NSP 6/26/00

dugan production corp.

- 6

June 5, 2000

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

13476

Re: Application for Approval of Unorthodox Proration Units
SE/4 Sec. 26 and SW/4 (Lots 4, 5, N/2SW/4) Sec. 25, T30N, R14W (± 320.36 acres)
NE/4 Sec. 26 and NW/4 Sec. 25, T30N, R14W (± 320 acres)
San Juan County, New Mexico
Basin Fruitland Coal Pool

Dear Ms. Wrotenbery:

Recently, Dugan Production Corp. submitted an application to the New Mexico Oil Conservation Division for administrative approval of an unorthodox location for the Carpenter Com # 90 well. The unorthodox location is necessitated by extreme topographic conditions and would insure the conservation of surface and subsurface resources in the area (Exhibit 1 and Exhibit 2). The application was rejected based on the Oil Conservation Division's concern that offsetting, correlative rights would not be protected if it were approved.

During a discussion with you and Frank Chavez at the Four Corners Oil and Gas Conference on May 9, 2000, a solution to Dugan's location problem with the Carpenter Com #90 was proposed. You recommended and encouraged Dugan to make application for two unorthodox proration units. These proration units would protect correlative rights and insure full, orderly development of the Fruitland Coal in the subject area. Dugan would be able to locate and operate a Fruitland Coal well at an orthodox location in an area of very rough topographic terrain, and the impact on surface resources and risk to producing gas wells would be minimized.

Attached for your reference are the following exhibits:

1. Topographic map.
2. Letter to Ms. Lori Wrotenbery asking the NMOCD to review their ruling on Dugan's unorthodox location application for the Carpenter Com #90 well.
3. BLM letter supporting application.
4. Offsetting operator and mineral owner map.
5. Offset operator and mineral owner notification list.

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dugan production corp.

In a meeting on May 16, 2000 the proposed application for unorthodox proration units was presented to Jim Lovato, Neil McBride and Joe Hewitt with the Bureau of Land Management. This meeting was followed up with a formal letter from Dugan, asking for the BLM to write a supporting letter for the application. The Farmington office of the BLM approves and supports Dugan Production in this application (Exhibit 3).

Dugan Production Corp. hereby requests approval for the following two unorthodox proration units:

1. SE/4 of Sec. 26 and SW/4 Sec. 25, T30N, R14W (± 320.36 acres)
2. NE/4 of Sec. 26 and NW/4 Sec. 25, T30N, R14W (± 320 acres)

Copies of this application and an objection waiver have been sent by certified mail to all offsetting Fruitland Coal operators and mineral owners (Exhibit 4 and Exhibit 5).

From our previous discussion, it is our understanding that twenty days after receiving this letter; the Division Director will schedule this application for hearing. In the absence of any objections, the matter will be taken under advisement.

Please contact me if you have any questions or need additional information.

Very Sincerely,

Kurt Fagrelius

Kurt H. Fagrelius
Geologist

Attachments

cc: Mr. Frank Chavez - New Mexico Oil Conservation Division, Aztec
Mr. Jim Lovato - U.S. Bureau of Land Management, Farmington
New Mexico State Land Office, Santa Fe

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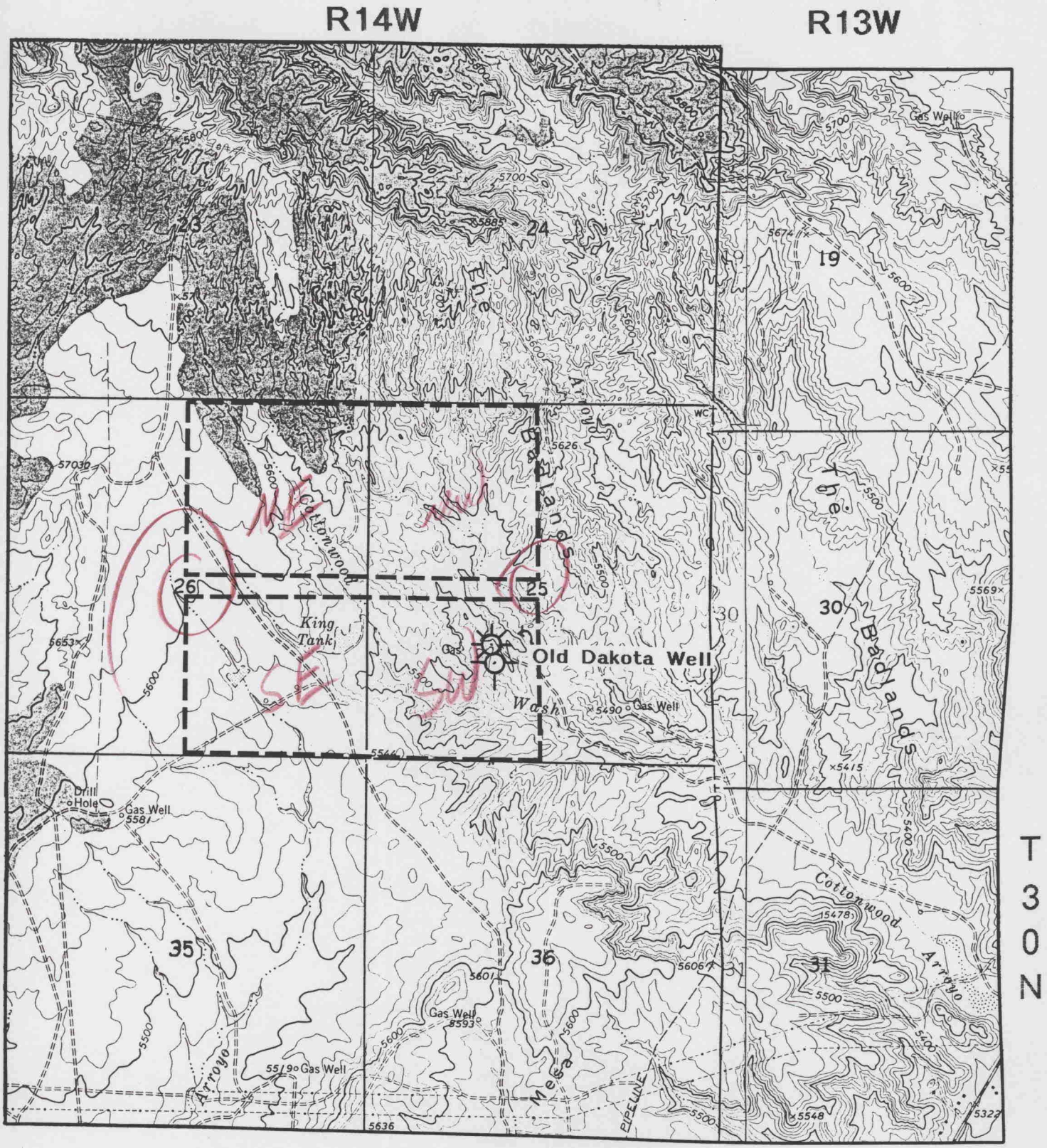

Exhibit 1.

Dugan Production Corp.
Application For Unorthodox Proration Units

TOPOGRAPHIC MAP

Exhibit 2.

dugan production corp.

March 2, 2000

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

Re: Application for Administrative Approval of
Unorthodox Location for Dugan Production Corp's. Carpenter Com # 90
1767' FSL & 280' FWL (NW/4 SW/4)
Unit L, Section 25, T30N, R14W
San Juan County, New Mexico
Basin Fruitland Coal Pool

Dear Ms. Wrotenbery:

Recently, Dugan Production submitted an application to the New Mexico Oil Conservation Division for administrative approval of an unorthodox location (necessitated by topographic conditions) for the Carpenter Com # 90. The application was rejected based on the Oil Conservation Division's opinion that an existing well pad at a standard location was available and suitable for usage by the operator. The Oil Conservation stated that "staking the proposed Carpenter Com. Well No. 90 on an existing well pad would serve to minimize surface resource damage and/or avoid the topographic conditions mentioned" in our original application. Two well bores occupy the existing well pad that the NMOCD was referring to, the producing Carpenter #1 and the plugged and abandoned Carpenter #2.

Dugan Production expressed their concern with the NMOCD's opinion and provided additional information to support the need for the unorthodox location. However, in it's final decision, the NMOCD failed to recognize the following concerns of the operator:

1. Topographic problems with the Carpenter #1 and Carpenter #2 well pad.
2. Minimizing risk to an existing well bore.
3. Minimizing surface resource damage.
4. Maximizing efficient development of the Fruitland coal gas resource.

The first concern is that the existing topographic conditions at the Carpenter #1 and Carpenter #2 well pad create difficult operation problems that will be expensive, unnecessary and wasteful to deal with. This well pad is merely a small island of flat terrain (roughly 300-feet in diameter), that is surrounded by a sea of very rough, Bad

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Lands type topography. To operate a Fruitland coal well here, a considerable amount of expensive dirt work would be required in order to make the pad useable. The produced water from the well (150 - 250 bls per day) would have to be either pipelined to our gathering system (1/2 mile away) across very rough terrain, or, the access road would have to be improved and graveled (2-miles) in order to provide year round access to haul the produced water to our injection facility (five miles away). Also, a large 3-stage compressor would be required at the well site in order to produce into El Paso's high-pressure pipeline. However, if allowed to build our location at the unorthodox site, a minimal amount of dirt work would be necessary to build the pad and only a short distance (1/4 mile) of pipeline across flat terrain would be needed in order to transport the produced gas and water to our existing, centralized compression and injection facilities.

The second concern of Dugan Production is to minimize risk exposure to the producing, Carpenter #1 well bore (38-years old). The Carpenter #1 was cemented across the deeper, productive Dakota and Gallup zones only. It has a history of shallow casing problems and does not have any cement across the Fruitland coal zone. To locate a coal well within 500-feet of this Dakota producer is a risk that our sound engineering practices will not allow us to willingly take. The well bore could be damaged or lost, the remaining Dakota reserves would be left in the ground and the expense of our frac could be wasted if we were forced to drill and frac the Fruitland coal within close proximity to it. Only careless and reckless engineering would recommend that a Fruitland coal well be drilled and frac'd on this well pad.

Another concern of Dugan Production is to minimize destruction of the wonderful surface resource that this unusual topography provides for the Farmington community. This area referred to as the Cottonwood Wash area being unique and close to town, is a very popular area for outdoors-recreational activities like hiking, bicycling and horseback riding. An employee of Dugan Production that lives close to this area has seen 3 - 4 different cars in the parking lot on a daily basis and as many as 15 - 20 on any given weekend. The primary trail that people use in and out of this area is the access road for the Carpenter #1. As noted earlier, this road would have to be improved to accommodate the water trucks. However, the road is very crooked with several blind corners along its length. Serious safety problems will occur if water trucks, bicycles and horseback riders are forced to share the same road. Also, a large compressor at the head of the wash would destroy the peaceful serenity of this region that many people come to enjoy.

The final concern of Dugan Production is to maximize efficient development of the Fruitland coal gas reserve. The topography of the subject area and our reluctance to put an existing well bore at risk make it difficult to drill our well at the site recommended by the New Mexico Oil Conservation Division. If we are not allowed to drill our Fruitland

coal well at the proposed, unorthodox location we will be forced to take a very close look at the economics and determine if they will justify drilling at the location that the NMOCD is recommending. If they do not, the Fruitland coal gas reserves will not be developed.

It is in the best interest of both the NMOCD and Dugan Production that we maximize efficient development of the Fruitland coal gas and at the same time protect the existing Dakota gas and surface resources in this area. We urge the New Mexico Oil Conservation to review your ruling on our application, recognize our concerns and grant us administrative approval of our unorthodox location.

If you have any questions or need additional information on this matter, please contact me.

Very Sincerely,

Kurt H. Fagrelius
Geologist

cc: Mr. Lee Otteni, U.S. Bureau of Land Management, Farmington
Ms. Mary Lou Drywater, U.S. Bureau of Land Management, Farmington
Mr. NeelMcBride, U.S. Bureau of Land Management, Farmington
Mr. Frank Chavez, New Mexico Oil Conservation Division - Aztec
Mr. Michael Stogner, New Mexico Oil Conservation Division - Santa Fe
Ms. Kathy Valdes, New Mexico Oil Conservation Division - Santa F
Mr. Steve Salzman, U.S. Bureau of Land Management, Santa Fe
Mr. Bob Gallagher, New Mexico Oil and Gas Association, Santa Fe

BUREAU OF LAND MANAGEMENT
Farmington Field Office
1235 La Plata Highway, Suite A
Farmington, New Mexico 87401

IN REPLY REFER TO:
3162.2 (07100)

JUN 1 2000

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

Dear Kurt:

Reference is made to your letter dated May 19, 2000 requesting the Bureau of Land Management's concurrence on two proposed non standard proration units in the following areas:

SE/4 Sec. 26 and the SW/4 Sec. 25, T.,30N., R.14W., (320.36 acres more or less) and the NE/4 Sec 26 and the NW/4 Sec 25, T.30N., 14W., (320 acres), San Juan County, New Mexico.

We have reviewed the issues and concerns outlined in your letter and concur that these non-standard proration units are necessary to fully develop the Fruitland Coal because of topographic and well location constraints. Please be advised, that if these non-standard proration units are created, all of section 25 and 26 must be fully developed in the Fruitland Coal to prevent drainage of natural gas resources from federal lands. Both the terms of your leases and the oil and gas operating regulations require you to protect the federal lands from drainage. In addition, you are responsible for providing notice of this proposal and its drainage ramifications to all offsetting mineral interest owners. We will continue to monitor Fruitland Coal development in these areas to assure that prudent development takes place.

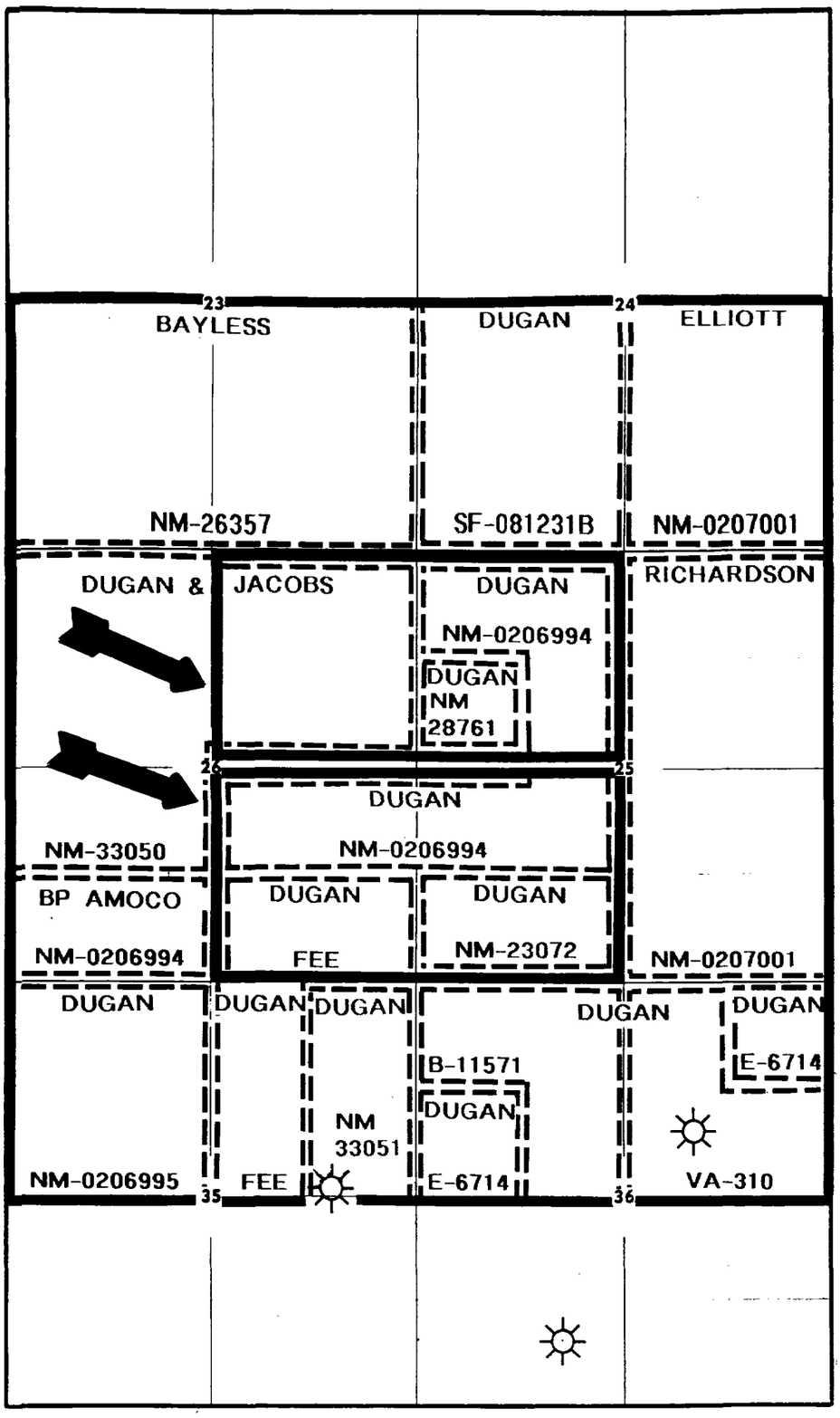
Sincerely,

Jim Lovato
Petroleum Engineer
Petroleum Management Team

JUN 2000
RECEIVED

Exhibit 3.

R14W



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Dugan Production Corp.

Application For Unorthodox Proration Units

OFFSETTING OPERATORS AND MINERAL OWNERS MAP
FRUITLAND COAL WELLS ONLY

All offsetting operators are 100% working interest owners

Exhibit 4.

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OFFSET OPERATOR AND MINERAL OWNER NOTIFICATION LIST

Robert Bayless Producer, L.L.C.
P.O. Box 168
Farmington, NM 87499

Elliott Oil Company
P.O. Box 1355
Roswell, NM 88202-1355

Richardson Production Co.
1700 Lincoln, Suite 1700
Denver, Co 80203

Jim L. & Mary Lou Jacobs Trust
3505 Crescent Ave.
Farmington, NM 87401

BP Amoco
200 Amoco Court
Farmington, NM 87401

Exhibit 5.

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