

September 13, 1985

Mountain States Natural Gas Corp.  
P. O. Box 35426  
Tulsa, Oklahoma 74136

Attention: Mr. Albert Blair

Re: Oil and Gas Farmout Proposal  
Rio Arriba County, New Mexico

Dear Mr. Blair:

Pursuant to our telephone conversation two weeks ago, we are submitting a proposal for a continuous drilling program on your acreage or on acreage pooled with your acreage in Rio Arriba County, New Mexico. This proposal would involve drilling wells deep enough to penetrate the Dakota Formation.

McHugh proposes to drill the subject acreage on a 90 day continuous drilling commitment. We request that Mountain States, Ralph Guillard and Duer Wagner, Jr. (Mountain States, et al) farmout to McHugh a 100% working interest of Mountain States, et al, interest in the lands, reserving a proportionate share of an overriding royalty interest to assure that McHugh would be drilling at least an 80% net revenue interest before payout. After payout of the subject well on a given tract, Mountain States, et al, would have the option to convert to a proportionate 25% working interest. It is the intent and understanding of the parties hereto that Mountain States, et al, will deliver at least an 80% net revenue interest to McHugh before payout and an 85% net revenue interest after payout. I believe, however, that net revenue interests would have to be worked out on a tract by tract basis in that these working interests vary from tract to tract.

Enclosed is a production map showing the current Gallup/Dakota wells which we have drilled in the area. These are approximately 8,000' deep wells. The Gavilan Mancos-Dakota Pool has been pooled by the State of New Mexico on 320 acre drilling units and are also shown on the map. A proposed Gavilan Mancos-Dakota Pool Extension is also indicated on the map.

Jerome P. McHugh & Associates  
Operating Affiliate: Nassau Resources, Inc.  
650 South Cherry, Suite 1225  
Denver, Colorado 80222  
(303) 321-2111

BEFORE EXAMINER STOGNER OIL CONSERVATION DIVISION	
McHugh	EXHIBIT NO. 2
CASE NO.	8788

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Jerome P. McHugh & Associates has been active in the San Juan Basin for twenty years. As an independent producer, McHugh operates over 125 wells and has an interest in an additional 30. The majority of our operations lately have been in the Lindrith-Gavilan area as we operate over 20 wells as indicated on the map.

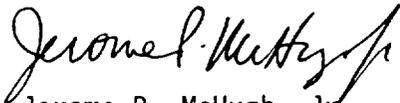
Mountain States, et al, acreage and interest are shown on the map. Our proposed locations and drilling units are as indicated and we would earn your working interest in the 640 acre section in which we drill. Since these drilling units will most likely be in 320 acre tracts, we will need to pool additional interests in order to proceed with our drilling proposal.

McHugh has recently staked a well in the NW/4NE/4 of Section 12, Township 25 North, Range 2 West, which we hope to commence work on soon. We have dedicated this prospect, the #1 Continental Divide Well, to the East one-half of the subject section. In light of your interest in said Section 12, we propose to commence the drilling of your interests on this drilling unit as the first well.

McHugh has been the most active operator in the Gavilan area and we are anxious to proceed on this proposal with you. Please let us know of your decision on this matter.

Thank you very much.

Sincerely,



Jerome P. McHugh, Jr.

JPH/rm

enclosures