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August 26, 1996

HAND DELIVERED

William J. LeMay, Director
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
2040 South Pacheco Street
Santa Fe, New Mexico 87505

RECEIVED
AUG 28 1996
OIL CON. DIV.
DIST. 3

Re: NEW MEXICO OIL CONSERVATION DIVISION CASE 11509

In the Matter of the Hearing Called by the Oil Conservation Division on its Own Motion to Permit Chuza Operating, Operator, Underwriters Indemnity Company, Surety, and All Other Interested Parties to Appear and Show Cause Why the El Poso Ranch Well Nos. 1, 2, 3, 4, 7, 9 and 10 Located in Sections 11, 14, 23, and 26, Township 28 North, Range 1 East, NMPM, as Projected into the Unsurveyed Tierra Amarilla Land Grant, Rio Arriba County, New Mexico, Should Not be Plugged and Abandoned in Accordance with a Division Approved Plugging Program

Dear Mr. LeMay:

This letter confirms our recent conversations concerning the above referenced case and the need to proceed with the plugging of the subject wells pursuant to the provisions of Order No. R-11509.

As Chuza has advised the Division, the wells which are the subject of this pooling order were involved in litigation in Taylor County, Texas, District Court Cause No. 20,540-B. That suit was resolved with a Compromise Settlement Agreement and Mutual Release which was approved by the Court. Pursuant to that Agreement and Release, Fred Shelton, III is obligated to assume operation of these wells through an operator who is bonded in New Mexico thereby relieving Chuza of this plugging obligation. To date Fred Shelton, III has not complied with the Settlement Agreement and Release.

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It is our opinion that the actions of the parties and the Texas Court have no effect on this Oil Conservation Division plugging order. However, as you are aware, Kachina Production Company appeared at the May 2, 1996 hearing in this matter and through its attorney represented it had plans to assume operations of these wells and return them to production. We understand the President of Kachina Production Company to be Fred Shelton, III.

On July 30, 1996, Chuza filed an application for hearing de novo in this case. The purpose of that application was to assure that Kachina, if it has plans for these wells, have the opportunity to present its proposal to the Commission and seek amendment of this plugging order. We have advised Kachina of the de novo appeal and, to date, have not received a response from Kachina.

Accordingly, by copy of this letter, we are advising Roger Prucino, attorney for Kachina Production Company and Fred Shelton, III, that Chuza will not appear at the September 18, 1996 Commission hearing in this case and that we are posting one well cash plugging bonds for each of the subject wells. It is our understanding that the Division will immediately proceed to use the cash bonds to plug these wells.

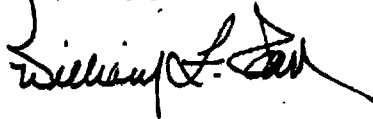
This course of action affords Kachina Production Company every opportunity to perform its obligations under the Settlement Agreement in the Texas litigation or otherwise proceed with its plans for this property. It also enables Chuza to meet our obligations to the State of New Mexico if Kachina fails to act. This also will enable the Division to plug these wells without proceeding against Chuza's plugging bond which secures its plugging obligation on the other properties it operates in New Mexico.

We are proceeding with arrangements to post the cash bonds and, based on our prior conversations, assume these arrangements are satisfactory to the Division.

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If you have questions or concerns about our proceeding in accordance with the procedure set out above, please advise.

Very truly yours,



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