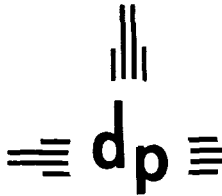


NSP 6/12/00



dugan production corp.

May 19, 2000

Mr. Jim Lovato  
Bureau of Land Management  
1235 La Plata Highway  
Farmington, New Mexico 87401

Re: Application for Administrative Approval of Unorthodox Proration Units  
SE/4 Sec. 26 and SW/4 Sec. 25, T30N, R14W (320.36 acres, more or less)  
NE/4 Sec. 26 and NW/4 Sec. 25, T30N, R14W (320 acres, more or less)  
San Juan County, New Mexico  
Basin Fruitland Coal Pool

Dear Mr. Lovato:

On May 16, 2000, I met with you, Joe Hewitt and Neil McBride to discuss Dugan Production's application with the New Mexico Oil Conservation for Administrative Approval for the unorthodox proration units cited above. With your approval, we are asking the BLM to write a supporting letter that we can include in our application.

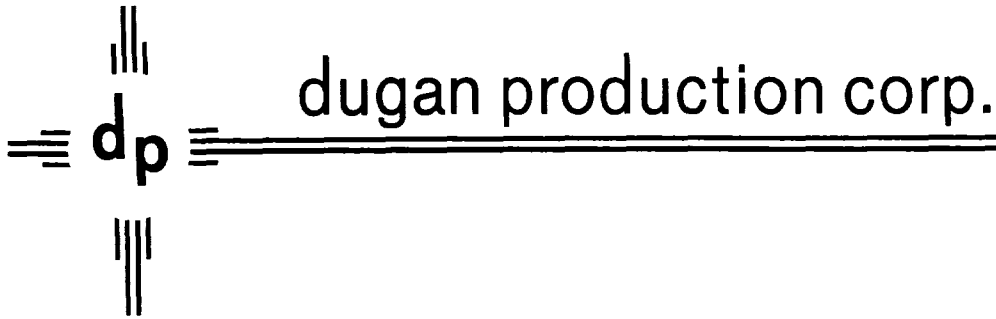
In response to questions and requests you brought up during our meeting, I have enclosed the following discussion and exhibits:

1. Letters of application to the NMOCD for an unorthodox location.
2. Topographic map.
3. Letters from the NMOCD denying our application for an unorthodox location.
4. Offsetting operator map showing proposed unorthodox proration units.
5. Map showing Dugan Production's development plans for the subject area.
6. Structure map drawn on the top of the Pictured Cliffs Sandstone.
7. Isopach map of the Basal Fruitland Coal.

On January 10, 2000 Dugan Production initiated the application process for an unorthodox location for the Carpenter Com # 90 (1767' FSL - 280' FWL, Sec. 25, T30N, R14W)(Exhibit 1a, 1b and 1c). Our application was necessary due to the rough topography of the area (Exhibit 2). Other concerns which warranted the need for an unorthodox location included a need to:

1. Minimize risk to an existing well bore.
2. Minimize damage to surface resources.
3. Maximize efficient development of the Fruitland coal gas resource.

The NMOCD denied our applications (Exhibit 3a and 3b). They felt that we should locate our well on the same pad as an old, producing Dakota well, that has a history of shallow, casing failures. Also, they felt that offsetting correlative rights would not be protected if our application were approved.



On May 9, 2000 Ms. Lori Wrotenbery and Frank Chavez explained to me how the offsetting correlative rights would be protected if Dugan Production would form an unorthodox proration unit for the subject well and encouraged me to file an application.

When I met with you and other BLM personnel on May 16, you expressed some concern that Federal royalties would be diluted if this unorthodox proration unit were formed. However, Dugan Production is filing an application to form two unorthodox proration units in this area (Exhibit 4). This will insure that the Fruitland Coal can be fully developed on 320-acre spacing and allow for future orderly development of the coal gas resource in these two sections.

Exhibit 5, is a map which shows Dugan Production's Fruitland Coal and/or Fruitland and Pictured Cliffs sandstone activities in the subject area. Currently, there are eight wells producing into Dugan's low-pressure gas and water gathering system (pink circles). There are four new wells that were drilled and completed last year and will be hooked up as soon as approval on our right of way applications (green circles) is received. Next week (May 22, 2000), drilling will begin on five new wells (blue circles), which again, will be hooked up as soon as right of way applications are approved. There are four wells that will be drilled as soon as the APD's are approved (orange circles). And finally, upon approval of the proposed unorthodox proration units, Dugan Production will permit, drill and complete three additional wells (circles with dots).

The coal in the subject area ranges from nine to twelve feet in thickness and has a gentle dip of about two degrees down to the northeast (Figure 6 and 7). This geology does not support nor condemn formation of the proposed unorthodox proration units.

In conclusion, Dugan Production is asking the BLM to write a letter supporting our application for the two unorthodox proration units cited above. Approval of these proration units will insure that the Fruitland Coal will be fully developed in an area of very rough topographic terrain, with minimal surface disturbance.

If you have any questions or need additional information on this matter, please contact me.

Very Sincerely,

*Kurt Fagrellius*  
Kurt H. Fagrellius  
Geologist

cc: Ms. Lori Wrotenbery, New Mexico Oil Conservation Division - Santa Fe  
Mr. Frank Chavez, New Mexico Oil Conservation Division - Aztec