

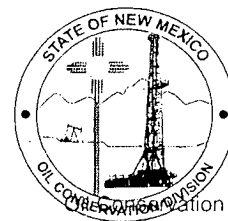
New Mexico Energy, Minerals and Natural Resources Department

Susana Martinez
Governor

John H. Bemis
Cabinet Secretary-Designate

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Deputy Cabinet Secretary

Jami Bailey
Division Director
Oil Conservation Division



April 11, 2011

Dugan Production Corporation
P.O. Box 420
Farmington, NM 87499

Dugan Production Corporation
709 East Murray Dr.
Farmington, NM 87401

NON-DENIAL OF APD(S) DESPITE NON-COMPLIANCE WITH INACTIVE WELL REQUIREMENTS

Re: Dugan Production Corporation, OGRID #6515

- Moncrief Com #100, API #30-045-35235, San Juan County, NM

Dear Operator:

The Director of the Oil Conservation Division ("OCD") or her designee **may deny a permit to drill, deepen or plug back** if the applicant is not in compliance with 19.15.5.9(A) NMAC [Part 5.9(A)]. See 19.15.14.10(A) NMAC.

An Operator is not in compliance with Part 5.9(A) if the Operator:

- does not meet the financial assurance requirements of 19.15.8 NMAC;
- is subject to a division or commission order finding the operator to be in violation of an order requiring corrective action;
- has a penalty assessment that has been unpaid for more than 70 days since the issuance of the order assessing the penalty; or
- has more than the allowed number of wells out of compliance with 19.15.25.8 NMAC (inactive well rule).

According to the attached inactive well list, your company is out of compliance with Part 5.9(A) due to having too many wells in violation of 19.15.25.8 NMAC [Part 25.8] that are not subject



to an inactive well agreed compliance order ("ACOI"). See Part 5.9(A)(4) NMAC. As an operator of 910 wells, your company may have no more than 7 wells in violation of Part 25.8. Your company has 8 wells in violation of Part 25.8.1

I have decided, as the Director's designee, **not to deny** your APD application on the basis of your company being out of compliance with Part 5.9 due to too many wells in violation of Part 25.8. **My decision not to deny your APD on the basis of Part 5.9 does not constitute approval of your APD by the OCD.**

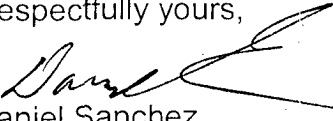
Please note, however, that the OCD cannot assign an allowable to a well or issue authorization to transport oil or natural gas from a well if the operator is out of compliance with Part 5.9. See 19.15.16.19(A) NMAC. Therefore, if your company is not in compliance with Part 5.9(A) at the time it requests an allowable and authorization to transport, its request will be denied.

To come into compliance with Part 5.9(A) as to inactive wells the operator must reduce the number of wells on its inactive well list or otherwise demonstrate that it has no more than the tolerated number of wells out of compliance with the inactive well rule. A well will be removed from the inactive well list when the operator takes one of the following actions:

1. plugs the wellbore and files an approved C-103 reporting the plugging;
2. places the well on approved temporary abandonment status;
3. returns the well to production or other beneficial use and files a C-115 reporting that production or use; or
4. enters into an ACOI with the OCD covering the well.

An ACOI sets a schedule for returning the operator's inactive wells to compliance and imposes a penalty if the schedule is not met. If you would like to discuss entering into an ACOI for your non-compliant inactive wells, please contact OCD attorney Sonny Swazo at (505) 476-3463 or sonny.swazo@state.nm.us.² Attached is an information sheet explaining Part 5.9.

Respectfully yours,


Daniel Sanchez
Division Enforcement & Compliance Manager

EC: Jami Bailey, Division Director
Larry "Buddy" Hill, District I Supervisor

¹ To check an operator's compliance with the inactive well rule, go to the OCD's website at www.emnrd.state.nm.us/oqd. On the left-hand side of the main window, click on "OCD Online"; select "E-Permitting"; click on "Compliance"; click on "Inactive Well List." Leave the search terms as "Exclude Wells Under ACOI," "Exclude Wells in Approved TA Period," and "15" months from last production or injection. Enter the operator's name or OGRID and select "Get Report." The report will list wells operated by that operator that are presumed to be out of compliance with the division's inactive well rule, and that will be considered in determining if the operator is out of compliance with Part 5.9(A).

² Please note that Agreed Compliance Orders are offered at the discretion of the OCD, and that not all Operators are eligible to enter into such agreements.

April 11, 2011

Page 3

Randy Dade, District II Supervisor

Charlie Perrin, District III Supervisor

Ed Martin, District IV Supervisor

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Theresa Duran-Saenz, Legal Assistant-Santa Fe

Sonny Swazo, Division Attorney

Inactive Well List

Total Well Count: 910 Inactive Well Count: 8

Printed On: Monday, April 11 2011

District	API	Well	ULSTR	OCD Unit	OGRID	Operator	Lease Type	Well Type	Last Production	Formation/Notes	Status	TA Exp Date
3	30-039-21136	ADOBE #001	5-5 -23N-07W	A	6515	DUGAN PRODUCTION CORP	F	O	09/2009	INT TO P&A/BLM APVD 1-7-11		
1	30-025-24321	BILBREY 51 #001	A-23-09S-37E	A	6515	DUGAN PRODUCTION CORP	F	S	06/2009	SAN ANDRES		
3	30-039-23191	CELSIUS #001	H-14-23N-06W	H	6515	DUGAN PRODUCTION CORP	F	O	08/2009	INT TO P&A/BLM APVD 1-7-11		
3	30-045-07023	FULLERTON #001	F-34-28N-13W	F	6515	DUGAN PRODUCTION CORP	F	G	08/2009	INT TO P&A/BLM APVD 1-5-11		
3	30-045-20786	GENTLE #003	P-3 -28N-11W	P	6515	DUGAN PRODUCTION CORP	F	G	12/2009	INT TO P&A/BLM APVD 1-4-11		
3	30-045-22307	OKIE #001	P-3 -24N-08W	P	6515	DUGAN PRODUCTION CORP	F	G	10/2009	FC/ RTP 2-25-11		
3	30-045-10488	PAUL HALL #001	10-20-31N-13W	N	6515	DUGAN PRODUCTION CORP	F	G	12/2009	INT TO P&A/BLM APVD 1-10-11		
3	30-045-23545	WESTERN FEDERAL #008Y	B-18-26N-11W	B	6515	DUGAN PRODUCTION CORP	F	G	11/2009			

WHERE Ogrid:6515, County:All, District:All, Township:All, Range:All, Section:All, Production(months):15, Excludes Wells Under ACOI, Excludes Wells in Approved TA Period

INFORMATION SHEET FOR PART 5.9

Oil Conservation Division (OCD) Rule 19.15.5.9 NMAC, commonly known as “Part 5.9,” requires operators to meet certain minimum compliance standards for the wells they already operate before they can drill, acquire, produce or inject into additional wells. If an operator is out of compliance as defined by Part 5.9, the OCD:

- May deny registration by the operator or certain related entities. *See* 19.15.9.8(B) NMAC.
- May deny applications for change of operator that would transfer wells to the operator. *See* 19.15.9.9(C) NMAC.
- Must deny injection permits. *See* 19.15.26.8(A) NMAC.
- May deny APDs. *See* 19.15.14.10(A) NMAC.
- Must deny allowable and authorizations to transport. *See* 19.15.16.19(A) NMAC.

In addition, the OCD may, after notice and hearing, revoke previously issued injection permits if the operator is out of compliance with Part 5.9. *See* 19.15.26.8(A) NMAC.

To stay in compliance with Part 5.9, an operator must:

- Keep current with the financial assurance requirements for well plugging. *See* 19.15.5.9(A)(1) NMAC.
- Comply with orders requiring corrective action. *See* 19.15.5.9(A)(2) NMAC.
- Pay properly assessed penalties. *See* 19.15.5.9(A)(3) NMAC.
- Have no more than a certain number of wells out of compliance with the inactive well rule. *See* 19.15.5.9(A)(4) NMAC.

FINANCIAL ASSURANCE REQUIREMENTS: The OCD’s financial assurance requirements for well plugging are set out in 19.15.8.9 NMAC. The OCD requires all state or fee wells to be covered by a financial assurance. The OCD does not require financial assurances for Federal or Indian wells.

The operator must either post a blanket financial assurance in the amount of \$50,000 to cover its state or fee wells, or post single-well financial assurances for each state or fee well in the amount set by the rule.

If the operator chooses to post a blanket financial assurance, it must also post single-well financial assurances for each state or fee well that has been inactive for more than two years that has not been plugged and released. Note that a single-well financial assurance is required even if the well is on approved temporary abandonment status, and even if the wellbore of the well has been plugged. To check compliance with this requirement, go to www.emnrd.state.nm.us/OCD, OCD Online, E-Permitting, Compliance, Financial Assurance. Insert the operator name or OGRID, and hit “Get Report.” The report will list all the wells for that operator that have not been plugged and released. Wells currently in violation of the single-well financial assurance requirement will have a “Y” in the far right column, titled “In Violation.”

For information on how to post financial assurances, please contact OCD Financial Assurance Administrator Dorothy Phillips, (505) 476-3461, Dorothy.phillips@state.nm.us.

CORRECTIVE ACTION REQUIREMENTS: If an operator fails to take an action required by a hearing order or an agreed compliance order, the OCD may go to hearing to obtain a formal order finding the operator “in violation of an order requiring corrective action.” Once such an order is issued and becomes final, the operator will be out of compliance with Part 5.9 until that order is lifted. To lift the order, the operator must

complete the corrective action required, and file a motion to declare the order satisfied. The Oil Conservation Division or the Oil Conservation Commission, as appropriate, may grant the motion without hearing or may set the matter for hearing.

UNPAID PENALTIES: An operator with a penalty assessment unpaid more than 70 days after issuance of the order assessing the penalty will be in violation of Part 5.9 until that penalty is paid. Penalties may be assessed by the district court, or may be agreed to by the operator under an agreed compliance order entered into to resolve a compliance action.

INACTIVE WELLS: The inactive well rule, 19.15.25.8 NMAC, requires any well that has been inactive for a period of more than 15 months to be plugged and abandoned, placed on approved temporary abandonment status, or returned to production or other beneficial use. An operator will be out of compliance with Part 5.9 if it has too many wells in violation of the inactive well rule; the number of non-compliant wells allowed depends on the size of the operator. Under Part 5.9, if an operator operates:

- 1 well, it may have no wells out of compliance;
- 2 or 3 wells, it may have no more than 1 well out of compliance;
- 4 to 100 wells, it may have no more than 2 wells out of compliance;
- 101 to 500 wells, it may have no more than 5 wells out of compliance;
- 501 to 1000 wells, it may have no more than 7 wells out of compliance; and
- 1000 or more wells, it may have no more than 10 wells out of compliance.

To check compliance with 5.9 as to inactive wells, go to www.emnrd.state.nm.us/OCD, OCD Online, E-Permitting, Compliance, Inactive Well List. Do not change the default search terms. Insert the operator name or OGRID, and hit "Get Report." The report will identify the wells that -- according to OCD records -- have been inactive for 15 months, are not on approved temporary abandonment status, do not have a plugged wellbore, and are not subject to an inactive well agreed compliance order. For purposes of Part 5.9, if a well appears on this list, there is a rebuttable presumption that the well is in violation of the inactive well rule. The heading of the list will also identify the total well count for the operator, and the total number of non-compliant inactive wells, so you can determine if the operator is in compliance with Part 5.9.

If your company has more non-compliant wells than allowed under Part 5.9, you will need to return wells to compliance by returning them to production or other beneficial use, placing them on approved temporary abandonment status, or plugging the wellbore. In some limited circumstances, the OCD may be willing to enter into an inactive well agreed compliance order setting a schedule for returning the wells to compliance and imposing sanctions if that schedule is not met. Wells covered by an inactive well agreed compliance order are not included when calculating Part 5.9 compliance. For information on inactive well agreed compliance orders, contact OCD Attorney Sonny Swazo at (505) 476-3463, Sonny.swazo@state.nm.us.