverse effect on the Company's liquidity, operations and financial condition.

**The Company could be adversely affected by increased costs of service providers utilized by the Company.**

In accordance with customary industry practice, the Company relies on independent third party service providers to provide most of the services necessary to drill new wells, including drilling rigs and related equipment and services, horizontal drilling equipment and services, trucking services, tubulars, fracing and completion services and production equipment. The industry has experienced significant price fluctuations for these services during the last year and this trend is expected to continue into the future. These cost uncertainties could, in the future, significantly increase the Company's development costs and decrease the return possible from drilling and development activities, and possibly render the development of certain proved undeveloped reserves uneconomical.

**The Company is subject to numerous drilling and operating risks.**

Oil and gas drilling activities are subject to numerous risks, many of which are beyond the Company's control. The Company's operations may be curtailed, delayed or canceled as a result of title problems, weather conditions, compliance with governmental requirements, mechanical difficulties and shortages or delays in the delivery of equipment. In addition, the Company's properties may be susceptible to hydrocarbon drainage from production by other operators on adjacent properties. Industry operating risks include the risk of fire, explosions, blow-outs, pipe failure, abnormally pressured formations and environmental hazards such as oil spills, gas leaks, ruptures or discharges of toxic gases, the occurrence of any of which could result in substantial losses to the Company due to injury or loss of life, severe damage to or destruction of property, natural resources and equipment, pollution or other environmental damage, clean-up responsibilities, regulatory investigation and penalties and suspension of operations.

**The Company's insurance policies may not adequately protect the Company against certain unforeseen risks.**

In accordance with customary industry practice, when conducting drilling operations, the Company maintains insurance against some, but not all, of the risks described herein. There can be no assurance that any insurance will be adequate to cover the Company's losses or liabilities. The Company cannot predict the continued availability of insurance, or its availability at premium levels that justify its purchase.

**The Company is subject to various environmental risks, and governmental regulation relating to environmental matters.**

The Company is subject to a variety of federal, state and local governmental laws and regulations related to the storage, use, discharge and disposal of toxic, volatile or otherwise hazardous materials. These regulations subject the Company to increased operating costs and potential liability associated with the use and disposal of hazardous materials. Although these laws and regulations have not had a material adverse effect on the Company's financial condition or results of operations, there can be no assurance that the Company will not be required to make material expenditures in the future. Moreover, the Company anticipates that such laws and regulations will become increasingly stringent in the future, which could lead to material costs for environmental compliance and remediation by the Company. Any failure by the Company to obtain required permits for, control the use of, or adequately restrict the discharge of hazardous substances under present or future regulations could subject the Company to substantial liability or could cause its operations to be suspended. Such liability or suspension of operations could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company's activities are subject to extensive governmental reg