dugan production corp.

June 22, 1998

Ms. Lori Wrotenbery, Director
New Mexico Oil Conservation Division
2040 South Pacheco Street
Santa Fe, NM 87505

Mr. Ray Powell, Commissioner
New Mexico State Land Office
P. O. Box 1148
Santa Fe, NM 87504-1148

Mr. Lee Otteni, District Manager
Bureau of Land Management
1235 La Plata Highway
Farmington, NM 87401

Re: Request for Surface Commingling, Off-lease Measurement, Storage, and Sale of Produced Natural Gas plus Gathering System Drip Accumulations
Dugan Production's Goodtimes Gas Gathering System
San Juan County, New Mexico

Dear Ms. Wrotenbery, Mr. Powell, and Mr. Otteni:

We are writing to request your approvals for the addition of 58 wells and/or meter sites to Dugan's Goodtimes Gas Gathering System (GGGS) which will require the surface commingling, plus off-lease measurement and sale of natural gas production along with a small amount of liquid hydrocarbons (drip) that may accumulate in the gathering system drip traps. In addition, we are also requesting approval for the off-lease storage of the drip collected at each drip trap. This application is the twelfth expansion to the GGGS which was initially approved by the BLM on 1-18-84. There currently are 121 wells (129 completions) that have previously been approved and with this application, the GGGS will have a total of 179 wells (187 completions). As of 6-1-98, there were 151 completions producing into the GGGS which includes 105 on Federal leases, 23 on State leases and 23 on Navajo Allotted leases. With the exception of four wells operated by Universal Resources (which deliver gas into the GGGS at a common meter site), all wells are operated by Dugan Production Corp. During 1997, the 151 completions connected to Dugan's GGGS produced a total of 142,614 bbl of oil and condensate plus 535,103 MCF of gas from nine pools (six oil and three gas), all located in Townships 23N & 24N, Ranges 8W thru 11W of San Juan County, New Mexico. In addition to adding 58 new wells to the GGGS, this application also serves to update the previously approved wells using the recently published Federal and Navajo Allotted guidelines for off-lease measurement and surface commingling.

709 E. MURRAY DR. • P. O. BOX 420 • FARMINGTON, N.M. 87499-0420 • PHONE: (505) 325-1821 • FAX# (505) 327-4613

Attachment No. 1 presents a participation statement for Universal Resources Corporation as an operator of wells delivering gas into the GGGS operated by Dugan Production. Universal Resource's wells are all within 1½ miles of Dugan's GGGS, the closest being approximately ½ mile. Since El Paso's pipeline is approximately 8 miles away, Dugan's GGGS provides an important option for the sale of gas from Universal's wells, and without Dugan's GGGS, it is likely that gas from Universal's wells would not be sold.

Attachment No. 2 consists of three full scale maps which were produced using USGS 7½ minute Quadrangle topography maps and present the Goodtimes Gas Gathering System lines, lease descriptions plus well and system equipment locations. There are two CDP meter sites for the GGGS. CDP No. 1 was placed into service on 12-1-86 and is located in the SE/4 SE/4 of Section 22, T-24N, R-8W (Map No. 3). Gas deliveries at this CDP were initially to Mesa Petroleum and subsequently to Bannon Energy, Inc., Lomak Petroleum, Inc., and currently Elm Ridge Resources as ownership of the downstream system changed. During 1997, approximately 72% of the gas sold from the GGGS occurred at CDP No. 1. CDP No. 2 was initially placed into service on 6-10-81 delivering gas from Dugan's GGGS to El Paso Natural Gas Co. at their pipeline in the NE/4 NE/4 of Section 13, T-24N, R-10W (Drip Tank No. 5 location on Map No. 2). On 7-16-92, El Paso moved this CDP meter approximately 3/4 mile north to it's current location in the SE/4 NE/4 of Section 12, T-24N, R-10W (Map No. 2) and gas at this CDP is currently delivered to El Paso Field Services and during 1997 accounted for approximately 28% of the total GGGS sales.

Attachment No. 3 presents well and lease information pertinent to this application for the 58 completions or meter sites to be added plus the 129 completions (121 wells) that have previously been approved for the GGGS. In addition, the application and approval dates for the prior 11 expansions to the GGGS are also listed.

The 58 completions/meter sites to be added with this application include 34 completions and meter sites that are currently connected and producing into the GGGS, 11 wells that are completed and producing but not yet connected, four wells that have been drilled but have not been completed, one well that was connected but has subsequently been plugged plus eight locations of wells proposed to be drilled in the vicinity of our GGGS which will likely be connected to the GGGS upon completion.

The 34 completions/meter sites that are producing into the GGGS include 19 Dugan operated wells that are on leases not previously approved, 14 Dugan operated wells located on leases previously approved for the GGGS plus one meter site which receives gas delivered to the GGGS by Universal Resources. For the most part all wells that have been completed during the ± four year period that guidelines for surface commingling and off-lease measurement on Federal and Indian lands were being developed through a joint BLM and Industry committee effort of the San Juan Basin Working Committee. This committee was formed in March of 1994 and Dugan Production has actively participated in this committee effort from the beginning which also included representatives of the BLM's Farmington District, Albuquerque District, and State

offices. This committee worked very diligently and on 5-31-94 produced draft guidelines for surface commingling and off-lease measurement issues involving Federal and Indian oil and gas leases. Attachment No. 9 is a copy of the cover letter dated 5-31-94 transmitting the subcommittee report and draft guidelines to the full San Juan Basin Working Committee. These guidelines had the support of both BLM and Industry committee members as they pertained to Federal lands, however for Indian lands, there were unresolved issues that resulted in guidelines being published initially on 6-30-95 for Federal leases only. Efforts of the subcommittee to address surface commingling and off-lease measurement issues on Indian lands continued and on 2-7-96 guidelines for Navajo Tribal oil and gas leases were published and finally on February 2, 1998 (approximately 2½ years after the Federal guidelines) guidelines for Navajo Allotted leases were produced.

Since there are 23 completions involving Navajo Allotted lands on the GGGS (21 of these were previously approved), Dugan Production Corp. was reluctant to submit any application addressing surface commingling and off-lease measurement issues at our GGGS until guidelines addressing the off-lease measurement and surface commingling involving Navajo Allotted leases were issued. Considering that off-lease measurement issues have been the focus of the San Juan Basin Working Committee since March 1994 and guidelines for Navajo Allotted leases were not issued until February 1998, several wells have been completed and the GGGS being expanded to include them during this period of time. Of the 33 wells/completions operated by Dugan Production Corp., all are being treated in the same manner as are the wells previously approved, however for royalty purposes on wells located on leases not previously included in prior approvals, we have been paying royalty based upon the volumes recorded at the wellsite allocation meters. For 19 of the 33 wells we are paying royalty based upon allocation meter volumes. We do not like doing this, but believe this is better than venting the gas production, and/or shutting in wells completed during the past ± four years while the various off-lease measurement issues were being resolved.

In addition to the 19 wells on which royalty is currently being paid based upon allocation meter volumes, 14 new wells/completions located on leases previously approved for the GGGS are being handled the same as are the other wells on those leases previously approved. Included in this group are four wells that have previously been approved in one zone and subsequently were completed in another zone (i.e. - our April Surprise No. 2 GA, Blanco Wash No. 1 MV, Harvey #2 GA and September #15 GA).

Also included in this application is the gas received into the GGGS at one meter site from four wells operated by Universal Resources, their Federal D wells No. 3, 4, 5 and 6. Natural gas from these four wells is gathered by Universal Resources and the combined production stream is delivered to a single meter on Dugan's GGGS located in the NE/4 NE/4 of Section 16, T-23N, R-9W (Map No. 1). Prior to this application, our agreement with BCO (Universal's predecessor) allowed a volume of gas determined at the allocation meter to be transferred to El Paso Natural Gas at their CDP in Section 12, T-24N, R-10W. It is our understanding that BCO had received BLM approval for this operation. For GGGS allocation purposes we are currently treating the Universal Resources meter the same as all other allocation meters and any differences in gas

volumes between what Universal Resources delivers to El Paso and the volume we allocate back to their allocation meter is being absorbed by Dugan Production. We have discussed this with Universal Resources and they are in agreement that Dugan's meter receiving gas from their wells will become an allocation meter for them and their sales volume will become the sales volume allocated to their meter as described in Attachment No. 6.

In addition to these 34 completions/meter sites, included in this application are 11 wells drilled and completed by Dugan Production which are currently producing, however are not connected to the GGGS. We also have four wells that have been drilled but not yet completed, eight proposed wells and one well, the Mesa No. 1, that was connected to the GGGS, however was plugged and abandoned in 9-97.

In addition to the 58 wells to be added with this application, Attachment No. 3 also presents well and lease information for the 129 completions (121 wells) that have previously been approved for the GGGS. It should be noted that of these previously approved wells, 11 completions (nine wells) have recently been plugged and abandoned, one well temporarily abandoned, and three locations remain to be drilled.

Attachment No. 4 presents the lease and system equipment plus fuel requirements for each well connected or anticipated to be connected. In addition, we have included other pertinent information such as volumes of gas that are periodically purged when attempting to keep low volume wells producing and from logging off. Also presented is the date that 11 wells began using alternative measurement which was approved by both NMOCD and BLM. Most wells on the GGGS produce at volumes which qualify for alternative measurement and we may convert other wells to alternative measurement in the future. We will obtain NMOCD and BLM approvals for each well prior to converting to alternative measurement methods. Also presented on Attachment No. 4 is a summary of the gas heating value and liquids content for all wells delivering gas into the GGGS. This information is intended to supplement the gas analysis information presented on Attachment No. 5. Also presented on Attachment No. 4 is a listing of the wells that share in the allocation of system drip accumulations and system compressor fuel use. Only those wells that produce gas through any one of the five system drip traps or benefit from the operation of any of the three system compressors will participate in the allocation procedures that are presented in Attachment No. 6.

Attachment No. 5 presents a summary of the gas analyses for each pool and a copy of the complete analysis for 34 different wells/meter sites (57 completions) which includes all Navajo Allotted wells plus a sufficient number of State and Federal wells to represent a significant percentage of the total production from each pool. Complete analyses are available for all wells on the GGGS, however we believe that there are sufficient similarities in the gas compositions for wells within the same pools that providing an analysis for all 151 wells serves no purpose and certainly adds bulk to this application. The analyses presented on Attachment No. 5 are believed to sufficiently represent each pool and if needed, the gas heating value (BTU/CF) and liquids content (GPM) for all 151 wells are presented in Attachment No. 4. Based upon these analyses

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Att. 4+5

and our experience in the field, all gas streams are believed to be compatible and there appears to be no problems resulting from the surface commingling of gas from these nine pools. In addition, since revenues from gas and drip are allocated back to individual wells using individual well BTU and GPM's there will be no loss of value to any one well.

Attachment No. 6 presents the allocation procedures for all wells connected to the GGGS. The factors for individual well allocations are presented on Attachment No. 4. To date we have had very few problems with line leaks or line freezes which could cause losses of gas from the gathering system. In the event that we have a system gas loss (either as a result of line leaks, venting to clear line freezes, or venting to perform repair or installation of equipment), the gas volumes will be volumetrically calculated utilizing the affected line capacity and accounting for the initial and final pressures within the system. Any gas volume computed in this manner will be allocated to the individual wells that contributed to the gas volume lost as shown in Attachment No. 6. The integrity of our gas gathering system is confirmed by periodic surveys of the line utilizing a Flame Pack Model 400 Gas Leak Detector which is owned by Dugan Production Corp. Initially, when the lines were installed they were pressure tested prior to being placed into service. The commingling of the natural gas production from each lease is the result of using a common system to gather and transport the produced gas to the CDP sales meters. All gas volumes will be continuously measured at each well using conventional metering equipment or an approved alternate measurement method installed and maintained by Dugan Production. The gas charts recorded at each well will be integrated for volumes to be used in determining allocation factors.

Attachment No. 7 presents 1997 production information and the current producing status for all 151 completions (142 wells) connected to the GGGS on 4-1-98. The total production from all wells during 1997 was 142,614 bbl of oil and condensate plus 535,103 MCF of gas, of which 312,024 MCF were sold with the balance being used for fuel. The average production for all wells during 1997 was 3.0 bbl/day plus 11.1 MCFD of which 6.5 MCFD was sold and 4.6 MCFD used for fuel. The average oil production of 3.0 BPD reflects a range of 0 to 24.2 BPD while the average gas production of 11.1 MCFD reflects a range of 0 to 144.7 MCFD. The higher average production rates typically come from new or recently completed wells which generally decline fairly steeply in production rates (45-75 %/year) during the first two to three years, prior to stabilizing at a decline rate of 5 to 6% per year. Although one well did average 24.2 BOPD and 144.7 MCFD (not the same well), only 25 wells averaged more than 5 BPD and of these 25, only five averaged more than 10 BPD. For gas production, only 20 wells produced an average gas rate greater than 15 MCFD and of these 20, only five averaged more than 25 MCFD.

Production comes from nine pools with the South Bisti Gallup oil pool accounting for 53.0% of the wells, 69.6% of the oil/condensate production and 41.8% of the gas production. The average individual well production in the South Bisti pool was 3.6 BOPD plus 8.1 MCFD. Of the nine pools, six are oil pools and account for 82.7% of the wells connected to the GGGS. During 1997, 99.7% of the oil/condensate plus 73.7% of the gas production from all wells connected to the GGGS came from 124 wells completed in oil pools averaging 3.3 BOPD plus 9.3 MCFD per well.

Production data for 1997 is fairly representative of production performance for wells connected to the GGGS from year to year since most wells exhibit low capacity and long life production performance, and after the first two to three years, production rates are fairly stable. During the past four years, production from wells connected to the GGGS is as follows:

		Annual Production			
	# of	Oil/Cond.	Gas MCF	Average per well	
Year	Completions	bbl	MCF	BPD	MCFD
1994	125	145,722	458,937	3.6	11.3
1995	133	132,597	508,313	3.1	11.9
1996	149	149,666	507,474	3.3	11.1
1997	151	142,614	535,103	3.0	11.1

Although the individual well average production is marginal and not too significant, total production for all wells connected to the GGGS is fairly significant. During the past four years summarized above, wells connected to the GGGS have produced just over ½ million bbl of oil and condensate plus 2.0 billion cubic feet of gas and as of 1-1-98, had produced approximately 2.5 million bbl of oil and condensate plus approximately 8.9 BCF.

Attachment No. 7 also summarizes the 1997 production by the type of lease from which it occurred. Of the 151 completions connected to Dugan's GGGS, 105 (69.6%) are on Federal lands, 23 (15.2%) on State of New Mexico leases and 23 (15.2%) on Navajo Allotted leases. For oil production; 77.1% occurred from wells on Federal leases, 11.5% from wells on State leases and 11.4% from wells on Navajo Allotted leases. For gas production; 71.8% occurred from Federal leases, 13.3% from State leases and 14.9% from Navajo Allotted leases.

Based upon the individual well average production presented on page six of Attachment No. 7, it appears that wells on Federal leases are slightly better, however it should be noted that a majority of our recent drilling activity has been on Federal leases and the early time production from the newer wells makes the Federal well averages slightly higher. For the most part, all wells exhibit very similar production performances and typically the Federal, State and Navajo Allotted wells all exhibit comparable production performances.

Attachment No. 8 presents the "Reasons, Justification and Benefits" for the off-lease measurement and surface commingling of gas production (plus a very small amount of condensed liquid hydrocarbons) in the operation of Dugan's GGGS. The primary reason and justification that surface commingling and off-lease measurement and sale of natural gas and drip is necessary for wells on the GGGS is the fact that wellhead pipeline connections are not available and if gas sales are to occur, the gas must be gathered and delivered to a central sales meter on the pipeline. The well operator has two options: A) build and operate a gas gathering system, delivering a commingled gas stream to a central delivery sales meter at some point very likely removed from the lease, or B) vent the casinghead gas on oil wells and shut in gas wells which cannot be vented. Having invested substantial monies in the acquisition of leasehold acreage, plus the drilling,

completion and equipping of wells, operators really have only one realistic option; to install and operate a gas gathering system such as the GGGS!

In the early field development of the South Bisti Gallup oil pool, Dugan Production recognized that the GGGS would be necessary to facilitate gas sales. We had a substantial undeveloped acreage holding and anticipated a majority of the development drilling would produce low volume oil wells. Individually, the gas volumes were not enough to justify much of an effort to sell the gas, however considering that we envisioned 100+ development wells, we set about to install and operate the GGGS initially for 11 wells. This system has grown with development to it's current 142 wells. None of the wells are very good but all of the wells together produce a significant amount of gas averaging ±1470 MCFD during 1997.

The economic benefit for approving individual wells for operation on the GGGS is also presented on Attachment No. 8 using actual production information. During 1997, the average well connected to the GGGS had an annual gas revenue of approximately $4,972 and in the previous three years, the estimated annual average gas revenue per well was $3438 during 1994, $2387 during 1995 and $3,909 during 1996. The variations in annual gas revenues is primarily a factor of gas price variations and not production rate variations. The annual average gas prices and ranges in gas prices during the year are also presented in Attachment No. 8. These gas revenues represent the value of all gas sales and should be divided amongst the royalty, overriding royalty and working interest owners based upon their respective interest ownerships. For example, during 1997, an average total gas revenue of $4,972 would produce $829 in revenue to the Navajo Allottee owning 16⅔% royalty or $622 to the MMS or State owning 12½% royalty. The balance of $4,143 to $4,350 would go to the working interest owners (assuming no overriding royalty owners) to pay ± $331in State production taxes, ± $4,200 in direct operating expenses and ± $5,400 in administrative overhead costs. Hopefully the revenue from oil sales will help cover these costs, and if not, the working interest owners will lose approximately $5,788 to $5,581 in the operation of an average well on the GGGS. Since gas revenues represent approximately 20% of the average oil well revenue, chances are good that the working interest owners will be able to cover the well operating costs, although these are all fairly marginal wells.

The economic benefit to the various types of leases is also presented on Attachment No. 8 using actual information from 1997. During 1997 production from Federal leases totaled 109,980 bbls of oil and condensate plus 384,371 MCF of gas which produced a total royalty revenue (assuming a 12½% royalty rate) of $264,089 from oil and $58,963 from gas for a total Federal royalty revenue of $323,052 from all 105 completions on Federal leases connected to the GGGS. Looking at the individual well average data for the 105 completions on Federal leases, the average production of 3.3 B/D plus 11.5 MCFD produced an average 12½% Federal royalty revenue of $7.92/day from oil and $1.76/day from gas production for a total of $9.69/day. Similar economic data is presented for the 23 completions on State leases and also the 23 completions on Navajo Allotted leases.

It should be noted that of the 124 oil wells connected to the GGGS, 86 wells on Federal and State leases currently qualify for and are receiving "stripper" incentives in terms of reduced oil royalty rates. Of these 86 wells, 80 are located on Federal leases with an average stripper oil royalty rate of 2.5% (ranging from 0.5 to 5.3%) and six wells are on State leases receiving a stripper oil royalty rate of 5.0%. The State and Federal reduced oil royalty incentive programs for low volume oil wells are a very important factor in the operating economics of marginal oil wells connected to the GGGS, and are a recognition by both the State Land Office and the BLM that when dealing with low volume wells such as exist at our GGGS, a reduced royalty rate will help to ensure that marginal wells are not prematurely abandoned. The reduced royalty rates only apply to oil revenues and do not change the base lease royalty rates for gas revenues. In contrast, all 23 oil completions on Navajo Allotted lands have royalty rates ranging from 16⅔% to 20.0% and there is no apparent effort on the part of the Navajo Allotted lands to allow any reduced royalty incentives for oil wells on Navajo Allotted leases that are all equally marginal to those wells receiving reduced royalty rates on State and Federal leases.

Thus the economics presented on Attachment No. 8 for individual leasehold interests are representative for all Navajo Allotted leases plus State and Federal leases which have not previously been developed or qualified for the reduced oil royalty rates. For Federal and State leases currently qualified for the stripper oil royalty incentives, the indicated gas royalty revenues will be representative, however the oil royalty revenues may be higher than actually exists.

The important issue here is that most oil wells connected to the GGGS (including those oil wells on Indian leases) produce at rates that qualify them for existing State and Federal stripper oil royalty production incentives in an effort to help extend the economic producing lives of marginally economic oil wells. This is especially important during times of low oil prices, such as currently exist.

In addition to the stripper royalty incentives available for State and Federal leases, Attachment No. 8 also includes copies of NMOCD order R-9617 and BLM NTL 92-5 New Mexico which both reflect a recognition that wells producing less than 100 MCFD are considered to be low capacity wells and warrant special considerations pertaining to gas measurement in order to avoid premature abandonment and subsequent loss of hydrocarbon reserves. Both documents also recognize wells producing 15 MCFD or less as not even requiring continuous flow measurement, but some alternate method of determining gas production that is mutually agreeable and equatable to all parties. During 1997, of the 151 wells producing into the GGGS, only one well exceeded the 100 MCFD rate and only 20 wells produced rates greater than 15 MCFD.

Attachment No. 9 is a copy of a letter dated 5-31-94 from the Off-lease Sales, Usage and Measurement Sub-Committee which transmits to the Joint BLM/Industry San Juan Basin Working Committee a report summarizing the sub-committee findings and recommends guidelines for authorizing the off-lease sale, use and measurement of natural gas produced from Federal and Indian leases. This sub-committee, which included representatives from the BLM and Industry (including Dugan Production Corp.) addressed many issues related to off-lease measurement. A

great deal of time was spent discussing the inherent problems common to low rate, irregular flow wells and the difficulties in obtaining gas volume measurements using conventional flow measurement equipment. The sub-committee documented these problems to be common to all low capacity, irregular flow wells and that the use of a gas gathering system and the allocation of gas sales from a central delivery meter using wellsite meters to determine allocation factors as being an acceptable method to deal with these type of wells and marketing gas when wellhead pipeline connections were not possible.

In summary, Dugan Production Corp. respectfully requests approval to add 58 wells/completions/meter sites to our Goodtimes Gas Gathering System which will require the surface commingling plus off-lease measurement and sale of produced natural gas and a small amount of liquid hydrocarbons (drip) that may condense within the system drip traps from time to time. In addition, we are requesting approvals for the off-lease storage of drip that may be recovered at the systems drip traps. All 58 wells/completions/meter sites along with the 129 completions currently approved for the GGGS are considered to be low capacity wells and do not qualify for wellhead gas sales. Dugan Production Corp. has incurred a substantial investment (approximately $3.6 million) in the construction of the GGGS which currently consists of approximately 71.2 miles of gathering system lines in order to deliver natural gas to central delivery sales meters or pipelines currently operated by El Paso Field Services and Elm Ridge Resources. With the exception of four wells operated by Universal Resources, all wells are operated by Dugan Production Corp. Dugan Production has expended a tremendous amount of time, effort and money to provide a means of delivering low volumes of gas produced from marginal oil and gas wells to a pipeline up to 22 miles away from some wells. Since 1981, we have attempted to operate this gathering system in a manner that ensures a fair and equitable allocation of natural gas and drip revenues to each individual well and interest owner. Without the GGGS and Dugan Production's efforts to operate this system, an average of approximately 855 MCFD of natural gas produced from 151 wells/completions would be vented rather than sold.

Should there be questions or if additional information is needed, please let us know.

Sincerely,

John D. Roe

John D. Roe
Engineering Manager

JDR/tmf

cc: NMOCD - Aztec
Universal Resources

Approved JUL 20 1998

COMMISSIONER OF PUBLIC LANDS

PLC 149

COMMERCIAL RESOURCES
(505)-827-5724

SURFACE RESOURCES
(505)-827-5793

MINERAL RESOURCES
(505)-827-5744

ROYALTY
(505)-827-5772

State of New Mexico
Commissioner of Public Lands
Ray Powell, M.S., D.V.M.
310 Old Santa Fe Trail, P. O. Box 1148
Santa Fe, New Mexico 87504-1148
Phone (505)-827-5760, Fax (505)-827-5766

PUBLIC AFFAIRS
(505)-827-5765

ADMINISTRATIVE MGMT.
(505)-827-5700

LEGAL
(505)-827-5713

PLANNING
(505)-827-5752

December 29, 1998

Dugan Production Corporation
P. O. Box 420
Farmington, New Mexico 87499-0420

Attn: Mr. John D. Roe

Re: Requested Exemptions
Gas Analysis and Meter Calibration Requirements
Dugan Production Corp.'s Good Times Gas Gathering System
San Juan County, New Mexico

Dear Mr. Roe:

We are in receipt of your letter of December 16, 1998. In your letter you requested that, due to depressed oil prices, oil wells located on State and Federal leases connected to your Good Times Gas Gathering System be exempted from required annual gas analysis testing and that the meter calibration frequency be extended from 6 to 12 months.

Please be advised that this office hereby grants approval to your proposed request. Our approval is given only until such time as oil prices improve and you are able to restore full time production on your oil wells. Our approval is subject to like approval by the New Mexico Oil Conservation Division and the Bureau of Land Management.

Please submit a $30.00 dollar filing fee.

If you have any questions or if we may be of further help, please contact Pete Martinez at (505) 827-5791.

Very truly yours.

RAY POWELL, M.S., D.V.M.
COMMISSIONER OF PUBLIC LANDS

BY:
JAMI BAILEY, Director
Oil, Gas and Minerals Division
(505) 827-5744
RP/JB/pm
pc: Reader File,
Commissioner's Reader File
OCD-Attention: David Catanach, Ben Stone,
BLM-Farmington Attn: Mr. Duane Spencer

LARGE FORMAT EXHIBIT HAS BEEN REMOVED AND IS LOCATED IN THE NEXT FILE