

RELIANCE OPERATING COMPANY

Oil & Gas Exploration and Development

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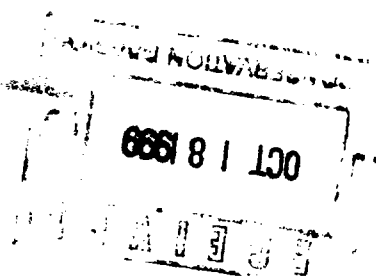
OCT 18 1999

October 13, 1999

U. S. Bureau of Land Management
Attn: Mr. Armando Lopez
2909 W. 2nd Street
Roswell, New Mexico 88201

OCT 18 1999

Re: Federal "D" No. 3 Well
1120' FSL and 1420' FEL of
Section 31, T-9-S, R-36-E,
Lea County, New Mexico



Dear Mr. Lopez:

Pursuant to our recent telephone conversation concerning the communitization of two BLM Leases into a unit covering the East Half of the above captioned Section, the following is a synopsis of the chain of events to explain the delays and status of the unit.

1. May 14, 1996 - The prospect was sold by a Mr. William C. Bahlburg (Bahlburg Exploration Inc.) and Mr. David L. Cherry (PetroVan, Inc.) to Mr. Bill Rutter, Jr. (Towhee Exploration / Rutter and Wilbanks Corporation).
2. Reliance acquired a small interest in the prospect and agreed to operate.
3. Bahlburg and Cherry sold all of their retained overriding royalty interests in the SE/4 of Section 31 to a majority of the working interest owners. Bahlburg and Cherry retained an overriding royalty interest in the NE/4 of Section 31.
4. August 19, 1997 - Spud date of the Federal D-3 Devonian Test Well (hereinafter referred to as the "Well").
5. October 16, 1997 - The Well was completed in the Devonian Formation.
6. August 19, 1998 - The Well was re-completed in the Atoka Formation.
7. August 27, 1998 - A four-point test was filed with the New Mexico Energy, Minerals and Natural Resources Department (hereinafter referred to as the "State") testing at 48 BO and 963 MCF, being a

OCT 18 1999

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RESERVATION #12345
20,060 to 1 gas to oil ratio (oil well under the State of New Mexico Regulations). When the Well was put on production, the actual gas to oil ratio decreased. Note: under the State regulations, the definitions of gas well and oil well are as follows:

"GAS WELL shall mean a well producing gas or natural gas from a gas pool, or a well with a gas-oil ratio in excess of 100,000 cubic feet of gas per barrel of oil producing from an oil pool."

"OIL WELL shall mean any well capable of producing oil and which is not a gas well as defined herein."

8. December 18, 1998 – Due to the high oil content and the fact that an Atoka well, the Union Oil Company State M-1 Well, across the section line to the south was classified as an oil well, a Request For Allowable And Authorization to Transport form was filed with the State and the Federal D-3 Well was put on production.
9. April 20, 1999 – Reliance received a fax from Donna with the State office in Hobbs stating that the well could not be approved as a gas well because of the non-standard location.
10. April 23, 1999 – Reliance received a letter from Mr. Michael E. Stogner, Chief Hearing Officer/Engineer with the State, instructing Reliance to file an appropriate application for an unorthodox Atoka gas well location.
11. May 13, 1999 – Reliance requested administrative approval in writing. Prior to this written request, Mr. Bahlburg, who is a geologist, told our production department that he had visited with the State and that the unit would be a stand-up 320-acre unit.
12. May, 1999 – Reliance contacted its title attorneys to prepare the Communitization Agreements and render the Division Order Title Opinion on the E/2 of Section 31.
13. June 7, 1999 – Administrative Order NSL-3838-A was issued by the State setting forth that the E/2 of Section 31 be dedicated to the Well.
14. September 15, 1999 – The Original Division Order Title Opinion covering the E/2 of Section 31 was rendered. Completion of the Opinion was delayed due to the complicated and voluminous title.
15. October 1, 1999 – The Federal D-3 Well was placed in the newly created Cross-Bough, Atoka, Gas Pool by the State.

Our Title Opinion states that BLM Lease NM LC 065249 covers Lot 4, S/E4 SW/4 of Section 30 and Lots 3, 4, E/2 SW/4, and the SE/4 of Section 31.

It also cites that BLM Lease NM NM 87276 covers NE/4 and the E/2 NW/4 of Section 31; all being in T-9-S, R-36-E, N.M.P.M, Lea County New Mexico. A plat with the base lease coverage colored is attached as Exhibit "A".

U. S. Bureau of Land Management
October 13, 1999
Page 3

There are thirty two (32) working interest owners and twenty eight (28) overriding royalty interest owners which will be required to sign the Communitization Agreement. Before we go through the time and expense of processing these Agreements, we need to be advised in writing if the BLM will even consider such communitization. Many of the interest owners will most likely refuse to sign the Communitization Agreement because they believe the well is an oil well and the communitization will reduce their net revenue interests. They will probably request a hearing to reclassify the well as an oil well.

Mr. Bahlburg and Mr. Cherry have contacted the BLM and the State and may have had some influence in the classification. They have also contacted the oil and gas purchasers to suspend their proportionate part of the production runs and have threatened litigation if they are not promptly paid their proportionate part of the overrides in the NE/4 of the unit. Due to their actions, they have incurred a liability for tortious interference in the contractual and legal obligations concerning the operations. Only the overriding royalty interests have been suspended pending resolution. The BLM royalties and working interests have been promptly and continuously paid.

Please notify the undersigned at your very earliest convenience concerning the BLM position concerning the communitization of the two BLM Leases.

Yours very truly,

Jack L. Waldrep, Jr.,
Land Manager

JLWJr/ms
Attachment

xc: cover letter only

Mr. Michael Stogner
Mr. Paul F. Kautz
Mr. Bill Rutter, Jr.
Mr. David L. Cherry
Mr. William C. Bahlburg

