dugan production corp.

October 26, 2007

FAX & MAILED
FAX NO: 505-476-3462

Ms. Florene Davidson, Commission Clerk
New Mexico Oil Conservation Commission
1220 South St. Francis Drive
Santa Fe, NM 87505

Re: Comments by Dugan Production Corp.
NMOCD's Proposed Pit Rule Changes
NMOCC Case No. 14015

Dear Members of the New Mexico Oil Conservation Commission,

Dugan Production Corp. (DPC) is an independent oil & gas producer whose primary area of operation is northwest New Mexico. We have been active in New Mexico for the past 48 years and during 2006, we drilled 47 wells. DPC ranked No. 23 in the state for volumes of gas produced and No. 60 for volumes of oil produced. We currently operate approximately 800 wells with a production of 24.6 mmcfd, 323 bopd plus 11,300 bwpd. We also have 128 wells using unlined production pits plus 77 below grade tanks, all registered under NMOCD Rule No. 50. We have participated in the work effort of the "New Mexico Industry Committee" which is a group of 19 oil and gas producers active in New Mexico and that will be impacted by the proposed pit rule regulations. The Industry Committee was established to provide an organized work effort to assess NMOCD's proposed rule changes. We have reviewed the subject draft rule and offer the following comments:

1. Dugan Production supports the comments submitted by the New Mexico Industry Committee, the New Mexico Oil & Gas Association (NMOGA) and the Independent Petroleum Association of New Mexico (IPANM) regarding the subject proposed pit rules;
2. Dugan Production does not support the New Mexico Oil Conservation Division's (NMOCD) application to repeal existing Rule 50 (Case No. 14015). There is nothing to support that Rule 50 is in need of revision and/or modification. Rule No. 50 became effective on 2-13-04 following a very extensive work effort, not only by the oil and gas industry, but also by the NMOCD, Bureau of Land Management (BLM) and of course other interested "stake holders". Dugan Production, along with all other New Mexico producers, expended a significant and consuming work effort in the development of Rule 50 and meeting the compliance schedules established by Rule 50. On April 20, 2004, Dugan Production submitted the pit and below grade tank inventory required by Rule 50 and on 1-17-05, we submitted applications for 242 earthen pits and 77 below grade tanks as required by Rule 50. In addition, we initiated an aggressive pit closure program and since Rule 50 has been in place we have spent approximately $1,500,000 closing pits. It is our firm belief that current Rule 50 does address the various issues associated with pits and below grade tanks and we are unaware of any pollution event that justifies a repeal of Rule 50 and the development of a complete new set of rules. We do acknowledge that there are documented incidents of ground water contamination, however it is our understanding these were all prior to implementing Rule 50 and either have been or are being addressed under Rule 50. We firmly believe the oil and gas industry has a very good record of controlling the fluids and wastes associated with our operations and considering that the oil and gas industry has been active in New Mexico for 86 years, has drilled in excess of 91,000 oil and gas wells in New Mexico and currently has approximately 50,000 active wells in New Mexico, the soil and water contamination issues that do exist, represent a very low rate of occurrence. Rule 50 does address the issues that need to be addressed and does not need to be repealed and replaced. In

doing so, a very significant work effort in developing and implementing Rule 50 will be completely wasted with no obvious corresponding benefit.

3. The subject proposed pit rule (Title 19, Chapter 15, Part 17 of NMAC) has been produced with little to no supporting scientific data. The "Pit Rule Task Force" was appointed by Governor Richardson and charged with reviewing the existing pit rule and "advising the Oil Conservation Division (OCD) on changes to the rules governing pits and below ground tanks". Scientific data was presented to the Task Force in support of current field practices, however for the most part the data appears to have been ignored and the proposed draft rule appears to be heavily influenced by environmental interests.

4. We are unaware of any pollution or contamination event that justifies NMOCD's requirement to use a closed loop system for the drilling of wells. To date, Dugan Production has not used a closed loop system, but anticipate that although it probably can be done, will add two to three days to our drilling time and will increase our drilling and completion costs by approximately 25% with no obvious benefit in the form of reduced contamination or reduced environmental impact. We typically drill 40 to 50 wells per year and to date have had no impacts to groundwater and have had no environmental impact that could not be restored. During 2006, 87% of our drilling activity was done using a small drilling rig with a kelly bushing approximately 4' above ground level. To use a closed loop system on a small rig, we will need to either elevate the drilling unit or place the mud tanks below ground level. In addition, we anticipate that it will be very difficult to separate the drill cuttings and maintain an effective mud system which will result in slower penetration rates plus increased abrasive wear on the mud pumps and drilling equipment. Our typical well during 2006 averaged 1410' in depth, cost $245,000 and produced approximately 46 cubic yards of drill cuttings, all of which will need to be physically removed from the metal tanks and transported to a landfill for disposal. Our current estimate of added costs to use a closed loop mud system is $60,000 to $75,000 for a well averaging 1410' and $100,000 to $150,000 for a well averaging 6000'. These added costs will result in a corresponding reduction in the number of wells we drill under the proposed new pit rules, since our drilling program costs are funded from our operating income and any increase in costs per well will result in a reduced number of wells to be drilled. Based upon our 2006 drilling program, we anticipate that our drilling will be reduced by approximately 12 wells per year as a direct result of the proposed pit rules.

5. The NMOCD's treatment of drilling reserve pit material as if it were a hazardous waste is unjustified and not supported by any data. The material contained within the reserve pit after completion of drilling consists of the earthen material that was ground up by the drill bit, plus whatever material that was added to maintain the mud system to control wellbore pressures during drilling, to provide efficient cuttings removal from the hole bottom and to provide sufficient cuttings transport to the surface. In northwest New Mexico, we typically use fresh or produced water and add no chemicals other than bentonite and starch, both of which are naturally occurring materials and neither of which provide any threat to the environment. The material in the pit for the most part is nothing more than a mixture of naturally occurring dirt, rock pieces and fresh water. The rock pieces are from the very same formations that occur at the surface throughout the southwest and upon which many communities are built upon. If produced water is used, the chlorides may be higher than had we used fresh water, however the water will separate from the mud solids and can be disposed of at a water disposal facility. To require that the material within the pit (including the pit liner) plus possibly some of the material below the liner be dug up, tested and hauled to an official disposal site is unnecessary, will add substantially to drilling costs and will not affect the environment other than to add to air emissions (dust and exhaust from the equipment digging the pit materials and transporting the material to a disposal site), will likely increase the costs of maintaining oilfield roads and will add unnecessary wear to public roads and state highways. As earlier stated, over 90,000 wells have been drilled in New Mexico during the past 86 years (all using a standard reserve pit) and to date we are aware of only two or three ground water contamination events involving a drilling pit. **To adopt the NMOCD's proposed pit rules that will prohibit future use of reserve pits is a very expensive fix for a problem that does not exist.**

6. The NMOCD's current proposal to prohibit the use of unlined pits for production operations is another attempt by the NMOCD to provide a very expensive fix to a problem that either does not exist or if it does exist, is being addressed by the current Rule No. 50. Dugan Production has expended approximately 1000 person hours bringing our wells into compliance with Rule 50. We did submit registrations for using 242 unlined earthen pits and 77 below grade

tanks, and currently have 128 wells (78 oil plus 50 gas) using unlined pits. The average production for the oil wells is 0.9 bopd, 6.8 mcfd (of which approximately 50% is used for lease fuel) plus 0.6 bwpd. The gas wells average 20 mcfd, 0.1 bbl condensate/day plus 0.5 bwpd. Each of these 128 wells are considered to be economically marginal, and any significant expenditure will likely result in these wells being plugged. Although individual well production is low, together they produce a total of 75 bopd, 1526 mcfd and 68 bwpd which results in an annual royalty of approximately $216,000 plus a state production tax of approximately $130,000/year. Throughout New Mexico, there are approximately 13,400 stripper oil plus 9,200 stripper gas wells that produce approximately 13,387,000 bbl oil plus 81,059,000 mcf per year (per well averages = 2.7 bopd and 24 mcfd) and generate an annual royalty of approximately $162.8 million and an annual state production tax of $97.7 million. As with DPC's stripper wells, individually the states stripper wells produce low volumes, but collectively they generate a significant royalty and production tax revenue, all of which is at risk of being lost should there be any significant change in the operating costs for each well. Dugan Production's wells are all registered under Rule 50, to use unlined pits for disposal of small volumes of produced water. At each well, there is either no ground water, or the ground water is deeper than 100' and the site assessment (NMOCD form C-144) required by Rule 50 produces a site specific determination that there is little to no risk of impacting ground water or surface waters. These wells have all produced many years and to date there has not been any un-repairable environmental impact from the operation of these wells.

Dugan Production Corp. has operated in New Mexico for 48 years. We have 153 employees and intend to maintain an active presence in the oil and gas industry. We are sincerely concerned over what appears to be an increasing regulatory emphasis on environmental issues with a total disregard as to problems created or the consequences. The oil and gas industry provides a significant portion of the economic base not only for the State, but also for the counties and municipalities in the producing areas of New Mexico. During 2006, a total of $467 million was paid for oil and gas royalties and rentals which represented 94.3% of the revenues received into the State's Land Grant Permanent Fund managed by the State Land Office. In addition, $1.2 billion was paid for production taxes on oil and gas. If the NMOCD does implement the pit rule revisions as proposed in their application, there will be an industry wide slowdown and corresponding reduction in revenues generated by royalties and taxes upon the oil, gas and business activities associated directly and indirectly with the oil and gas industry. If approved, Dugan Production Corp. will reduce our drilling activity to correspond with any cost increases we incur as a result of the new pit rules.

We respectfully submit these comments for your consideration. Should you have questions or need additional information, please let me know.

Sincerely,

Thomas A. Dugan

Thomas A. Dugan
President

TAD/JDR/tmf

xc: Governor Bill Richardson
Senator John Arthur Smith, Chairman, Legislative Finance Committee
Senator Tim Jennings, Chairman, Revenue Stabilization & Tax Policy Committee
Mark E. Fesmire, Director, New Mexico Oil Conservation Division
Steve Henke, Manager, Bureau of Land Management - FFO
New Mexico Oil & Gas Association
Independent Petroleum Association of New Mexico
Bill Carr, New Mexico Industry Committee
Lisa Winn, New Mexico Industry Committee