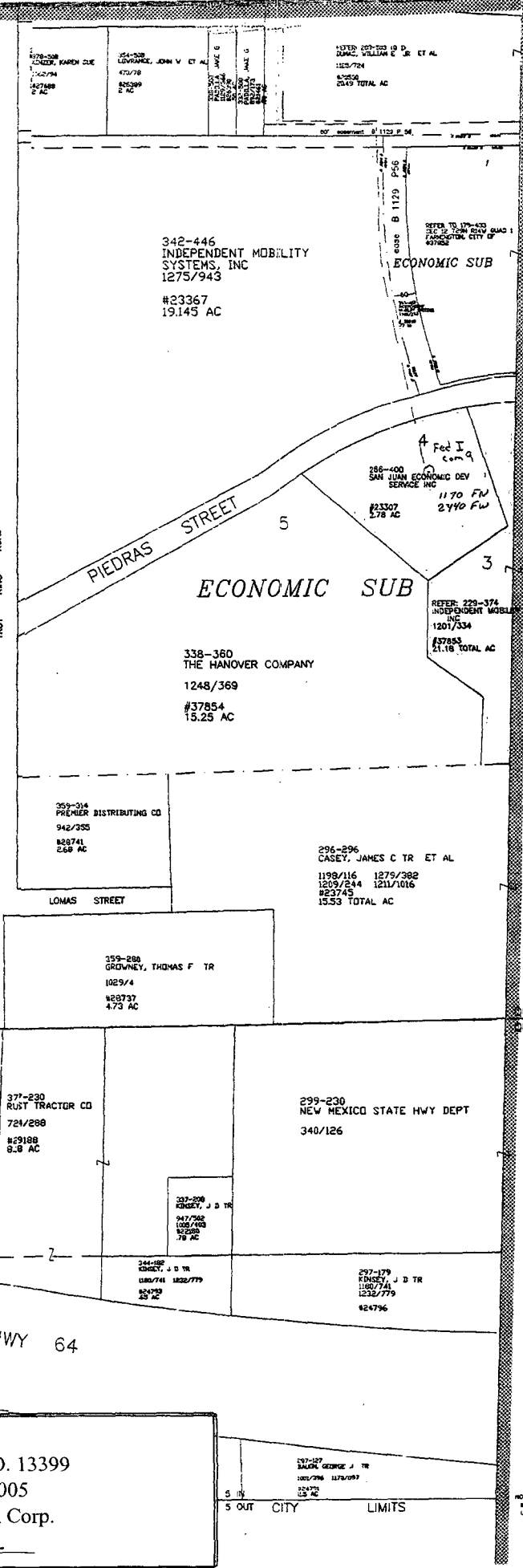
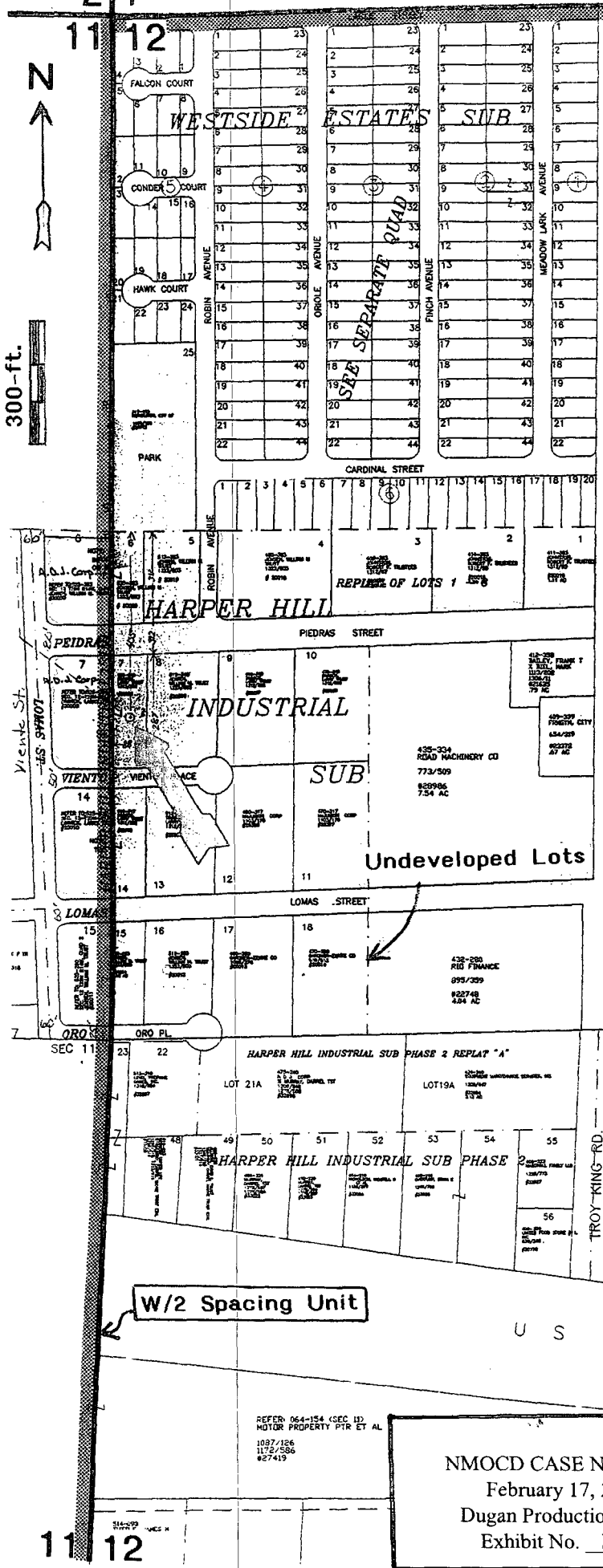


Sec. 12, T29N, R14W (NW/4 & N2/SW)

1



300-ft.



PROP
SA
SCAL
NOTE:
INFORMATION ON RECORD

NOTE:
THIS MAP

QUAD 1
QUAD 4

PROPERTY
SAN
N

SCALE:
NOTE:
INFORMATION ON
RECORD

NMOCD CASE NO. 13399
February 17, 2005
Dugan Production Corp.
Exhibit No. 2

REFER: 064-154 (SEC 12)
MOTOR PROPERTY PIR ET AL
1087/126
1172/586
#27419

297-127
SALON, GEORGE J TR
1001/276 1178/097
122/72
25.72 AC

11 12

Chapter 19

OIL AND GAS WELLS*

Article 1. In General

- Sec. 19-1-1. Definitions.
- Sec. 19-1-2. Obstructing streets.
- Sec. 19-1-3. Proximity of well, tanks or pipelines to building.
- Sec. 19-1-4. Removal of rigs from the premises; watchman.
- Sec. 19-1-5. Slush and reserve pits.
- Sec. 19-1-6. Abandonment and plugging.

Article 2. Administration and Enforcement

Division 1. Generally

- Sec. 19-2-1. Oil and gas inspector advised by commission.
- Sec. 19-2-2. Applicability of federal and state laws; conflicts.
- Sec. 19-2-3. Enforcement and penalties.
- Secs. 19-2-4—19-2-30. Reserved.

Division 2. Oil and Gas and Geologic and Engineering Hazards Advisory Commission

- Sec. 19-2-31. Established.
- Sec. 19-2-32. Membership.
- Sec. 19-2-33. Meetings.
- Sec. 19-2-34. Vacancies and removal from office.
- Sec. 19-2-35. Quorum.
- Sec. 19-2-36. Purpose.
- Sec. 19-2-37. Powers and duties.
- Secs. 19-2-38—19-2-65. Reserved.

Division 3. Permits

- Sec. 19-2-66. Required.
- Sec. 19-2-67. Exemption for existing wells.
- Sec. 19-2-68. Application; filing fee.
- Sec. 19-2-69. Issuance or denial; contents.
- Sec. 19-2-70. Limitations on authority.
- Sec. 19-2-71. Authority and rights conferred.
- Sec. 19-2-72. Suspension or cancellation for noncompliance.
- Sec. 19-2-73. Hearing required for denial, suspension or revocation.
- Sec. 19-2-74. Excavations; standards of operation.
- Secs. 19-2-75—19-2-100. Reserved.

Division 4. Bond and Insurance

- Sec. 19-2-101. Bond required; amounts.
- Sec. 19-2-102. Public liability insurance required; amounts.
- Sec. 19-2-103. Exceptions to division.

*Cross references—Businesses and sales, ch. 8; environment, ch. 12; fire prevention and protection, ch. 13; oil and gas wells in Lake Farmington watershed area, § 20-3-37; special uses for extraction, processing, removal and storing of oil and gas, § 27-27-16.

State law reference—Oil and Gas Act, NMSA 1978, § 70-2-1 et seq.

FARMINGTON CITY CODE

Article 3. Equipment, Operations, Standards and Practices

- Sec. 19-3-1. Cleanliness and sanitation at well site.
- Sec. 19-3-2. Fire prevention.
- Sec. 19-3-3. Nuisances and annoyances.
- Sec. 19-3-4. Operations generally.
- Sec. 19-3-5. Pipelines and valves.
- Sec. 19-3-6. Pipeline location markers.
- Sec. 19-3-7. Internal combustion engines; electrical equipment; percolating water.
- Sec. 19-3-8. Hours of delivering or removing tools and materials.
- Sec. 19-3-9. Storage at well site.
- Sec. 19-3-10. Fencing and landscaping of well site.
- Sec. 19-3-11. Storage tanks.

ARTICLE 1. IN GENERAL

Sec. 19-1-1. Definitions.

Technical or oil and gas industry words or phrases used in this chapter and not specifically defined shall have the meanings customarily attributable thereto by prudent operators in the oil and gas industry. The following words, terms and phrases, when used in this section, shall have the meanings ascribed to them in this subsection, except where the context clearly indicates a different meaning:

Building means any structure used or intended for supporting or sheltering any use or occupancy.

Curbline means the line established by the city for any particular street.

Drilling district means a tract of land comprising a spacing unit or proration unit, as determined by the state oil conservation commission.

Gathering lines means all pipelines operated as an incident to the development and operation of oil or gas wells.

Oil and gas inspector means the fire chief of the city or his designee.

Permitter means the person to whom is issued a permit or certificate for the drilling, operating and producing of a well under this chapter and his heirs, legal representatives, successors and assigns.

Person means and includes any natural person, corporation, association, partnership, receiver, trustee, guardian, executor, administrator and a fiduciary or representative of any kind.

Production equipment means any apparatus utilized for the extraction or processing of oil and gas on a well site, such as separators, dehydrators, meter houses, well heads, tanks, valves, compressors, pump jacks and cathodic protection devices.

Right-of-way is expressly limited to all public rights-of-way or streets or other public property within the city.

Street means any street, highway, sidewalk, alley, avenue, recessed parking area, or other public right-of-way including the entire right-of-way.

Well means any hole or bore to any sand horizon, formation, strata or depth for the purpose of producing any oil, gas, or liquid hydrocarbon or for use as an injection well for secondary recovery or any of them.

(Code 1969, § 22-1; Ord. No. 98-1068, § 1, 2-24-1998)

Cross reference—Definitions generally, § 1-1-2.

Sec. 19-1-2. Obstructing streets.

No oil or gas well shall be drilled and no permit shall be issued for any well to be drilled at any location which is within any of the streets or alleys of the city. No such street or alley shall be blocked or encumbered or closed in any drilling, production or pipeline operation except by written permission of the oil and gas inspector and the city engineer and then only temporarily.

(Code 1969, § 22-2)

Sec. 19-1-3. Proximity of well, tanks or pipelines to building.

(a) ~~No well shall be drilled and no permit shall be issued for any well to be drilled at any location, or hydrocarbon storage tank to be located, which is nearer than 75 feet to any public street, 200 feet to any residence or commercial or industrial building or 300 feet to any buildings used as a place of assembly, institution or school without the applicant's having first secured the written permission of the city council.~~

(b) No high-pressure gas injection well or a compressor used in conjunction with the gas injection well shall be located nearer than 200 feet to any residential, commercial or industrial building except by permission of the city council.

(c) No building other than buildings necessary for the operation of the well shall be constructed within 100 feet of any wellhead, production equipment or hydrocarbon storage tank. No building used as a place of assembly, institution or school shall be constructed within 300 feet of any well-

OIL AND GAS LEASE

AGREEMENT, Made and entered into the 22nd day of September, 19 98, by and between
Rilla E. King, a widow

whose post office address is P.O. Box 186, Dolores, CO. 81325, hereinafter called Lessor (whether one or more) and
Dugan Production Corp. whose post office address is P.O. Box 420, FMN, NM. 87499-0420, hereinafter called Lessee:

WITNESSETH, That the Lessor, for and in consideration of Ten and more DOLLARS cash in hand paid, the receipt of which is hereby acknowledged, and the covenants and agreements hereinafter contained, has granted, demised, leased and let, and by these presents does grant, demise, lease and let exclusively unto the said Lessee, the land hereinafter described, with the exclusive right for the purpose of mining, exploring by geophysical and other methods, and operating for and producing therefrom oil and all gas of whatsoever nature or kind, with rights of way and easements for laying pipe lines, and erection of structures thereon to produce, save and take care of said products, all that certain tract of land situated in the County of San Juan

State of New Mexico, described as follows, to-wit:

SE/4SE/4 Section 11; SW/4SW/4 Sec. 12; Lots 3 & 4 Sec. 13
Lot 1 Sec. 14 in Township 29 North, Range 14 West

together with any reversionary rights therein, and together with all strips, or parcels of land, (not, however, to be construed to include parcels comprising a regular 40 acre legal subdivision or lot of approximately corresponding size) adjoining or contiguous to the above described land and owned or claimed by lessor, and containing 167.32 gross acres, more or less.

1. It is agreed that this lease shall remain in force for a term of ten years from this date and as long thereafter as oil or gas of whatsoever nature or kind is produced from said leased premises or on acreage pooled therewith, or drilling operations are continued as hereinafter provided. If, at the expiration of the primary term of this lease, oil or gas is not being produced on the leased premises or on acreage pooled therewith but Lessee is then engaged in drilling or re-working operations thereon, then this lease shall continue in force so long as operations are being continuously prosecuted on the leased premises or on acreage pooled therewith; and operations shall be considered to be continuously prosecuted if not more than ninety (90) days shall elapse between the completion or abandonment of one well and the beginning of operations for the drilling of a subsequent well. If after discovery of oil or gas on said land or on acreage pooled therewith, the production thereof should cease from any cause after the primary term, this lease shall not terminate if Lessee commences additional drilling or re-working operations within ninety (90) days from date of cessation of production or from date of completion of dry hole. If oil or gas shall be discovered and produced as a result of such operations at or after the expiration of the primary term of this lease, this lease shall continue in force so long as oil or gas is produced from the leased premises or on acreage pooled therewith.

2. This is a PAID-UP LEASE. In consideration of the down cash payment, Lessor agrees that Lessee shall not be obligated, except as otherwise provided herein, to commence or continue any operations during the primary term. Lessee may at any time or times during or after the primary term surrender this lease as to all or any portion of said land and as to any strata or stratum by delivering to Lessor or by filing for record a release or releases, and be relieved of all obligation thereafter accruing as to the acreage surrendered.

3. In consideration of the premises the said Lessee covenants and agrees:

1st. To deliver to the credit of Lessor, free of cost, in the pipe line to which Lessee may connect wells on said land, the equal one-eighth (1/8) part of all oil produced and saved from the leased premises.

2nd. To pay Lessor one-eighth (1/8) of the gross proceeds each year, payable quarterly, for the gas from each well where gas only is found, while the same is being used off the premises, and if used in the manufacture of gasoline a royalty of one-eighth (1/8), payable monthly at the prevailing market rate for gas.

3rd. To pay Lessor for gas produced from any oil well and used off the premises or in the manufacture of gasoline or any other product a royalty of one-eighth (1/8) of the proceeds, at the mouth of the well, payable monthly at the prevailing market rate.

4. Where gas from a well capable of producing gas is not sold or used, Lessee may pay or tender as royalty to the royalty owners One Dollar per year per net royalty acre retained hereunder, such payment or tender to be made on or before the anniversary date of this lease next ensuing after the expiration of 90 days from the date such well is shut in and thereafter on or before the anniversary date of this lease during the period such well is shut in. If such payment or tender is made, it will be considered that gas is being produced within the meaning of this lease.

5. If said Lessor owns a less interest in the above described land than the entire and undivided fee simple estate therein, then the royalties (including any shut-in gas royalty) herein provided for shall be paid the Lessor only in the proportion which Lessor's interest bears to the whole and undivided fee.

6. Lessee shall have the right to use, free of cost, gas, oil and water produced on said land for Lessee's operation thereon, except water from the wells of Lessor.

7. When requested by Lessor, Lessee shall bury Lessee's pipe line below plow depth.

8. No well shall be drilled nearer than 200 feet to the house or barn now on said premises without written consent of Lessor.

9. Lessee shall pay for damages caused by Lessee's operations to growing crops on said land.

10. Lessee shall have the right at any time to remove all machinery and fixtures placed on said premises, including the right to draw and remove casing.

11. The rights of Lessor and Lessee hereunder may be assigned in whole or part. No change in ownership of Lessor's interest (by assignment or otherwise) shall be binding on Lessee until Lessee has been furnished with notice, consisting of certified copies of all recorded instruments or documents and other information necessary to establish a complete chain of record title from Lessor, and then only with respect to payments thereafter made. No other kind of notice, whether actual or constructive, shall be binding on Lessee. No present or future division of Lessor's ownership as to different portions or parcels of said land shall operate to enlarge the obligations or diminish the rights of Lessee, and all Lessee's operations may be conducted without regard to any such division. If all or any part of this lease is assigned, no leasehold owner shall be liable for any act or omission of any other leasehold owner.

12. Lessee, at its option, is hereby given the right and power at any time and from time to time as a recurring right, either before or after production, as to all or any part of the land described herein and as to any one or more of the formations hereunder, to pool or unitize the leasehold estate and the mineral estate covered by this lease with other land, lease or leases in the immediate vicinity for the production of oil and gas, or separately for the production of either, when in Lessee's judgment it is necessary or advisable to do so, and irrespective of whether authority similar to this exists with respect to such other land, lease or leases. Likewise, units previously formed to include formations not producing oil or gas, may be reformed to exclude such non-producing formations. The forming or reforming of any unit shall be accomplished by Lessee executing and filing of record a declaration of such unitization or reformation, which declaration shall describe the unit. Any unit may include land upon which a well has theretofore been completed or upon which operations for drilling have theretofore been commenced. Production, drilling or re-working operations or a well shut in for want of a market anywhere on a unit which includes all or a part of this lease shall be treated as if it were production, drilling or reworking operations or a well shut in for want of a market under this lease. In lieu of the royalties elsewhere herein specified, including shut-in gas royalties, Lessor shall receive on production from the unit so pooled royalties only on the portion of such production allocated to this lease; such allocation shall be that proportion of the unit production that the total number of surface acres covered by this lease and included in the unit bears to the total number of surface acres in such unit. In addition to the foregoing, Lessee shall have the right to unitize, pool, or combine all or any part of the above described lands as to one or more of the formations thereunder with other lands in the same general area by entering into a cooperative or unit plan of development or operation approved by any governmental authority and, from time to time, with like approval, to modify, change or terminate any such plan or agreement and, in such event, the terms, conditions and provisions of this lease shall be deemed modified to conform to the terms, conditions, and provisions of such approved cooperative or unit plan of development or operation and, particularly, all drilling and development requirements of this lease, express or implied, shall be satisfied by compliance with the drilling and development requirements of such plan or agreement, and this lease shall not terminate or expire during the life of such plan or agreement. In the event that said above described lands or any part thereof, shall hereafter be operated under any such cooperative or unit plan of development or operation whereby the production therefrom is allocated to different portions of the land covered by said plan, then the production allocated to any particular tract of land shall, for the purpose of computing the royalties to be paid hereunder to Lessor, be regarded as having been produced from the particular tract of land to which it is allocated and not to any other tract of land; and the royalty payments to be made hereunder to Lessor shall be based upon production only as so allocated. Lessor shall formally express Lessor's consent to any cooperative or unit plan of development or operation adopted by Lessee and approved by any governmental agency by executing the same upon request of Lessee.

13. All express or implied covenants of this lease shall be subject to all Federal and State Laws, Executive Orders, Rules or Regulations, and this lease shall not be terminated, in whole or in part, nor Lessee held liable in damages, for failure to comply therewith, if compliance is prevented by, or if such failure is the result of, any such Law, Order, Rule or Regulation.

14. Lessor hereby warrants and agrees to defend the title to the lands herein described, and agrees that the Lessee shall have the right at any time to redeem for Lessor, by payment, any mortgages, taxes or other liens on the above described lands, in the event of default of payment by Lessor and be subrogated to the rights of the holder thereof, and the undersigned Lessors, for themselves and their heirs, successors and assigns, hereby surrender and release all right of dower and homestead in the premises described herein, insofar as said right of dower and homestead may in any way affect the purposes for which this lease is made, as recited herein.

15. Should any one or more of the parties hereinabove named as Lessor fail to execute this lease, it shall nevertheless be binding upon all such parties who do execute it as Lessor. The word "Lessor," as used in this lease, shall mean any one or more or all of the parties who execute this lease as Lessor. All the provisions of this lease shall be binding on the heirs, successors and assigns of Lessor and Lessee.

IN WITNESS WHEREOF, this instrument is executed as of the date first above written.

Rilla E. King

Rilla E. King

S.S.#

