TENGASCO INC
Form 10-K
March 29, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

REPORT ON FORM 10-K

(Mark one)

[X} Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2012 or

[ ] Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from __________ to __________.

Commission File No. 1-15555

TENGASCO, INC.

(name of registrant as specified in its charter)

Delaware (state or other jurisdiction of Incorporation or organization)	87-0267438 (I.R.S. Employer Identification No.)

11121 Kingston Pike, Suite E, Knoxville, TN	37934
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (865) 675-1554

Securities registered pursuant to Section 12(b) of the Act: None.

Securities registered pursuant to Section 12(g) of the Act: Common Stock, $.001 par value per share.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. Yes [ ] [X] No

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 [ ] [X] No

Indicated by check mark whether the registrant (1) 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 [X] [ ] No

Indicate by checkmark 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 (§ 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) [X] Yes [ ] No

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K (§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 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 [X]

(Do not check if a Smaller Reporting Company)

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter was approximately $31 million (June 29, 2012 closing price $0.80).

The number of shares outstanding of the registrant's $.001 par value common stock as of the close of business on March 15, 2013 was 60,842,413.

Table of Contents

FORWARD LOOKING STATEMENTS

The information contained in this Report, in certain instances, includes forward-looking statements within the meaning of applicable securities laws. Forward-looking statements include statements regarding the Company's "expectations," "anticipations," "intentions," "beliefs," or "strategies" or any similar word or phrase regarding t future. Forward-looking statements also include statements regarding revenue margins, expenses, and earnings analysis for 2012 and thereafter; oil and gas prices; exploration activities; development expenditures; costs of regulatory compliance; environmental matters; technological developments; future products or product development; the Company's products and distribution development strategies; potential acquisitions or strategic alliances; liquidity and anticipated cash needs and availability; prospects for success of capital raising activities; prospects or the market for or price of the Company's common stock; and control of the Company. All forward-looking statements are based on information available to the Company as of the date hereof, and the Company assumes no obligation to update any such forward-looking statement. The Company's actual results could differ materially from the forward-looking statements. Among the factors that could cause results to differ materially are the factors discussed in "Risk Factors" below in Item 1A of this Report.

Projecting the effects of commodity prices, which in past years have been extremely volatile, on production and timing of development expenditures includes many factors beyond the Company's control. The future estimates of net cash flows from the Company's proved reserves and their present value are based upon various assumptions about future production levels, prices, and costs that may prove to be incorrect over time. Any significant variance from assumptions could result in the actual future net cash flows being materially different from the estimates.

GLOSSARY OF OIL AND GAS TERMS

The following are abbreviations and definitions of certain terms commonly used in the oil and gas industry and this document:

Bbl. One stock tank barrel, or 42 U.S. gallons liquid volume, used in reference to oil or other liquid hydrocarbons.

Bcf. One billion cubic feet of gas.

BOE. One stock tank barrel equivalent of oil, calculated by converting gas volumes to equivalent oil barrels at a ratio of 6 thousand cubic feet of gas to 1 barrel of oil.

BOPD. Barrels of oil per day.

Btu. British thermal unit. One British thermal unit is the amount of heat required to raise the temperature of one pound of water by one degree Fahrenheit.

Developed oil and gas reserves. Developed oil and gas reserves are reserves of any category that can be expected to be recovered: (i) through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and (ii) through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.

Development project. A development project is the means by which petroleum resources are brought to the status of economically producible. As examples, the development of a single reservoir or field, an incremental development in a producing field or the integrated development of a group of several fields and associated facilities with a common ownership may constitute a development project.

Development well. A well drilled within the proved area of an oil or gas reservoir to the depth of a stratigraphic horizon known to be productive.

Differential. An adjustment to the price of oil or gas from an established spot market price to reflect differences in the quality and/or location of oil or gas.

Economically producible. The term economically producible, as it relates to a resource, means a resource which generates revenue that exceeds, or is reasonably expected to exceed, the costs of the operation. The value of the products that generate revenue shall be determined at the terminal point of oil and gas producing activities. The terminal point is generally regarded as the outlet valve on the lease or field storage tank.

Estimated ultimate recovery (EUR). Estimated ultimate recovery is the sum of reserves remaining as of a given date and cumulative production as of that date,

Exploratory well. A well drilled to find a new field or to find a new reservoir in a field previously found to be productive of oil or gas in another reservoir. Generally, an exploratory well is any well that is not a development well, an extension well, a service well or a stratigraphic test well.

Farmout. An assignment of an interest in a drilling location and related acreage conditional upon the drilling of a well on that location.

Gas. Natural gas.

MBbl. One thousand barrels of oil or other liquid hydrocarbons.

MBOE. One thousand BOE.

Mcf. One thousand cubic feet of gas.

Mcfd. One thousand cubic feet of gas per day

MMcfe. One million cubic feet of gas equivalent.

MMBOE. One million BOE.

MMBtu. One million British thermal units.

MMcf. One million cubic feet of gas.

NYMEX. New York Mercantile Exchange.

Oil. Crude oil, condensate and natural gas liquids.

Operator. The individual or company responsible for the exploration and/or production of an oil or gas well or lease.

Play. A geographic area with hydrocarbon potential.

Polymer. The purpose of the polymer gel treatment is to reduce excessive water production and increase oil or gas production from wells that produce from water-drive reservoirs. These wells are typically produced from naturally fractured carbonate reservoirs such as dolomites and limestone in mature fields. Successful treatments are also run in certain types of sandstone reservoirs. Other practical applications of polymer gels include the treatment of waterflood injection wells to correct channeling or change the injection profile, to improve the ability of the injected fluids to sweep the producing wells in the field, making the waterflood much more efficient and allowing the operator to recover more oil in a shorter period of time.

Proved oil and gas reserves. Proved oil and gas reserves are those quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for estimation. The project to extract the hydrocarbons must have commenced, or the operator must be reasonably certain that it will commence the project, within a reasonable time.

The area of the reservoir considered as proved includes all of the following: (i) the area identified by drilling and limited by fluid contacts, if any; and (ii) adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil and gas on the basis of available geoscience and engineering data.

In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons as seen in a well penetration unless geoscience, engineering or performance data and reliable technology establish a lower contact with reasonable certainty.

Where direct observation from well penetrations has defined a highest known oil elevation and the potential exists for an associated gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering or performance data and reliable technology establish the higher contact with reasonable certainty.

Reserves which can be produced economically through application of improved recovery techniques (including, but not limited to, fluid injection) are included in the proved classification when: (i) successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir or an analogous reservoir or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and (ii) the project has been approved for development by all necessary parties and entities, including governmental entities.

Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price shall be the average price during the twelve-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.

Proved reserve additions. The sum of additions to proved reserves from extensions, discoveries, improved recovery, acquisitions and revisions of previous estimates.

Reserves. Reserves are estimated remaining quantities of oil and gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and gas or related substances to market and all permits and financing required to implement the project. Reserves should not be assigned to adjacent reservoirs isolated by major, potentially sealing, faults until those reservoirs are penetrated and evaluated as economically producible. Reserves should not be assigned to areas that are clearly separated from a known accumulation by a non-productive reservoir (i.e., absence of reservoir, structurally low reservoir or negative test results). Such areas may contain prospective resources (i.e., potentially recoverable resources from undiscovered accumulations).

Reserve additions. Changes in proved reserves due to revisions of previous estimates, extensions, discoveries, improved recovery and other additions and purchases of reserves in-place.

Reserve life. A measure of the productive life of an oil and gas property or a group of properties, expressed in years.

Royalty interest. An interest in an oil and gas lease that gives the owner of the interest the right to receive a portion of the production from the leased acreage (or of the proceeds of the sale thereof), but generally does not require the owner to pay any portion of the costs of drilling or operating the wells on the leased acreage. Royalties may be either landowner's royalties, which are reserved by the owner of the leased acreage at the time the lease is granted, or overriding royalties, which are usually reserved by an owner of the leasehold in connection with a transfer to a subsequent owner.

Standardized measure. The present value, discounted at 10% per year, of estimated future net revenues from the production of proved reserves, computed by applying sales prices used in estimating proved oil and gas reserves to the year-end quantities of those reserves in effect as of the dates of such estimates and held constant throughout the productive life of the reserves and deducting the estimated future costs to be incurred in developing, producing and abandoning the proved reserves (computed based on year-end costs and assuming continuation of existing economic conditions). Future income taxes are calculated by applying the appropriate year-end statutory federal and state income tax rate with consideration of future tax rates already legislated, to pre-tax future net cash flows, net of the tax basis of the properties involved and utilization of available tax carryforwards related to proved oil and gas reserves.

SWD. Salt water disposal well.

Undeveloped oil and gas reserves. Undeveloped oil and gas reserves are reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances.

Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances justify a longer time. Under no circumstances shall estimates for undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, or by other evidence using reliable technology establishing reasonable certainty.

Waterflood. A method of secondary recovery in which water is injected into the reservoir formation to displace residual oil. The water from injection wells physically sweeps the displaced oil to adjacent production wells.

Working interest. An interest in an oil and gas lease that gives the owner of the interest the right to drill for and produce oil and gas on the leased acreage and requires the owner to pay a share of the costs of drilling and production operations.

References herein to the “Company”, “we”, “us” and “our” mean Tengasco, Inc.

PART I

ITEM 1. BUSINESS.

History of the Company

The Company was initially organized in Utah in 1916 under a name later changed to Onasco Companies, Inc. In 1995, the Company changed its name from Onasco Companies, Inc. by merging into Tengasco, Inc., a Tennessee corporation, formed by the Company solely for this purpose. At the Company’s Annual Meeting held on June 11, 2011, the stockholders of the Company approved an Agreement and Plan of Merger previously adopted by the Company’s Board of Directors which provided for the merger of the Company into a wholly-owned subsidiary formed in Delaware for the purpose of changing the Company’s state of incorporation from Tennessee to Delaware. The merger became effective on June 12, 2011 and the Company is now a Delaware corporation.

OVERVIEW

The Company is in the business of exploration for and production of oil and natural gas. The Company’s primary area of oil exploration and production is in Kansas. The Company’s primary area of gas production is the Swan Creek field in Tennessee.

The Company's wholly-owned subsidiary, Tengasco Pipeline Corporation ("TPC") owns and operates a 65-mile intrastate pipeline which it constructed to transport natural gas from the Company's Swan Creek Field to customers in Kingsport, Tennessee.

The Company's wholly-owned subsidiary, Manufactured Methane Corporation ("MMC") operates treatment and delivery facilities using the latest developments in available treatment technologies for the extraction of methane gas from nonconventional sources for delivery through the nation's existing natural gas pipeline system, including the Company's pipeline system in Tennessee for eventual sale to natural gas customers.

The Company also had a management agreement with Hoactzin Partners, L.P. ("Hoactzin") to manage Hoactzin's oil and gas properties in the Gulf of Mexico offshore Texas and Louisiana (See below, "General 4. Management Agreement with Hoactzin"). Peter E. Salas, the Chairman of the Board of Directors of the Company, is the controlling person of Hoactzin. He is also the sole shareholder and controlling person of Dolphin Management, Inc., the general partner of Dolphin Offshore Partners, L.P., which is the Company's largest shareholder. This management agreement expired on December 18, 2012.

General

1. The Kansas Properties

The Kansas Properties are located in central Kansas and as of December 31, 2012 include 196 producing oil wells, 21 shut-in wells, and 37 active disposal wells. Our management and staff have a great deal of Kansas exploration and production experience. We have onsite production management and field personnel working in Kansas.

In 2012, the Company continued to focus on both development and exploration drilling. Many of the wells that were drilled were on leases that are still in effect because they are being held by existing production. The leases provide for a landowner royalty of 12.5%. Some wells are subject to an overriding royalty interest from 0.5% to 9%. Other than such wells bearing overriding royalties, the Company maintains a 100% working interest in most of its older wells and any undrilled acreage in Kansas. The terms for most of the Company's newer leases in Kansas are from three to five years.

During 2012, the Company drilled 20 gross wells. The Company has a 100% working interest in all of the wells. The success rate of the 20 wells drilled by the Company in Kansas was 75% resulting in 15 producers and 5 dry holes.

Kansas as a whole is of major significance to the Company. The majority of the Company's current reserve value, current production, revenue, and future development objectives are centered in the Company's ongoing interest in Kansas. By using 3-D seismic evaluation on existing locations owned by the Company in Kansas, the Company has added and continues to add proven direct offset locations.

A. Kansas Ten Well Drilling Program

On September 17, 2007, the Company entered into a ten well drilling program with Hoactzin, consisting of three wildcat wells and seven developmental wells to be drilled on the Company's Kansas Properties (the "Program"). Under the terms of the Program, Hoactzin paid the Company $0.4 million for each producing well and $0.25 million for each per dry hole. The terms of the Program also provided that Hoactzin would receive all the working interest in the producing wells, and would pay an initial fee to the Company of 25% of its working interest revenues net of operating expenses, referred to as a management fee. The fee paid to the Company by Hoactzin will increase to an 85% working interest when net revenues received by Hoactzin reach an agreed payout point of approximately 1.35 times Hoactzin's purchase price (the "Payout Point").

Nine of the ten wells in the program were completed as oil producers and during the 4th quarter 2012 had gross production of approximately 36 barrels per day in total. Hoactzin paid a total of $3.85 million (the "Purchase Price") for its interest in the Program resulting in the Payout Point being determined as $5.2 million. The Purchase Price paid by Hoactzin for its interest in the Program wells exceeded the Company's actual drilling cost of approximately $2.6 million for the ten wells by more than $1 million.

In 2012, the wells from the Program produced 14.3 MBbl of which 9.1 MBbl were net to Hoactzin. As of December 31, 2012, net revenues received by Hoactzin from the Program totaled $4.6 million which leaves a balance of $0.6 million until the Payout Point is reached.

Although production level of the Program wells will decline over time in accordance with expected decline curves, based on the drilling results of the Program wells to date and the current price of oil, the Program wells are now expected to reach the Payout Point by late 2013 or early 2014. However, under the terms of the agreement reaching the Payout Point could be accelerated by applying 75% of the net profits Hoactzin receives from the methane extraction project developed by MMC at the Carter Valley, Tennessee landfill (the "Methane Project"), toward reaching the Payout Point. (The Methane Project is discussed in greater detail below.)

The reserve information for the parties' respective Ten Well Program interests as of December 31, 2012 is indicated in the table below. Reserve reports are obtained annually and estimates related to those reports are updated upon receipt of the report. These calculations were made using commodity prices based on the twelve month arithmetic average of the first day of the month price for the period January through December 2012 as required by SEC regulations. The table below reflects eventual pay as occurring through the realization of proceeds at prices used in the reserve report dated December 31, 2012 of approximately $88.08 per barrel.

Reserve Information for Ten Well Program Interest as of December 31, 2012

	Barrels Attributable to Party's Interest MBbl	Undiscounted Future Cash Flows Attributable to Party's Interest (in thousands)	Present Value of Future Cash Flows Discounted at 10% Attributable to Party's Interest (in thousands)
Tengasco	113.7	$6,657	$2,609
Hoactzin Partners, L.P.	29.9	$1,835	$1,098

B. Kansas Production

The Company's gross oil production in Kansas increased from 241 MBbl in 2011 to 279 MBbl in 2012. Approximately 30 MBbl of the 279 MBbl in 2012 were related to production from the 15 successful wells drilled during 2012 and approximately 44 MBbl were related to production increases as a result of the 12 polymers that were performed during 2012. These increases were partially offset by normal production declines.

The capital projects undertaken by the Company in 2012 were initially funded by borrowings from the Company credit facility. However, these additional borrowings under the Company's credit facility were repaid by December 31, 2012.

2. The Tennessee Properties

In the early 1980's Amoco Production Company owned numerous acres of oil and gas leases in the Eastern Overthrust in the Appalachian Basin, including the area now referred to as the Swan Creek Field. Amoco successfully drilled two natural gas discovery wells in the Swan Creek Field to the Knox Formation. In the mid-1980's, however, development of this field was cost prohibitive due to a substantial decline in worldwide oil and gas prices which was further exacerbated by the high cost of constructing a necessary 23-mile pipeline to deliver gas from the Swan Creek Field to the closest market. In July 1995, the Company acquired the Swan Creek leases and began development of the field.

As of December 31, 2012, the Company has evaluated Swan Creek and nearby properties for the purpose of determining the value of continued development. In addition, the Company has evaluated the likelihood of realizing additional revenues from transportation of third party gas. As a result of these evaluations, Management has determined that Swan Creek and Pipeline are no longer considered core properties to the Company. At December 31, 2012, the Company was in the process of negotiating the sale of the Swan Creek and Pipeline assets. On March 1, 2013, the Company entered into an agreement with Swan Creek Partners LLC to sell the Company's Swan Creek and Pipeline assets for $1.5 million. Final closing of this transaction is contingent upon customary due diligence as well as certain regulatory and easement holder approvals.

A. Swan Creek Pipeline Facilities

The Company's completed pipeline system is owned and operated by TPC and extends 65 miles from the Swan Creek Field to several meter stations in Kingsport, Tennessee. The pipeline system was built for a total cost of $16.4 million. The Company reviews the carrying value of the pipeline for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends, and prospects, as well as the effects of obsolescence, demand, competition, and other economic factors. During 2010 there were indicators the pipeline may be impaired and the Company performed an assessment of the carrying value as of December 31, 2010 based on expected future cash flows. The assessment resulted in the Company recording an impairment of approximately $5.0 million for the year ended December 31, 2010. At December 31, 2012 management determined that an additional impairment of approximately $5.2 million was required. This determination at December 31, 2012 was based on negotiations with a third party regarding the sale of the pipeline assets as well as the Company's inability to realize additional revenues from transportation of third party gas.

The carrying value of the pipeline has been classified in assets held for sale and the associated revenues and expenses net of taxes have been classified as discontinued operations. The carrying value of the pipeline included in assets held for sale was approximately $1.4 million and $6.9 million at December 31, 2012 and 2011, respectively.

B. Swan Creek Production and Development

The Company has concluded based on the results of previously drilled wells and seismic data that drilling new gas wells in the Swan Creek Field would not achieve any significant increase in daily gas production totals from the Field. Current wells in production in the Swan Creek Field would be capable of and would likely produce all the remaining reserves in that Field. As a result, the Company has not drilled any new gas wells in the Swan Creek Field since 2004.

Because no drilling for natural gas in the Knox formation in Swan Creek is anticipated in the future, the current production levels less decline are the sole value of natural gas reserves and natural gas production. The existing production from the current wells producing natural gas are showing typical Appalachian production declines, which exhibit a long-lived nature but more modest volumes. The experienced decline in actual production levels from existing wells in the Swan Creek Field was expected and predictable. Although there can be no assurance, the Company expects these natural rates of decline in the future will be comparable to historical decline experienced over the 2010-2012 period.

As the Swan Creek assets represent only a small portion of the Company's full cost pool, these asset will remain in oil and gas properties and related operations will continue to be classified in continuing operations.

During 2012, the Company had 14 producing gas wells and 4 producing oil wells in the Swan Creek Field. Gross gas production from the Swan Creek Field during 2012 averaged 216 Mcfd compared to 145 Mcfd in 2011. Gross oil sales volumes from the Swan Creek field during 2012 averaged approximately 13 BOPD compared to 15 BOPD in 2011.

3. Methane Project

On October 24, 2006, the Company signed a twenty-year Landfill Gas Sale and Purchase Agreement (the "Agreement") with BFI Waste Systems of Tennessee, LLC ("BFI"), an affiliate of Allied Waste Industries ("Allied"). In 2008, Allied merged into Republic Services, Inc. ("Republic"). The Company assigned its interest in the Agreement to MMC and provides that MMC will purchase the entire naturally produced gas stream being collected at the Carter Valley municipal solid waste landfill owned and operated by Republic in Church Hill, Tennessee and located about two miles from the Company's pipeline. The Company installed a proprietary combination of advanced gas treatment technology to extract the methane component of the purchased gas stream. Methane is the principal component of natural gas and makes up about half of the purchased raw gas stream by volume. The Company constructed a pipeline to deliver the extracted methane gas to the Company's existing pipeline (the "Methane Project").

The total cost for the Methane Project, including pipeline construction, was approximately $4.5 million. The costs of the Methane Project were funded primarily by (a) the money received by the Company from Hoactzin to purchase its interest in the Ten Well Program which exceeded the Company's actual costs of drilling the wells in that Program by more than $1 million; (b) cash flow from the Company's operations; and (c) $0.8 million of the funds the Company borrowed under its then credit facility with Sovereign Bank of Dallas, Texas ("Sovereign Bank"). Methane gas produced by the project facilities was initially mixed in the Company's pipeline and delivered and sold to Eastman under the terms of the Company's natural gas purchase and sale agreement with Eastman. The gas supply from this landfill is projected to grow over the years as the underlying operating landfill continues to expand and generate additional naturally produced gas, and for several years following the closing of the landfill, estimated by Republic to occur in 2041. Gas production will continue in commercial quantities up to approximately 14 years after closure of the landfill.

MMC declared startup of commercial operations on April 1, 2009. During the month of April, the facility produced and sold 14 MMcf of methane gas to Eastman Chemical Company ("Eastman") and was online about 91% of the calendar month. System maintenance and landfill supply adjustments accounted for the remainder of the time. On May 1, 2009, Eastman advised MMC that it was suspending deliveries of the methane gas stream pending approval by the federal Environmental Protection Agency ("EPA") of Eastman's petition for inclusion of treated methane gas as natural gas within the meaning of the EPA's continuous emission monitoring rules applicable to Eastman's large boilers during the annual "smog season" beginning May 1st of each year. Although Eastman had begun seeking this approval in February, 2009, with the assistance of the Air Quality Department of the Tennessee Department of Environment and Conservation, the EPA had not acted by May 1, 2009. Eastman furnished to the EPA information provided by MMC that establishes that the methane gas stream is better fuel under the rule standards than even "natural" gas, which is technically defined in the smog season rules to include gas being “found in geologic formations beneath the earth’s surface”. Because approval was not promptly received, MMC was forced to seek alternative markets for the methane gas stream.

The Company concluded an agreement for sale of the methane gas to Hawkins County Gas Utility District, a local utility commencing August 1, 2009 on a month to month basis. Effective September 1, 2009 the Company also began sales of its Swan Creek gas production to Hawkins County Gas Utility District, because the physical mixing of Swan Creek natural gas with MMC’s methane gas caused Eastman to suspend deliveries of both categories of gas as mixed.

On August 27, 2009, the Company entered into a five-year fixed price gas sales contract with Atmos Energy Marketing, LLC, (“AEM”) in Houston, Texas, a nonregulated unit of Atmos Energy Corporation (NYSE: ATO) for the sale of the methane component of landfill gas produced by MMC at the Carter Valley Landfill. The agreement provides for the sale of up to 600 MMBtu per day. The contract was effective beginning with September 2009 gas production and ends July 31, 2014. The agreed contract price of over $6 per MMBtu was a premium to the then current five-year strip price for natural gas on the NYMEX futures market.

MMC’s plant is capable of remaining in operation for a full 24 hours per day. Daily production decreases during days when the plant operates less than 24 hours, whether due to any equipment or collection system supply issue. The primary reason experienced for less-than-24-hour operation since April 2009 has been frequent spiking in the oxygen content in the raw gas collected by Republic and delivered to the plant, rather than being caused by equipment malfunctions in MMC’s plant.