PLC 9/22/99
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dp dugan production corp.

SEP - 2 1999

September 1, 1999

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, FFO Manager
Bureau of Land Management
1235 La Plata Highway
Farmington, NM 87401

Re: Application for surface commingling of produced gas
Dugan Production's Com No. 1, Com No 3 & King Com No. 90
Plus the off-lease measurement and sale of produced gas from the King Com No. 90
State Leases: LG-3736, NM B-11242-43, NM E-6714-4; Federal Lease: SF 078110;
Multiple Fee leases
Basin Fruitland Coal & Harper Hill Fruitland Sand PC Pools
San Juan County, New Mexico

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

We are writing to request your approvals for the proposed surface commingling of produced natural gas from the three captioned wells, all three of which are operated by Dugan Production Corp. In addition, we are also requesting your approvals for the off-lease measurement and sale of natural gas from the King Com No. 90. The proposed CDP meter is currently the gas sales meter for the Com No. 1 and is located at the Com No. 1 well.

Dugan Production holds 99.9% to 100% of the working interest and Attachments 1 and 2 present the spacing unit, lease and interest ownership details for all three wells. The proposed surface commingling includes production from two Basin Fruitland Coal wells (the Com No. 1 and King Com No. 90), plus one Harper Hill Fruitland Sand-PC well (the Com No. 3). To date, there has been no liquid hydrocarbon production from any of the three completions to be commingled and none is anticipated. The ownership interest in all three wells is not common, and all interest owners (working, royalty and overriding royalty) will receive a copy of this application by certified mail. Attachments 7, 8 & 9 are copies of letters to the various interest owners.

The Com No. 1 (API #30 045 08722) was initially completed in the Basin Dakota pool on 4-9-61 and after producing 133.9 MMCF of gas, the Dakota completion was abandoned and the well recompleted in the Basin Fruitland Coal on 12-1-90. The spacing unit for the Com No. 1 is the E/2 (316.65A) of Section 2, T-29N, R-14W and Administrative Order NSL-3826 authorizes the non-standard Basin Fruitland Coal well location. The Com No. 1 Fruitland Coal completion was placed on production during 5/98, and upon installing rod pumping equipment and well head compression, the Fruitland Coal averaged 255 MCFD + 90 BWPD during 7/99. Attachment No. 4 includes the production history for the Com No. 1 Fruitland Coal completion which has

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produced a total of 68,529 MCF + 32,186 bbl water as of 8-1-99. The gas is delivered into El Paso Field Service's Blanco Plant system which averages 250 to 300 psig and has necessitated the installation of wellhead compression. We currently operate two compressors, a screw compressor which feeds a single stage conventional compressor and provides a wellhead operating pressure of ±12 psig. The water production is disposed of in Dugan's Stella Needs a Com No. 1E water disposal well.

The Com No. 3 well (API No. 30-045-23267) was completed in the Harper Hill-Fruitland PC pool 3-14-79 (renamed Harper Hill Fruitland Sand PC Pool 11-1-88) and has produced a total of 77,943 MCF of gas as of 8-1-99. The spacing unit comprises the SE/4 (160A) of Section 2, T-29N, R14W. This well has been shut in since 5/91, being uneconomical to continue to operate the wellhead compressor that was necessary to deliver gas into the pipeline which was averaging 250-425 psi at the time of shut in. As a result of low pipeline deliveries, El Paso removed the metering equipment in 1994. The Com No. 3 currently has a shut in wellhead pressure of ±250 psi and is ±383' from the Com No. 1. It is proposed to use the production equipment and compressors currently installed at the Com No. 1 to return the Com No. 3 to production which will require the surface commingling of production and will entail re-routing the Com No. 3 gas sales line to connect to the separator for the Com No. 1 as shown on the proposed facility diagram (Attachment No. 3). Use of the existing Com No. 3 sales line will be discontinued and as previously discussed, El Paso has removed the metering equipment. We are hopeful that at the lower operating pressures made available with the compressors on the Com No. 1, production from the Com No. 3 can be restored. The production history for the Com No. 3 is presented on Attachment No. 4, which shows that the well has never produced very well, averaging 10-15 MCFD at the time it was shut in.

The King Com No. 90 (API No. 30-045-29883) was completed 6-15-99 in the Basin Fruitland Coal pool, with an initial potential of 20 MCFD + 31 BWPD from perforations 958'-1084'. The spacing unit comprises the E/2 (320.13A) of Section 11, T-29N, R-14W. Testing to date is encouraging and is summarized on Attachment No. 4. This is an area that the Fruitland Coal pool is fairly shallow (±1000') and the reservoir pressure fairly low (±350 psi). The coal outcrops and is being strip mined approximately 7-8 miles to the west. To date very little gas has been produced from the Fruitland Coal in this area. Based upon the initial testing, we do anticipate obtaining commercial gas volumes from the King Com No. 90, however to deliver gas into El Paso's system, which currently averages 250-300 psi, wellhead compression and production equipment to separate gas and water will be necessary. We propose to utilize the production equipment and compressors at the Com No. 1 which will require surface commingling and off-lease measurement for the King Com No. 90. This will minimize our expenditures to place this well on production, will allow the existing surplus compressor capacity at the Com No. 1 to be utilized and will eliminate the need to install a compressor at a location that is ±1/3 mile from the Mesa Residential Community mobile home park in the northwest part of the city of Farmington.

This proposed conversion of the Com No. 1 gas sales meter to a central delivery gas sales meter for the Com No. 1, Com No. 3 and King Com No. 90 plus the proposed use of the separator and gas compressor currently on the Com No. 1 for all three wells will allow Dugan Production to use existing equipment to return a currently idle and marginally productive well (the Com No. 3) to production and place on production a recently completed well which tested an initial potential of 20 MCFD + 31 BWPD. All production (gas and water) from each well will be surface commingled and separated at the separator located on the Com No. 1. The commingled gas stream will be compressed and delivered into El Paso Field Service's (EPFS) pipeline from the CDP sales meter operated and maintained by EPFS. The water will be stored in a tank on the Com No. 1 location and trucked to Dugan's Stella Needs a Com No. 1 water disposal system (or possibly a commercial facility if needed). Each well will be tested at regular intervals using a portable three phase test unit owned by DPC and the tests used to establish factors for allocating the CDP gas sales and water production. For the first year of operation, we propose testing each well every three months and then at a frequency to be established by production performance. Any

unexplained change in either total gas or water would initiate a re-test of all wells and new allocation factors. After the first 12 months, we plan to test each well annually unless a shorter frequency is indicated by production. Our proposed allocation procedures are presented on Attachment No. 5. Dugan's portable test unit is a trailer mounted three-phase separator capable of measuring oil, water and gas. Gas production is recorded on a conventional flow chart using a Barton Dry Flow Orifice Meter which is calibrated and maintained by DPC. The test unit will be connected to the flow line at each well site, the total production stream separated and individual streams measured, and then all fluids returned to the flowline and transferred to the central battery. We have been using this unit for approximately four years and have found it to produce accurate measurements especially in the lower volume wells such as two of those on our proposed system.

The integrity of our system will be periodically monitored using DPC's gas detector and the entire system will be pressure tested prior to being placed into service.

The gas from each completion is compatible and very similarly in composition. Copies of the current gas analyses for the Com No. 1 (Basin Fruitland Coal) and Com No. 3 (Harper Hill Fruitland Sand-PC) are presented on Attachment No. 6. We do not have an analysis from the King Com No. 90 Basin Fruitland Coal completion, but believe it will be very similar to the Fruitland Coal gas in the Com No. 1. Upon placing this system in operation, we plan to take individual well gas analyses in accordance with the BLM's Onshore Order No. 5 to ensure the accurate allocation of BTU's and revenues from the CDP sales meter.

The installation of this three well gathering system will provide an economic benefit for each of the three wells and their various interest owners. The Com No. 1 interest owners will benefit from increased gas sales since the ±41 MCFD currently being used for compressor fuel, and supplied 100% from the production of the Com No. 1, will be allocated between the three wells. If the Com No. 3 and King Com No. 90 produce a combined rate of ±50 MCFD, approximately 16% of the lease fuel will be allocated away from the Com No. 1 which will result in increased gas sales of ±7 MCFD or ±200 MCF/month. At the current gas price of ±$1.83/MMBTU, this will produce an increased revenue of ±$385/month or $4,600/year for the interest owners presented on page no. 1 of Attachment No. 2.

The Com No. 3 interest owners will benefit from a well being idle for the past ±8 years being returned to production with very minimal expenditures for equipment. The Com No. 3 currently has no metering equipment and based upon production prior to shutting in, this well did not produce sufficient gas volumes to justify the necessary individual wellhead compressor, however we are hopeful that production from the Com No. 3 will justify the sharing of production and compression equipment. In addition, an idle well will be returned to production and expenditures to formally temporarily abandon and/or plug and abandon this well will not be necessary. If a production rate of 10-15 MCFD is restored, the interest owners of the Com No. 3 (presented on page no. 2 of Attachment No. 2) will realize a revenue of ±$600-$900/month which will net ±$100-$400/month after operating expenses.

The King Com No. 90, being newly completed has no production equipment for separating gas and water and will need wellhead compression to deliver gas to EPFS. An initial production rate of ±25-35 MCFD is anticipated which will produce a revenue of ±$1,400-$2,000/month and the anticipated expenditures of ±$25,000 for metering and production equipment will not be necessary which will benefit the King Com No. 90 interest owners listed on page no. 3 of Attachment No. 2. In addition, since the King Com No. 90 is located only ±1/3 of a mile west of a mobile home park, and considering all of the attention compressor noise is currently receiving, there is an additional benefit of not installing a compressor at the King Com No. 90 well site, but using an existing compressor located ±1/2 mile away.

In summary, Dugan Production proposes to install a three well gathering system that will allow a low volume idle well to be returned to production, a low volume recently completed well to be placed on production and will extend the economic life of an existing well. The natural gas will be delivered to El Paso Field Services at their CDP sales meter and will be allocated to each well using allocation factors, determined from periodic individual well tests. We do not anticipate any liquid hydrocarbon production and believe that the operation of this system will provide an economic benefit to all interest owners.

Should you have questions or need additional information, please let me know.

Sincerely,

John D. Roe

John D. Roe
Engineering Manager

JDR/tmf

xc: NMOCD - Aztec
All interest owners - WI, RI, ORRI