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March 27, 2000

**HAND DELIVERED**



Lori Wrotenbery, Director
David Catanach, Hearing Examiner
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
2040 South Pacheco Street
Santa Fe, New Mexico 87501

***Re: Statutory Unitization of the North Square Lake Unit***
***Eddy County, New Mexico.***
***Order No. R-12113.***

Dear Ms. Wrotenbery and Mr. Catanach:

We understand that the Division is considering setting a hearing to require GP II Energy, Inc. ("GP II) to appear before it and show cause why Order No. R-11207, the statutory unitization order approving the North Square Lake Unit, should not be rescinded. We further understand that the reason for this action is that the Division has received complaints about GP II's operations from certain interest owners in the unit area, and communications with those parties.

In response to recent general statements of concerns about unit operations from Mr. David Catanach, GP II responded by letter dated March 6, 2000 and attempted to explain the current status of our efforts to develop this acreage. A copy of GP II's letter is attached hereto. Now we learn that this response was somehow inadequate and that, based upon additional conversations with those who oppose this unit, a hearing is to be scheduled.

As you are aware, GP II has repeatedly offered to meet with you to discuss the status of our operations in this unit. Having never discussed this unit with GP II Energy, Inc., we are surprised that the Division would consider setting this matter for hearing based only on the representations of other owners in the unit area. Furthermore, as of this date, we have not seen any of the letters which apparently complain about our operations, or anything else which defines the nature of the Division's concerns about our operations. Surely a show cause hearing is premature before we have an opportunity to know the exact nature of the complaints being made against us or are afforded an opportunity to respond.

A show cause hearing would place the burden of proof on GP II of defending its actions. To date, we do not even know the exact nature of the matters to which we are to respond. Furthermore, we question the propriety of the Division calling this case. If another interest owner has a complaint, they could file an application for a show cause hearing, present their complaint to an Examiner and, if their complaint is warranted, GP II can respond.

We are very concerned that this action by the Division would violate the due process rights of GP II and would be administrative action which is arbitrary, capricious and actionable. Before you act, I encourage you to refresh yourselves on the history of GP II's efforts to obtain Division approval of this unit and waterflood as summarized below.

HISTORY OF GP II ENERGY'S EFFORTS TO WATERFLOOD THE NORTH SQUARE LAKE UNIT AREA:

In 1997, GP II determined that substantial reserves remain to be recovered in the North Square Lake Unit Area. GP II's evaluation was buttressed by the success of the Devon Energy Corporation-operated waterflood project which adjoins the North Square Lake Unit along four miles of the Southern boundary of the Unit. For three years, GP II has been attempting to duplicate Devon's methods and success in the acreage which offsets and adjoins the GP II acreage in the North Square Lake Unit Area.

In May of 1997, GP II borrowed 5.8 million dollars to acquire acreage in the current North Square Lake Unit Area. In September 1997, GP II filed eleven drilling applications on its acreage within what is now the unit boundary. These permits were all approved by the BLM subject to state regulatory approval of the proposed unorthodox well locations. These locations were unorthodox because they were to be drilled as 20-acre infill locations, as are Devon's approximately 140 20-acre wells in its acreage which offsets the unit. However, even though GP II owned 100% of the acreage on either side of the spacing unit boundaries affected by these proposed unorthodox locations, and the base royalty was owned by either the State of New Mexico or the federal government, the Division would not approve the locations because of the varying overriding royalty interests. GP II discussed this matter with Mr. Stogner in Midland in the fall of 1997, and he required that GP II unitize the subject acreage.

In response to Mr. Stogner's request, GP II began its effort to statutorily unitize approximately 4500 contiguous acres in which GP II owns 100% of the working interest. The BLM required that the unit be expanded for geologic reasons to maximize recovery in all areas of the field that would be affected by the project. This increased the unit to its current size of 6125 acre, more or less.

This expansion of the unit area required the solicitation of support from six additional operators and a total of more than 20 additional working interest owners. This effort, including the solicitation of participation from 167 overriding royalty owners, consumed most of 1998. Finally, with more than 80% of the working interest committed to the unit, we came to hearing in early 1999.

At the hearing, GP II presented all of the available data for the wells in the unit area. Because of the vintage of some of these wells, GP II hired people to search through the records of the Oil Conservation Division and information libraries to supplement any data relative to these wells, other than what could be found in the various operator files which had been passed down to GPII as successor operator of these properties.

Statutory unitization of the North Square Lake Unit Area was approved by Division Order No.

R-11207 and the Order has been ratified by the necessary owners of interest therein. The Unit was approved by the Commissioner of Public Lands on December 17, 1999, and by the BLM on December 21, 1999.

The waterflood project has not been approved. At the hearing on our unitization and waterflood applications, we agreed to develop the project in a staged and concentrated approach. It was your request that GP Energy, Inc. identify one, two, or three areas of the field, initiate development in these areas, then bring to the Division Form C-108s for these smaller groups of patterns, thereby making the areas of review manageable. Accordingly, GP II has embarked on with its staking and applications for drilling of the first 10 pattern producing wells, in compliance with your directivies.

The ten wells represent two areas – one covering four contiguous five-spot patterns and the other covering six contiguous five-spot patterns. I am sure the Division understands that you must have a producing well in the center of a five-spot pattern before the pattern can be waterflooded. This is exactly what the Division allowed Devon to do in the project offsetting GP II. Once modern data can be gathered for the injection parameters for these patterns, Form C-108's for these patterns will be filed.

The Division also directed that no new injection occur in the Unit until the Division had approved the subject injection wells. The process proposed by the Division was to create an efficient way to manage wellbore integrity for the multitude of old wellbores that will ultimately be reworked to modern integrety standards. GP II is then to continue development, growing out from these concentrated areas, filing subsequent C-108's for new patterns as development progresses.

GP II is drilling wells and will use the information from these wells and other data to re-propose the waterflood project in phases –one area at a time–after it conducts necessary remedial work on the wells within each injection well's area of review, and receives Division approval for the waterflood project, as it was requested to do.

It was the Division's opinion in 1997 that GP II's initial effort to downspace this originally cooperative waterflood, as Devon has, would result in too many pooled lease line units. Therefore, the Division asked GP II to unitize this acreage. The BLM required that the

statutory unit be expanded to cover all geologic areas affected by this waterflood. GP II formed and expanded the unit as it was required.

Surely the Division had the same concerns when Devon implemented its waterflood project–although Devon did not unitize its waterflood project area. Furthermore, since Devon did not unitize, a similar approach must have been followed to obtaining approval from the Division–individual injection wells were approved as they were proposed to be converted to injection.

For over three years, GP II has been attempting to implement a waterflood on properties it owns, using the same methods as were utilized in the waterflood operated by Devon on offsetting acreage to the south. Now, less than ninety days after GP II obtained the necessary approvals and have an effective unit, the Division is threatening to withdraw its approval. Any suggestion that GP II is not doing everything possible to implement this project at the earliest possible time in the most efficient way is absolutely absurd. To date GP II has incurred millions of dollars in expenses to implement a waterflood project in this unit. Furthermore, GP II has incurred in excess of $1700 per day in interest charges on the monies borrowed to finance this effort, charges which are incurred every day GP II has lost as part of its effort to comply with the regulatory requirements of both the Oil Conservation Division and the BLM.

CONCLUSION:

GP II hereby again requests the opportunity to meet with you and discuss our efforts to develop this property. We are available to do so at any time starting on Monday March 27, 2000. Before a hearing is set, we believe that if the Division should at least meet with GP II If the Division does not desire to meet with us, at the very least it must identify in writing its concerns about our operations and provide us with an opportunity to respond–prior to being called before a Division Examiner in a show cause hearing–where the burden will be on us to defend our operations against charges the exact nature of which we are unaware.

Furthermore, GP II requests copies of the letters which have been sent to the Division complaining about its operations. The interest owners who have complained have not sent

copies of their letters to GP II, and we must have copies of these letters to properly defend against these allegations. We are prepared to respond to the complaining parties directly as well as to the Division.

We believe other operator complaints are from interest owners who either have not agreed to participate–and were statutorily unitized because the BLM required that their interests be brought into the unit-- or who are concerned about delays in moving forward with this project–delays which GP II has incurred while it has attempted to comply with regulatory requirements. Requirements we believe were not imposed on the Devon waterflood project.

GP II has expended substantial effort to implement this project. GP II has made a good faith effort to comply with the regulatory requirements of the Division and the BLM. Substantial costs have been incurred and continue to be incurred by GP II. All GP II requests is to be advised of the allegations being made against it and the concerns the Division may have about its operations, and then be afforded the opportunity to respond to these allegations and to address any concerns the Division may have concerning efforts to implement this project. We request that we have this opportunity to respond prior to being called before the Division in a hearing where the issue will be the termination of the unit–an action which will result in the loss of GP II's investment in this project and the loss of the benefits of a waterflood project which should recover 11 million barrels of oil.

Very truly yours,

William F. Carr
Attorney for GP II Energy, Inc.

WFC/md

cc: Marilyn S. Hebert
M. A. Sirgo