

MALLON OIL COMPANY

2850 Security Life Building, Denver, Colorado 80202
(303) 572-1511

November 27, 1985

Mesa Grande Resources, Inc.
1200 Philtower Building
Tulsa, OK 74103

Attention: Mr. Gregory Phillips

RE: Gavilan Prospect
Mallon #12-5 Johnson well
Rio Arriba County, New Mexico

Dear Greg:

I am in receipt of your letter dated November 20, 1985. I feel that perhaps a quick reiteration of the events leading up to the commencement of the Mallon #12-5 Johnson well would better substantiate Mallon's request for a Risk Factor from Mesa Grande.

At the time the Johnson well was commenced, the Rules and Regulations set out by the NMOCD stated that the well location was considered "unspaced" in terms of the Gallup-Dakota formations and thus 40 acre spacing would be required. Mallon Oil Company had originally tried to obtain a 320 acre spacing, but the State insisted upon 40 acres. We were told that if and when the spacing had been designated for the area, the Johnson well would be considered a sub-standard proration unit and would remain spaced on 40 acres.

Prior to the discovery of the designated 40 acre spacing, Mallon had every intention of drilling on 320 acre spacing. We even went so far as to contact A.G. Hill and N.W. Pipeline for a Farmout, of which we were refused at that particular time. To our knowledge, Mesa Grande did not own any acreage within the W/2 of Section 12-T25N, R2W at the time we drilled, thus we did not contact you in terms of including your interest that you presently own.

As you can see, Mallon did not have an option to include your current interest, which at the time was owned by N.W. Pipeline, in the dedicated unit prior to commencement of the Johnson well. Regardless of the spacing patterns established for the area, Mallon had no choice but to follow the rules and regulations that prevailed.

BEFORE THE OIL CONSERVATION COMMISSION Santa Fe, New Mexico	
Case No. <u>8900</u>	Exhibit No. <u>E</u>
Submitted by <u>MESA GRANDE</u>	
Filing Date <u>5/20/86</u>	

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The situation now is obviously different. If Mallon had been in flagrant violation of the then prevailing regulations, then Mallon could understand Mesa Grande finding the assessed Risk Factor unwarranted. But after reading this letter, perhaps you can better understand Mallon's position. We took the full risk in drilling the well, because we were not allowed to dedicate 320 acres to the well. Now, after the well is drilled and completed we are told that our original understanding with the State, in reference to an automatic sub-standard proration unit, is inaccurate and that the spacing will be changed to a 320 acres, thus allowing other parties, who did not take any risks, to participate in a completed well.

It is at this time that Mallon requests that Mesa Grande re-review the Operating Agreement and AFE as was originally sent by Mallon. We would prefer to settle the Risk Factor issue between the two parties, with both parties satisfied with the results.

Your attention to this matter is greatly appreciated.

Sincerely,

MALLON OIL COMPANY



Karen E. McClintock
Landman

/kem