

dugan production corp.

December 12, 2006

David Catanach
New Mexico Oil Conservation Division
1210 South St. Francis Drive
Santa Fe, NM 87505

Re NMOCD Commingling Order PLC-191-A dated 7/24/06
Dugan Production Corp.'s
Big Band Gas Gathering System

Dear Mr. Catanach,

I am writing to request that you reconsider three provisions set out in the subject order.

The first item is OCD's approval to "periodically, and when necessary, deliver gas from the Rusty Chacra Gas Gathering System to the Big Band Gas Gathering System". We appreciate OCD's approval to move gas from one gathering system into the other and this is a very important part of our application, however our request was to deliver gas from the Big Band Gathering System to the Rusty Chacra Gathering System. Hopefully this will be a minor amendment, however if additional information is needed, please let me know.

The second item is a request that federal lease NM-116056 be added to the listing of leases that are within the Big Band Gathering System Area. This lease was identified as Map Code "E" on Attachment No. 1 to our application and comprises the S/2 of the SE/4 of Section 3, T-22N, R-8W. This lease is within the 320A E/2 spacing unit proposed for the Basin Fruitland Coal completion attempt in the Sage Creek No. 1 well and is included in the description of the Big Band Gathering System Area.

The third item is OCD's establishment of a "Gathering System Area" and considering that area as a "defined parameter" with regards to future wells to be added to the gathering system. We appreciate the OCD's approval to not require additional application and notice to interest owners for future wells located within the Big Band Gathering System System Area, however since the "Gathering System Area" as defined in the order is basically the lands currently developed and within spacing units for wells currently approved for the gathering system, this will provide very limited relief and does not address future wells on leases not currently developed.

A good example is presented by the future drilling of Bisti Chacra development wells offsetting the Cochran No. 1 which is located in the NE/4 of Section 16, T-22N, R-8W. This well currently has no offset wells and the Gathering System Area identified in the order surrounding the Cochran No. 1 consists only of the 160A NE/4 spacing unit for the Cochran No. 1. As the order is currently written, offset development at any of the eight offsetting locations will not only require notice to the interest owners in the wells to be added to the gathering system, but will also require notice to the 12 interest owners in the 35 wells currently authorized to be connected to the Big Band Gathering System (BBGS). Similar notice requirements exist for direct offset development on many of the other Chacra completions. This is a terrible waste of time and effort and serves no benefit (or purpose) to anyone.

OCD Rule 19.15.5.303B(4)(d)(vii) does not specify what constitutes a "defined parameter", however it is my belief that the committee that labored for 32 months on revising the surface commingling rules did not

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intend to require specific acreage or pools to be a previously defined parameter. I participated on this committee (as did Richard Ezeanyim and David Brooks) and the issue of notice for future additions was an issue for which we spent a significant effort to deal with. Attachment No. 1 presents a sequence of e-mails between committee members regarding the issue of notice for adding future wells and even though David Brooks presented his concern that "there is a need for the owners who share in the existing common facility to have an opportunity to protect themselves" (e-mail No. 2 on Pg. 4), he also presents the important issues for adding wells are;

- a) measurement method remains the same for wells added,
- b) owners in the existing commingled stream will not be adversely affected,
- c) including language assuring the characteristics of the combined stream are not changed by adding production.

After much discussion, e-mail No. 6 from Richard Ezeanyim on 10-29-02 presented wording that the committee agreed would address the issue of notice for future additions to a gathering system. Richard presented the two issues that were important for future additions and it is my belief should be considered to be the "defined parameters", which are;

- 1) additions will not, in reasonable probability, reduce the value of the commingled production, and
- 2) additions will not adversely affect existing interest owners

Although not specifically stated, Richard's proposed wording does not require that the pools and/or leases to be added at some future date have previously been identified in the order. Your suggestion that on future applications, we include all of the acreage and pools that may ever be added, will necessitate including a lot of acreage plus interest owner notice that may never be added and should there be any changes in lease ownership prior to actually being added to the gathering system, we will again have a notice issue.

We propose that the allocation procedures presented on Exhibit A to the order be the primary "defined parameter" that future wells will need to comply with in order to insure little to no impact or adverse affect upon wells and interests currently approved for operation on the subject gathering system. The interest owners in all wells previously approved for operation on the gathering system ideally will not be affected by the addition of other wells and really have no basis for approving or objecting to the addition of other wells, provided that the additional wells will not impact the existing wells. These interest owners have previously addressed the issue of production from their interest being surface commingled and delivered to an off-lease central delivery sales meter. Once a well has been approved for surface commingling and off-lease sales, the interest owners only concern should be that any future wells added to the gathering system will be treated for production and sales allocation in exactly the same manner as are the existing wells. The issue of where the wells being added are located or what pools are completed in the wells being added should be of very little importance to the existing wells and owners. The only issue should be that all wells on the gathering system (existing and added) will be treated the same so that production and sales accountability will continue to exist.

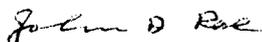
In considering our request to amend Commingling Order PLC-191-A, please include the following:

1. Dugan Production Corp. has a working interest of 100% (net interest 80.0% to 87.5%) in the 35 wells currently authorized for the gathering system. Thus, a significant portion of the production currently authorized to be in the BBGS belongs to Dugan Production and any concern that future additions to the gathering system will adversely affect existing production is certainly shared by Dugan Production.
2. The 12 royalty and overriding royalty interest owners in the 35 wells currently authorized for operations on the BBGS have paid none of the costs to install and operate the gathering system. Each interest owner however, receives full benefit from the gathering system and there is no other means to get their share of production to a sales point.

3. The 35 wells currently authorized to be on the BBGS are anticipated to have an average gas production of approximately 35 mcf. Of the 35 wells authorized to be on the BBGS, only nine were producing at the time of application and average 2.1 mcf. The other 26 wells were either drilled and not connected to the BBGS or were proposed locations, all of which are anticipated to produce with an initial rate of approximately 50 mcf per well. None are anticipated to produce more than 100 mcf.
4. Each of the 35 wells on the BBGS are approved for surface commingling plus off-lease measurement and sale of natural gas. This is necessary for the gathering system to function since wellhead sales to the pipeline company are not available due to the low producing rates of each well. The off-lease measurement and sale occurs at the central delivery sales meter located on the pipeline companies system which is also the point that custody changes and payment for the gas occurs. It should be remembered that prior to entering the BBGS, for allocation purposes, production from each well is measured at the well using a conventional dry flow meter or an approved method of alternative gas measurement. Each of the allocation meters is calibrated and maintained and gas samples taken in accordance with the BLM's Onshore Order No. 5. The gas charts from the allocation meters are integrated monthly by a commercial chart integration service. So even though the sales meter is off-lease, production from each well is measured at each well (mcf and mmbtu's) prior to being surface commingled. This is all done in an effort to insure the interest owners in each well receive their fair and equitable share of the mcf and mmbtu's sold at the CDP sales meter.
5. To provide the required notice for our 6/20/06 application, the certified mail with return receipts plus the newspaper ad totaled approximately \$500. In addition; to create the necessary mailing list, verify addresses to be current, produce the separate mailings of notice to the 12 interest owners, track the return receipts and follow-up with the interest owners for which return receipts were not received required approximately 2 weeks of time and effort. This is a work effort that will be necessary each time we are required to provide notice to all interest owners in wells previously approved for the BBGS.
6. A majority of the interest owner responses received were nothing more than the individual (particularly the overriding royalty owners) needing to be reassured that there shouldn't be any changes to their monthly revenues (even though that information was clearly stated in our notice letters to them).
7. Dugan Production supports providing whatever notice is necessary, however, once a well has been approved for operation on a gathering system requiring the surface commingling and off-lease sale of gas, it is difficult for us to understand why the interest owners of that well should have anything to say about other wells doing the same thing, especially when there are no costs, affects or impacts to those interest owners.

We are preparing a similar request for Commingling Order PLC-147-A dated 7/25/06 which addresses similar issues for Dugan Production's Rusty Chacra Gas Gathering System. Should you have questions or need additional information, please let me know.

Sincerely,



John D. Roe
Engineering Manager

JDR/tmf

enclosures

Handwritten
No. 1

John Roe

#3
From: "John Roe" <johnroe@duganproduction.com>
To: <Rick_Foppiano@oxy.com>; <REzeanyim@state.nm.us>; <DKBrooks@state.nm.us>
Cc: <wcarr@hollandhart.com>; <Craig.E.Moody@conoco.com>; <dave.l.wacker@usa.conoco.com>; <r-dale.smith@conoco.com>; <lmsande@ppco.com>; <WJDueease@MarathonOil.com>; <prddept@ypcnm.com>
Sent: Wednesday, October 30, 2002 9:04 AM
Subject: Re: Proposed Surface Commingling Rules

I'm ok with Richard's rewrite. Thanks for everyone's effort on this issue.

A final thought! Once in final draft, I proposed we ask David Catanach and Will Jones to review and comment, as they are the two NMOCD individuals I work with on applications for Dugan Production, and they will have valuable perspectives.

John Roe

-----Original Message-----

#7
From: Rick_Foppiano@oxy.com
To: REzeanyim@state.nm.us ; DKBrooks@state.nm.us ; johnroe@duganproduction.com
Cc: wcarr@hollandhart.com ; Craig.E.Moody@conoco.com ; dave.l.wacker@usa.conoco.com ; r-dale.smith@conoco.com ; lmsande@ppco.com ; WJDueease@MarathonOil.com ; prddept@ypcnm.com
Sent: Wednesday, October 30, 2002 6:21 AM
Subject: RE: Proposed Surface Commingling Rules

Richard's proposal is much better than mine. I vote for it.

Rick Foppiano

Senior Advisor - Regulatory Affairs
 OXY Permian - Houston, TX
 Phone: 281-552-1303
 Fax: 281-552-1383
 E-Mail: Rick_Foppiano@oxy.com

-----Original Message-----

#6
From: Ezeanyim, Richard [mailto:REzeanyim@state.nm.us]
Sent: Tuesday, October 29, 2002 5:06 PM
To: Foppiano, Rick; Brooks, David K; johnroe@duganproduction.com; Ezeanyim, Richard
Cc: wcarr@hollandhart.com; Craig.E.Moody@conoco.com; dave.l.wacker@usa.conoco.com; r-dale.smith@conoco.com; lmsande@ppco.com; WJDueease@MarathonOil.com; prddept@ypcnm.com
Subject: RE: Proposed Surface Commingling Rules

I have read the language proposed by David K. Brooks and Rick Foppiano regarding notice requirements (as commented by John Roe) for future additions of leases or pools to an existing order. Remember, we are striving to make this rule easier to understand by everyone. I offer the following language instead and hope that it meets the requirement for which it is intended to accomplish. Replace No. 7 with the following language:

7. A future surface commingling order may authorize the addition of pools and/or leases to an existing order, provided however, that such additions will not, in reasonable probability, reduce the value of the

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commingled production or otherwise adversely affect the interest owners. Applications to add such pools and/or leases shall only require notice to the owners of production on the leases and/or pools to be added, unless the Division otherwise directs."

-----Original Message-----

From: Rick_Foppiano@oxy.com [mailto:Rick_Foppiano@oxy.com]

Sent: Tuesday, October 29, 2002 10:39 AM

To: DKBrooks@state.nm.us; johnroe@duganproduction.com; REzeanyim@state.nm.us

Cc: wcarr@hollandhart.com; Craig.E.Moody@conoco.com; dave.l.wacker@usa.conoco.com; r-dale.smith@conoco.com; lmsande@ppco.com; WJDueease@MarathonOil.com; prddept@ypcnm.com

Subject: RE: Proposed Surface Commingling Rules

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First, I think everyone agrees that this is only an issue when commingling pools and/or leases with diverse ownership. So the proposed language will only address notice requirements when adding pools/leases with diverse ownership. That said, here is an engineer's rewrite of David's proposed paragraph (7):

"7) A surface commingling order may authorize, prospectively, the addition of pools and/or leases within defined parameters set forth in the order provided that (a) the notice to the interest owners included a statement that authorization for subsequent additions is being sought and of the parameters for such additions proposed by the applicant, and (b) the Division finds that subsequent additions within the defined parameter will not, in reasonable probability, reduce the value of the commingled production or otherwise adversely affect the interest owners. Applications to add pools and/or leases under this authority shall only require notice to the owners of production on the leases and/or pools to be added, unless the Division otherwise directs."

Rick Foppiano

Senior Advisor - Regulatory Affairs

OXY Permian - Houston, TX

Phone: 281-552-1303

Fax: 281-552-1383

E-Mail: Rick_Foppiano@oxy.com

-----Original Message-----

From: Brooks, David K [mailto:DKBrooks@state.nm.us]

Sent: Monday, October 28, 2002 6:23 PM

To: 'John Roe'; Brooks, David K; Foppiano, Rick; Ezeanyim, Richard

Cc: Bill Carr; Craig E. Moody; Dave Wacker; R. Dale Smith; Larry Sanders; Brooks, David K; Walter J. Dueease, Jr.; Darrell Atkins

Subject: RE: Proposed Surface Commingling Rules

Gentlemen:

At a meeting following the Commission hearing on October 25, Richard Ezeanyim, Rick Foppiano and I discussed the issue raised by Mr. Roe regarding adding additional wells to an existing commingled stream without notice to the owners of the existing commingled

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stream. While I remain persuaded that we cannot do this as a general proposition because the owners are entitled to notice and opportunity for a hearing where they could be adversely affected, I suggested a compromise position that might be viable. My idea is that the Division could determine, in processing a surface commingling application, that additional production within certain geographic or geologic parameters would not adversely affect the owners of the existing stream. Then the Division could enter an order pre-authorizing such additions without notice to the owners of the existing stream. I attach suggested language to be added to the procedural portion of the Surface Commingling rule to effect this proposal. The language, I concede is somewhat awkward, and I would be very receptive to suggested drafting improvements.

"7) A surface commingling order may authorize, prospectively, the inclusion therein of additional pools and/or leases within defined parameters set forth in the order provided that (a) the notice to the interest owners has included a statement that authorization for subsequent additions is being sought and of the parameters for such additions proposed by the applicant, and (b) the Division finds that subsequent additions within the defined parameter will not, in reasonable probability, reduce the value of the commingled production or otherwise adversely affect the interest owners. A subsequent application to amend an order so providing to add to the commingled production other leases/pools that are within the parameters for addition provided in the order sought to be amended shall require notice only to the owners of the production to be added, unless the Division otherwise directs."

Not to put pressure on anyone, but I believe we need a final draft by Friday if we are to go to hearing on November 22 as scheduled.

David Brooks

-----Original Message-----

From: John Roe [mailto:johnroe@duganproduction.com]

Sent: Monday, October 28, 2002 11:12 AM

To: Brooks, David K; Rick Foppiano; Ezeanyim, Richard

Cc: Bill Carr; Craig E. Moody; Dave Wacker; R. Dale Smith; Larry Sanders; Brooks, David K; Walter J. Dueease, Jr.; Darrell Atkins

Subject: Re: Proposed Surface Commingling Rules

David -

I agree with Nos. 1 & 2.

For No. 3, we need to somehow address the issue of notice for circumstances that require adding one or two wells to large existing systems. If we don't, there will be instances that operators cannot justify notifying all interest owners of existing systems to add one or two wells. Dugan Production has several systems that this is important to, and you might talk to Will Jones (at the OCD) for his input regarding units. It is my belief that if new wells are added to an existing system using the same criteria and conditions as used for the existing wells, and the additions do not change anything for the wells already approved to be on that system, then I don't understand why interest owners of production already authorized need to have notice of subsequent additions. Those owners accepted and/or approved the surface commingling of production from their wells and agreed that the procedures for allocating CDP volumes and revenue to individual wells was fair and equitable. Providing that subsequent wells agree to use the same procedures, then nothing changes for the existing wells. Regarding the quality of the commingled streams,

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whether oil or gas, as long as individual well oil gravities or gas BTU's included in the allocation factors for CDP volumes and revenues, there should be little risk of creating inequities.

I proposed we look at it as an interest owner is actually approving and/or accepting the surface commingling and/or off-lease measurement as a necessary method to get their production to a sales point and that there are procedures established to equitably allocate sales volumes and revenues to individual wells. It really doesn't make any difference (provided the system capacity isn't an issue, and most interest owners will have no idea about this) as to how many wells are involved as long as all wells use the same allocation and operational procedures. Thus, interest owners in each well approve/accept the surface commingling for their well only.

John D. Roe

— Original Message —

From: Brooks, David K

To: 'John Roe'; Rick Foppiano; Ezeanyim, Richard

Cc: Bill Carr; Craig E. Moody; Dave Wacker; R. Dale Smith; Larry Sanders; Brooks, David K; Walter J. Duesease, Jr.; Darrell Atkins

Sent: Friday, October 25, 2002 7:54 AM

Subject: RE: Proposed Surface Commingling Rules

Gentlemen:

This is a reply to John's email dated at 10:00 on Oct 23, to Rick's of 10:17, and to the attached email.

I recognize the nature of the problem John is raising. I have the following thoughts:

(1) Off-lease storage and measurement. If the application is for off-lease storage and measurement only, and there is to be no commingling; then only owners of production to be moved off lease should be required to be notified. The use of the term "affected leases" was something of a cop out on my part in that it avoided determination of whether the owners of the lease to which production was to be transported were "affected." I believe they are not, so long as THEIR production is measure before it is put in the common battery or stream. If not, it would seem that adding production from elsewhere to their tank or stream would required surface commingling approval, and not just off-lease storage approval. Accordingly, I would suggest that what is now proposed 303.B.(5) [formerly propose 315.A(5), and before that 315.B(5)] be revised to read:

"all parties owning working interests in any production proposed to be transported prior to measurement."

(2) The common ownership situation present no notice problems in that no notice is required.

(3) In the diverse ownership situation, where production is to be commingled prior to measurement, I am concerned that there is a need for the owners who share in the existing common facility to have an opportunity to protect themselves, even though the addition would be relatively small in comparison to the total commingled production (and under John's proposed language, there is actually no assurance, so far as I can see, that it would be). Perhaps with respect to gas, as long as the measurement method remains the same, there is not a hazard of

adversely affecting the owners in the existing commingled stream, but I am not sure. With regard to oil, it would seem that there is a possibility that adding lower quality oil could adversely affect these owners.

Accordingly, I am reluctant to accept the changes proposed by John with respect to notice for surface commingling in diverse ownership context. If we accept those changes I would like to add language such as that suggested by Ric regarding a requirement of showing that the facility was otherwise unchanged, as well as language assuring that the characteristics of the combined stream were not changed by the addition.

DB

[Brooks, David -----Original Message-----

From: John Roe [mailto:johnroe@duganproduction.com]

Sent: Wednesday, October 23, 2002 12:01 PM

To: Rick Foppiano

Cc: Richard Ezeanyim; Bill Carr; Craig E. Moody; Dave Wacker; R. Dale Smith; Larry Sanders; David Brooks; Walter J. Dueease, Jr.; Darrell Atkins

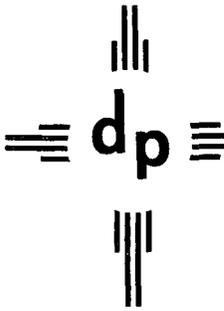
Subject: Re: Proposed Surface Commingling Rules

Rick,

My primary concern is the addition of wells on new leases and/or in new pools to existing systems with diverse ownership, but I also think we need to be clear about adding wells on leases and in pools covered by the existing approval. As I read the proposed rules; for off-lease measurement, Section 315.A.(5) states "all parties owning.....in any of the affected leases". Although I don't believe existing wells will be affected by adding other wells, some might argue.

Also, it is not clear to me that the addition of wells on leases and in pools previously authorized for surface commingling will automatically be covered by the initial authorization. If this is so, then my concern is only for adding production not covered in the initial approval.

John Roe



dugan production corp.

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April 13, 2007

Oil Conservation Division
1220 S. St. Francis Drive
Santa Fe, NM 87505

David Catanach
New Mexico Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, NM 87505

Re: Dugan Production Corp.'s
NMOCD Commingling Order PLC-147-A – Rusty Chacra Gas Gathering System
NMOCD Commingling Order PLC-191-A – Big Band Gas Gathering System

Dear Mr. Catanach,

I am writing to check on the status of two letters, both dated 12-12-06, requesting corrections and amendments to the captioned commingling orders.

Please let me know if you have questions or need additional information.

Sincerely,

John D. Roe
Engineering Manager

JDR/tmf