AMEND PLC 6/20/00

dugan production corp.

May 30, 2000

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, Manager
Bureau of Land Management - Farmington Field Office
1235 La Plata Highway
Farmington, NM 87401

Re: Add four wells to Dugan's Com 1 CDP
Plus surface commingling, off-lease measurement and sale of natural gas
Dugan Production's Com No. 91 & Federal I wells No. 7, 8 & 98
San Juan County, New Mexico

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

We are writing to request your administrative approvals to add the subject four wells operated by Dugan Production Corp. (DPC) to the central delivery sales meter (CDP) currently authorized for three wells operated by DPC, the Com No. 1, Com No. 3 and King Com No. 90. This will also require the surface commingling of production from all seven wells plus the off-lease measurement and sale of natural gas for six of the seven wells (Com No. 91 is on-lease). Since all seven wells are completed in either the Basin Fruitland Coal or Harper Hill Fruitland Sand-Pictured Cliffs pool, we do not anticipate any oil or condensate production, however should any ever occur, it will be separated, stored, and sold at the well site from which it is produced.

We are also requesting your approvals to change the CDP location from the Com No. 1 well site (J-2-29N-14W) to the Com No. 91 well site (L-2-29N-14W). This will simply mean using El Paso's meter currently installed at the Com No. 91 as the CDP sales meter rather than El Paso's meter at the Com No. 1. El Paso is agreeable to making this change. The current CDP meter at the Com No. 1 well will be taken out of service. El Paso will continue to operate and maintain the CDP sales meter at the Com No. 91 well site.

The Com No. 1 CDP (located at the Com No. 1 well site) and surface commingling of natural gas

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from the Com No. 1, Com No. 3 and King Com No. 90 along with the off-lease measurement and sale of gas from the King Com No. 90 was approved by the New Mexico State Land Office (NMSLO) on 9-9-99, the New Mexico Oil Conservation Division (NMOCD) on 9-22-99 (NMOCD Administrative Order PLC-157), and the Bureau of Land Management (BLM) on 10-1-99. This CDP was placed into service during 11/99 and has allowed the Com No. 1 and Com No. 3 to be produced using only one compressor. The King Com No. 90 has not been placed on production through the CDP since we have not yet obtained all of the necessary pipeline rights-of-way.

Dugan Production has recently completed the Com No. 91 and is currently drilling the Federal I No. 8 with plans to then drill the Federal I No. 7 and 98 wells. Since all wells will require wellhead compression to deliver gas into El Paso's system, which is currently being operated at a pressure of ±250 psi (and at times the pressure will approach 350 psi), we are proposing to add all four wells to the gathering system of the Com No. 1 CDP. Each of these four wells will be completed in either the Basin Fruitland Coal or the Harper Hill Fruitland Sand-Pictured Cliffs gas pools, and will likely produce a significant volume of water along with natural gas. We are proposing to produce natural gas from each well up the casing-tubing annulus and after metering the gas at the individual well sites using conventional gas metering equipment (a Barton dry flow meter or some other approved gas metering method), transport the gas to the central battery located at the Com No. 91 well where it will be collected and compressed using a central compressor for delivery to the CDP sales meter also located at the Com No. 91 well.

The water from each well, plus any natural gas that is associated with the water production, will be produced up the tubing (likely with rod pump artificial lift equipment) and will be transported in a separate pipeline to a central battery separator located at the Com No. 91 location. At the central battery, the produced water streams will be commingled and any associated natural gas will be separated. The water will be transferred to water storage tanks located at DPC's Com No. 1E (A-2-29N-14W) well and then transferred to DPC's Stella Needs A Com Water Disposal System. The commingled stream of natural gas separated from the water at the Com No. 91 central battery will be metered using conventional gas metering equipment (likely a Barton dry flow meter) and after metering, the gas will be delivered to the Com No. 91 central compressor for compression and sale. This meter will be of similar design to the gas metering equipment located at each well and will serve as an allocation meter, the same as at each well. The gas sales allocated to the central battery water separator will then be allocated to the individual wells contributing production to the separator based upon the volumes of water each well produced. Attachment No. 7 presents a sketch of the central battery and the proposed allocation procedures for water and gas are presented on Attachment No. 6. The water production rates will be periodically tested at each well using Dugan's portable, 3 phase test unit. The test frequency will be based upon need as determined by volumes at the central battery, i.e. any changes of significance in the total volume will indicate the need for retesting each well. It should be noted that we are changing our allocation procedure from using periodic individual well tests (as is currently approved) to using an allocation meter at each well for determining monthly allocation factors. Each allocation meter will be installed and maintained by DPC and will be continuous recording conventional gas metering equipment such as a Barton Dry Flow meter. The charts from each meter will be integrated monthly by a commercial chart service and the chart volumes will be used for determining allocation factors.

Attachment No. 1 was reproduced from portions of the Youngs Lake and Kirtland USGS Quadrangle Topography maps and presents Dugan Production's proposed King Gathering System. In addition, the subject wells and Dugan's leases are also identified. We are currently securing the necessary rights-of-way for this gathering system.

Attachment No. 2 presents individual well and lease information and Attachment No. 3 presents the C-102 for each of the seven wells, along with the dedicated spacing units and associated leases. A total of two Federal (NM-101992 and SF-078110), six State (B-11242, E-2526, E-3555, E-6714, LG-3736 and V-5411), and 12 Fee (Dugan's King and King Com) leases are involved. Dugan Production Corp. is the operator of all seven wells and holds 100% of the working interest in six of the seven wells. An individual leaseholder, Mr. Lee Atchison, holds a 0.12% working interest in the King Com No. 90 with Dugan holding the balance (99.88%) of the working interest. The ownership for each well is presented on Attachment No. 4 with page no. 1 presenting a summary for all wells, and pages two through six the specific data for each well.

The Com No. 1 and Com No. 3 both currently produce through a common compressor and the production histories are presented in Attachment No. 5. The Com No. 1 is currently averaging 300 MCFD plus 80 bbl of water per day from the Basin Fruitland Coal pool and production appears to be typical for the Fruitland Coal, i.e. a trend of increasing gas and decreasing water volumes. The Com No. 3 is averaging 2 MCFD from the Harper Hill Fruitland Sand-Pictured Cliffs gas pool and although we have been able to return the Com No. 3 to production using the Com No. 1 CDP and central compression, we have not been able to achieve the desired surface operating pressure for the Com No. 3. As part of our effort to relocate the CDP and compressor from the Com No. 1 to the Com No. 91 and to expand the gathering system to include the four additional wells, we will be installing a larger compressor which hopefully will allow for reduced surface operating pressures on all wells.

The King Com No. 90 will be placed on production through the CDP upon securing the necessary pipeline rights-of-way and has been tested at 24 MCFD + 19 BWPD from the Basin Fruitland Coal.

The Com No. 91 was completed in the Basin Fruitland Coal pool on 12/6/99 and has tested ±225 MCFD plus 175 BWPD. The Com No. 91 has been connected to El Paso's pipeline and upon installing rod pump artificial lift equipment, will be placed on production. Upon securing the necessary regulatory approvals, we plan to convert El Paso's Com No. 91 gas sales meter to a CDP gas sales meter and to move the production currently authorized for the Com No. 1 CDP meter to the Com No. 91 CDP.

In addition, DPC has commenced a three well drilling program on our Federal I lease and plans to place all three wells into a gathering system which will deliver gas to the Com No. 91 CDP gas sales meter. We spudded the Federal I No. 8 on 5/23/00 with plans to complete the No. 7 and 8 wells in the Harper Hill Fruitland Sand-Pictured Cliffs pool and the No. 98 in the Basin Fruitland Coal pool. All three Federal I wells should produce gas and water volumes comparable to the other wells proposed for the gathering system.

The proposed King Gathering System will allow all seven wells to be produced using only one

compressor and will also allow the water production to be transported for disposal by pipeline at a cost of 50¢ to 75¢ per barrel, rather than by hauling with a truck at a cost of $1.50 to $3.00/bbl. At the anticipated water volumes, it will be necessary to haul eight to ten loads per day. Thus pipelining the water for disposal will save between $720 and $1,600/day ($22,000 to $48,000/month) in operating expenses along with a reduction in road wear and tear plus maintenance. In addition, the gas gathering system will eliminate the need to operate compressors at each well which will reduce fuel requirements (with a corresponding increase in volumes available for sale) and will allow for reduced compressor noise and exhaust emissions, both of which are important considering the proximity of these wells to the cities of Farmington and Kirtland.

Production from both formations to be surface commingled is compatible and mixing will not create any operational problems. Attachment No. 8 presents copies of representative gas analyses from the Harper Hill Fruitland Sand-Pictured Cliffs and the Basin Fruitland Coal.

We are sending copies of this application to all interest owners and Attachments No. 9 and 10 present copies of the transmittal letters to the working interest, plus the royalty and overriding royalty interest owners, respectively.

In summary, we are proposing to add four wells (one recently completed, one being drilled and two to be drilled) to Dugan's existing central delivery sales meter for the Com No. 1, Com No. 3 and King Com No. 90 wells. We are also proposing to convert the Com No. 91 gas sales meter to a CDP sales meter and move the Com No. 1 CDP to the Com No. 91 CDP sales meter. This will require the surface commingling of production from all seven wells and the off-lease measurement of production from six of the wells. In addition, we are proposing a gathering system which will allow produced water to be transported for disposal by pipeline rather than trucking. The net result will be eliminating the need to haul eight to ten loads of water per day and the operation of only one compressor rather than five. Thus the King Gathering System will reduce water truck traffic and will allow a significant reduction of noise and exhaust emissions in an area close to the cities of Farmington and Kirtland. In addition, there will be an increased volume of gas available for sale which otherwise would have been needed for compressor fuel, had each well required a separate wellhead compressor.

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

Sincerely,

John D. Roe

John D. Roe
Engineering Manager

JDR/tmf

cc: All interest owners
NMOCD - Aztec