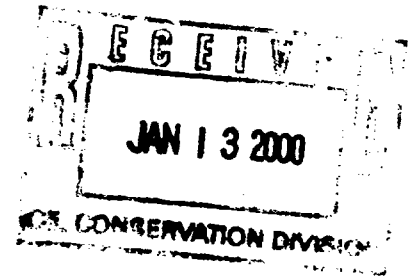




**BAHLBURG EXPLORATION INC.**

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January 10, 2000

Ms. Lori Wrotenbery  
Director, Oil Conservation Division  
New Mexico Energy, Minerals & Natural Resources Dept.  
2040 South Pacheco Street  
Santa Fe, New Mexico 87505

RE: Reliance Operating Co.  
Federal D No.3 Well  
E/2 Section 31, T9S, R36E  
Lea County, New Mexico

Dear Ms. Wrotenbery:

This letter is written in an effort to resolve a conflict that exists between BLM spacing guidelines and the existing proration unit for the above referenced well. The Federal D No.3 well has been classified as an Atoka gas well under Oil Conservation Division rules and the E/2 of Section 31, T9S, 36E is the designated 320 acre proration unit per NMOCD Form C-102 filed by the operator (copy enclosed). William C. Bahlburg and David L. Cherry are mineral interest owners of record in the NE/4 of Section 31, T9S, R36E, and as such, own interest in the Atoka gas production from the Federal D No.3 well and established E/2 Section 31 proration unit.

The Federal D No.3 well is operated by Reliance Operating Co. The well was plugged back from the Devonian formation and completed as a gas well in the Atoka formation during August 1998. The Federal D No.3 was put on production during December 1998 and has been producing regularly since that time. We have been unable to obtain any monthly production reports for this well in the OCD records, but have contacted the BLM and received production data filed by the operator through the month of October 1999. As interested parties, Mr. Cherry and I have contacted Reliance Operating Co. and requested payment for our share of the Atoka production from Federal D No.3 well, but have not received such payment. We have been informed by Reliance Operating Co.'s title attorney that title to our interest in the NE/4 of Section 31 is clear and unencumbered.

However, we have also been informed by both Reliance and the BLM that the formation of an E/2 320-ac proration unit for the Atoka gas production from the Federal D No.3 well does not comply BLM general guidelines relating to well spacing and available leasehold. This was explained by a letter dated October 20, 1999 from the BLM to Reliance Operating Co. (copy enclosed).

Presently, the 320 ac. E/2 Atoka proration unit established for the Federal D No.3 well includes two 160 ac. tracts from two (2) separate Federal Leases. One Federal lease covers the S/2 of Section 31, but the operating rights in that lease have been segregated between the SW/4 and SE/4 since the early 1960's. While Reliance is the "record owner" of the entire S/2 of Section 31, they only own operating rights from the surface to a depth of 100 ft. in the SW/4. As stated in the October 20<sup>th</sup> letter from the BLM, their spacing guidelines dictate that the 320 acre unit for the Federal D No.3 should incorporate all of the S/2 of Section 31 instead of the E/2 since there is adequate leasehold in that particular Federal Lease to form the required 320-ac. proration unit. We have spoken to Mr. Armando Lopez in the Roswell District Field Office regarding this situation. Mr. Lopez has indicated to us that the BLM would consider communitizing the two separate Federal Leases into an E/2 unit if there was sufficient geologic evidence to support same. As of this date, Reliance Operating Company has continued to produce the well, but has not contacted the BLM and taken appropriate action with regard to spacing conflict that now exists between BLM guidelines and the established E/2 proration unit. Reliance has collected production revenue, but has not paid either Mr. Cherry or me our share of production. According to representatives at both the Roswell BLM office and the Hobbs OCD District office, Reliance has not initiated any action to resolve the conflict as of this date.

Our company, Bahlburg Exploration, Inc., operated the subject Federal Leases prior to transferring the majority of our ownership to Rutter and Wilbanks Corporation and lease operations to their partner, Reliance Operating Co. in 1996. We believe the productive Atoka sand channel reservoir producing in the Federal D #3 well is oriented in a general N-S direction through the E/2 of Section 31. Consequently, we also believe Mr. Cherry and I are entitled to our share of the Atoka production from the well by virtue of our interest in the NE/4. We have enclosed copies of two geologic maps showing subsurface structure of the Atoka and the distribution of the productive Atoka sand reservoir system producing from the Federal D No.3 well. This geologic interpretation is based on a combination of 3-D seismic data, well logs and stratigraphic analysis. I have prepared this interpretation myself and I have been previously recognized and accepted as an expert witness in several Examiner Hearings with the NMOCD. In an effort to resolve the continued conflict between BLM spacing guidelines and the existing E/2 proration unit for the Federal D #3 well we ask that both the NMOCD and BLM consider and recognize this geologic interpretation as sufficient reason and cause to communitize the two Federal Leases in the existing E/2 Section 31 proration unit for the Federal D #3 well. We believe the presently established E/2 proration unit is reasonable, fair and serves to protect the correlative rights of all interested parties in this matter.

We submit our geologic interpretation in an effort to bring resolution to the spacing issues regarding the Atoka gas production from the Federal D #3 well in the absence of appropriate action by the operator, Reliance Operating Co. If necessary, we would be willing to present testimony at an Oil Conservation Division Hearing regarding this matter.

Please contact myself at the letterhead address and telephone number if you have any questions or need anything further. Thank you.

Sincerely,

A handwritten signature in black ink, appearing to read 'William C. Bahlburg', written in a cursive style.

William C. Bahlburg  
Certified Petroleum Geologist  
CPG No. 4868

Enclosures

cc: Armando Lopez, BLM  
Michael Stogner, NMOCD  
Chris Williams, NMOCD  
David L. Cherry  
Reliance Operating Co.