DOCUMENTING THE EXPLORATION VENTURE – PART III

"Putting It All Together"

By

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TABLE OF CONTENTS

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I.
Introduction

Structuring the Exploration Venture. The term "exploration venture" means different things to different people. When I use this term, I intend for it to include any association or common enterprise between two or more persons that is formed for the joint exploration and development of lands that are believed to be prospective for oil and gas. An exploration venture may take the form of a separate legal entity (the "Project Entity") that is created for the sole purpose of conducting the joint exploration and development activities. Under this structure, the newly formed Project Entity (*e.g.* General Partnership, Limited Partnership or Limited Liability Company) owns the venture's assets and the participants in the venture own an equity interest in the Project Entity. Since this ownership structure can impose higher standards of conduct on the participants and significantly limit a participant's ability to assign, pledge or otherwise dispose of its interest in the venture, its use is usually limited to those situations where special tax considerations (*e.g.* special allocations of deductions or credits; avoiding the tax consequences of Rev. Rule 77-176) or participant considerations (multiple individual investors) dictate that a separate legal entity be created.

An exploration venture may also take the form of a common enterprise that is bound together by contractual commitments (collectively, the "E&P Agreement"), but is not a separate legal entity. Under the E&P Agreement structure, the ownership of, or the right to acquire an ownership interest in, the venture's assets is vested directly in each participant and the respective rights and obligations of the participants with respect to the joint exploration and development of the venture's assets is set forth in the E&P Agreement. The most common forms of E&P Agreement are the Exploration Agreement, the Participation Agreement and the Farmout Agreement. When I use the term "**Exploration Agreement**", I am referring to a joint exploration and development contract that covers a large amount of acreage that requires a significant amount of exploration activity (*e.g.* 3-D or 2-D seismic survey, magnetic survey and/or geochemical survey) before the participants can identify prospects and drill wells on the acreage. The term "**Participation Agreement**" refers to a joint exploration and development contract that covers one or more defined prospects that are "drill bit ready" (*i.e.* no significant exploration activity is required before the initial test well is drilled). The term "**Farmout Agreement**" refers to a contract by which one party (the farmor) agrees to assign all or a portion of its oil and gas rights in certain acreage to another party (the farmee) in exchange for the performance of certain obligations (usually including the drilling of one or more wells) by the farmee.

Goals of the Documentation Process. Regardless of which structure is used for the exploration venture, the goals of the documentation process are the same:

1. To accurately reflect the business deal;

2. To clearly identify and effectively manage risks; and

3. To create an understandable and legally enforceable document.

This paper will focus on the key issues that should be considered in documenting two different E&P Agreements, the Exploration Agreement and the Farmout Agreement.

II.
Getting the Business Deal Right

The first goal of the documentation process is to ensure that the E&P Agreement accurately reflects the "business deal" between the parties. One of the most effective ways to achieve this goal is to set out all of the material trade terms in a term sheet or letter of intent and have all of the parties agree to such terms before drafting the definitive E&P Agreement. In addition to facilitating the review and approval of the trade by management, the term sheet/letter of intent can be used as a "business terms" checklist for the draftsman of the E&P Agreement.

Another advantage of using a term sheet/letter of intent is that it can eliminate the problem of the "unintended contract". The only thing worse than having a business deal fall through because the parties cannot agree on the contract terms, is having a dispute with the other party over whether a contract exists or not. The legal analysis of contract formation is relatively straight forward (Has there been an offer? If so, has the offer been accepted?). However, the line between "preliminary negotiations" and "offer and acceptance" can often be blurred by the actions of the parties during negotiations (*e.g.* when one party detrimentally relies on the promises or actions of the other party). The issue is further complicated in those jurisdictions that readily impose an obligation on each party to "negotiate the contract in good faith". By preparing a term sheet or letter of intent early in the negotiation process, the parties can expressly negate any inference that a binding contract is intended to be formed prior to the execution of a definitive E&P Agreement. The following are examples of language that could be used in a term sheet or a letter of intent to avoid the "unintended contract".

Example 1:

> **This term sheet sets forth the basic terms and conditions under which Jethro Exploration Company ("Jethro") is willing to grant Drysdale Exploration Company ("Drysdale") the right to earn one or more assignments of Jethro's interest in the Program Area, insofar and only insofar as such interest covers those formations located below the base of the Spiro Formation. This term sheet is being submitted for discussion purposes only and, even if accepted by Drysdale, shall not create any obligation on the part of either Jethro or Drysdale to consummate the transaction described herein. Neither Jethro nor Drysdale shall have any obligation with respect to the subject matter of this term sheet unless and until the parties execute a definitive Farmout Agreement incorporating the terms hereof.**

Example 2:

> **Upon execution of this letter of intent, the parties agree to undertake, diligently and in good faith, to devote such time and resources as are reasonably necessary to prepare, negotiate and execute a definitive Exploration Agreement incorporating the terms hereof (the "Definitive Agreement"). If the Definitive Agreement has not been executed by the parties on or before _____, 2007, then this letter of intent shall terminate and neither party shall have any further rights or claims against, or obligations to, the other party. For the period commencing with the execution of this letter of intent and ending on _____, 2007, the parties agree that they shall not, directly or indirectly, encourage, solicit or entertain any other offers, inquiries or proposals for, or engage in any discussions with respect to, the joint exploration and development of the Program Area.**
>
> **Except for the covenants contained in the immediately preceding paragraph, this letter of intent, even if accepted by Drysdale, shall not constitute a binding obligation on the part of either Drysdale or Jethro and no such obligation shall arise until the execution of the Definitive Agreement.**

III.
The Document Preparation Checklist

Once you are confident that the parties fully understand and agree to the terms of the "business deal", the next step is to prepare a draft of the E&P Agreement. For most people, this means getting out a copy of a previously negotiated agreement (a "go by" agreement) and marking it up to fit the new transaction. While a "go by" agreement can be very useful, it can also create some real problems if the draftsman is not mindful of the inherent limitations of using such an agreement.

For example, it is important to recognize that the "go by" agreement is usually negotiated under materially different circumstances than those surrounding the new transaction. The failure to account for these differences can result in an E&P Agreement that does not allocate risks appropriately between the parties. All to often, a provision finds its way into an E&P Agreement because the draftsman incorrectly assumes that it is a "standard way" of handling an issue. Another limitation of the "go by" agreement is that it does not come with instructions on how to modify it to fit the new transaction. While many of the necessary changes are fairly obvious, some are more subtle and can be difficult to identify when the draftsman relies too heavily on the "go by" agreement.

To help avoid the limitations of the "go by" agreement, it is recommended that a document preparation checklist be used while drafting the E&P Agreement. Using such a checklist in conjunction with the "go by" agreement is the best way to achieve the remaining two goals of the documentation process (i.e. clearly identify and manage risks; create an

understandable and legally enforceable document) and ensure that all of the material issues that should be addressed in an E&P Agreement are addressed.

The following checklists identify the most important issues that should be considered when negotiating an Exploration Agreement and a Farmout Agreement.

A. Exploration Agreement Checklist.

1. The Parties – Capacity to Execute.

(a) All parties to the Exploration Agreement should be adequately identified and the authority of the individual executing the agreement on behalf of each such party should be verified.

(b) If a party is a corporation or limited liability company, determine the state of incorporation/organization and what authorized officer/representative will sign the Exploration Agreement on behalf of such party (e.g. President, Vice President, Member, Attorney-in-Fact). Any person that is executing as "Attorney-in-Fact" should provide a copy of the Power of Attorney under which such person is given authority to execute the document.

(c) If a party is a general partnership, all partners must execute the Exploration Agreement unless documentary proof of authority to execute on behalf of the partnership is obtained to the contrary. If a party is a limited partnership, an authorized officer of the general partner must execute the Agreement.

(d) If a party is a fiduciary (executors, administrators, guardians, trustee), determine such party's power to contract and the capacity in which such party will execute the Exploration Agreement. With respect to individuals, some states require the joinder of the wife for a contract to be binding.

2. The Parties – Ability to Perform. One should also assess each party's ability to perform its obligations under the Exploration Agreement. While requiring the advance payment of all joint operation costs can alleviate many concerns, it cannot solve all of the problems associated with a party's inability or refusal to comply with the terms of the Exploration Agreement. This is especially true in the context of a bankruptcy. If a party does not have a substantial balance sheet, consideration should be given to requiring such party to provide additional credit support for its obligations (e.g. parent guaranty or letter of credit).

3. Description of Lands Covered.

(a) An Exploration Agreement usually covers a large area of land that the company believes is prospective for oil and gas production (the "Program Area"). Since the Program Area is so large, it is often not feasible (or even desirable) to acquire oil and gas leases (the "Leases") over the entire Program Area before the Exploration

Agreement is executed. Therefore, in order to provide a valid legal description of the Program Area, it is necessary for the boundary of the Program Area to follow government survey lines (*i.e.* Section, Township and Range) or some other natural or man-made boundary (*i.e.* survey lines or subdivision plats) so that the Program Area can be "identified and located on the ground".

(b) As the exploration work progresses under the Exploration Agreement, the parties will identify prospects and allocate portions of the Program Area to such prospects ("Prospect Areas"). Each Prospect Area must be identified in the manner described in (a) above.

4. Interest of the Parties.

(a) Each party's participation interest in the Program Area should be clearly set forth in the Exploration Agreement. In many situations, it will be desirable to describe each party's percentage interest in a schedule or table that is attached as an Exhibit to the Exploration Agreement. This is especially true if there are any carried interests or other cost sharing arrangements that require certain parties to pay more than their "ownership percentage" share of the cost of conducting operations on the Program Area (the "Program Area Costs").

(b) If there is a disproportionate sharing of Program Area Costs (*e.g.* carried interest), what Program Area Costs are included in the "carry"? If there are cost overruns, is the carried interest subject to a cap?

(c) Not all of the participants in the Program Area will participate in all Prospect Areas. Therefore, the Exploration Agreement must clearly distinguish between the participation interests in the Program Area and the participation interests in each Prospect Area.

(d) Some Exploration Agreements provide for the "prospect generating company" to receive a carried working interest in one or more of the test wells drilled on the Prospect Areas. Does this carried interest include all costs incurred through "casing point" or through completion of the well? If the carry applies through completion of the well, what does completion mean? Does it include all costs of completing and equipping the well "through the tanks" (including the cost of all flow lines up to and including the wellhead check meter)? Will the carried interest apply to any substitute well that is drilled in replacement of the original "carried well"? If so, is the carried interest in the substitute well subject to a cap?

(e) When a "carried party" shares any portion of the working interest before payout, the "paying party" must capitalize that portion of the IDC's that are attributable to the carried party's pre-payout working interest. To avoid this problem, (i) the interest of the carried party will need to be restructured as a "back-in interest" or (ii) the Exploration Agreement will need to include a tax partnership.

5. Exploration Data. Most Exploration Agreements contemplate that the parties will acquire seismic data (either through purchase of existing data or through conducting a new seismic survey) and utilize such seismic data in the identification of prospects within the Program Area. The following are some issues to consider in connection with the acquisition, ownership and utilization of such seismic data.

(a) If the seismic data is to be acquired by conducting a new geophysical survey over the Program Area (the "Geophysical Survey"), what are the technical parameters of the Geophysical Survey? Have all parties had an opportunity to review, comment on and approve these parameters? If possible, the scope, design and other parameters of the Geophysical Survey should be set forth in an Exhibit to the Exploration Agreement.

(b) What are the terms of the Seismic Contract with the company that will shoot the Geophysical Survey? Will all parties to the Exploration Agreement execute the Seismic Contract or will they severally agree in the Exploration Agreement to be bound by its terms? Has provision been made for each party to receive a license to the data resulting from the Geophysical Survey (the "Program Data")? For a party to be able to take possession of the Program Data, "work" the Program Data on its own workstation and/or have it reprocessed, it will be necessary for such party to receive a separate license to use the Program Data.

(c) If the seismic data is to be purchased, the data license will usually provide that each party to the Exploration Agreement must obtain its own license in order to receive a copy of the data. The data license should be reviewed to determine what restrictions are imposed on each licensee's right to use the seismic data and to disclose or transfer it to third parties.

(d) Will the parties conduct any exploration activities in addition to those contemplated by the Geophysical Survey (*e.g.* additional seismic acquisition or processing work, magnetic surveys, geochemical surveys, etc.)? If so, are all parties required to join in such additional exploration activities? How will the additional data be owned?

(e) The parties to the Exploration Agreement should be entitled to disclose the Program Data to certain third parties (*e.g.* consultants, potential purchasers, etc.). What limitations will be imposed on a party's right to disclose the Program Data to third parties? Will such third parties be required to execute a Confidentiality and Non-Competition Agreement?

(f) Will a party have the right to sell an interest in the Program Data? If there is a general prohibition on the transfer of Program Data, what exceptions (if any) should there be to such prohibition? What about transfers to affiliates, transfers by merger, reorganization or consolidation, transfers to third parties acquiring an interest in the Program Area, or transfers in connection with a financing transaction.

6. Program Area Operator.

(a) Will management of Program Area operations be handled in the same manner as the Prospect Area operations under the Operating Agreement? If so, who will be responsible for conducting/managing the exploration activities on the Program Area (the "Program Operator")? How is the Program Operator to be selected? If the Program Area operations are to be managed by an "operating committee", what mechanism will be used to make operational decisions?

(b) If one party is designated Program Operator, the Exploration Agreement should contain provisions concerning (i) the Program Operator's status as an independent contractor, (ii) the Program Operator's standard of conduct, (iii) the resignation and removal of the Program Operator and (iv) the selection of a successor Program Operator.

(c) Will the Program Operator be entitled to receive advance payment of all Program Area Costs, including the cost of conducting the Geophysical Survey (the "Geophysical Costs")? If so, will the Program Operator be required to maintain all such advance payments in a segregated account? The term "Geophysical Costs" should be defined to include all costs associated with seismic permitting, surface damages, data acquisition, initial processing and reproduction, but should specifically exclude interpretation costs. The term "initial processing" usually includes such processing as is required to deliver the final stack and migrated processed sections to the parties.

(d) What type of "spending controls" will be imposed on the Program Operator? Will the parties establish an "exploration budget" and require the Program Operator to stay within the budget? Will Program Area Costs be handled in the same manner as expenditures under the Operating Agreement, with the Program Operator submitting AFE's to the parties?

(e) What are the consequences of a party's failure to fund its share of the Geophysical Costs? Will such party be required to pay interest on the unpaid balance? Will the other parties have the right to withhold the Program Data from the defaulting party? Will the defaulting party be deemed to have gone nonconsent on all proposed operations until the unpaid amounts are paid in full? Will the defaulting party be required to forfeit its interest in the Program Area?

(f) If there is a bona fide dispute concerning the payment of Program Area Costs, how should such disputes be handled?

7. Program Area Operations.

(a) To prevent competition among the parties, the Exploration Agreement should contain an area of mutual interest ("AMI") provision that requires each party to offer the other parties the right to acquire their proportionate share of any oil and gas interest that is acquired within the AMI (the "Acquired Interest")? To avoid any claims that the AMI provision violates the Rule Against Perpetuities, it should have a fixed term.

(b) Under an Exploration Agreement, the lands that comprise the AMI are often the same as the lands that comprise the Program Area. The description of the AMI will need to satisfy the requirements of the Statute of Frauds (See paragraph 3(a) above).

(c) What is included within the definition of "Acquired Interest"? In addition to Leases and options to acquire Leases ("Lease Options"), does Acquired Interest include seismic permits, royalty interests, mineral interests, farmouts and other oil and gas interests? What about interests in producing wells, disposal wells, gathering systems, production processing facilities, easements and surface use agreements? If an acquisition includes lands both inside and outside the AMI, will the acquiring party be required to offer both the "inside acreage" and the "outside acreage"? If only the inside acreage is required to be offered, how are the acquisition costs to be allocated between the inside acreage and the outside acreage? How will any "non-cash consideration" (*e.g.* drilling obligations, etc.) be shared?

(d) If a party does not participate in an Acquired Interest, how will the interest of the non-acquiring party be handled? What effect will the failure to participate in an Acquired Interest have on the non-acquiring party?

(e) To the extent any of the lands included within the Program Area are or may be covered by Lease Options, there should be a procedure in place to allow each party to elect whether or not it wants to participate in the exercise of such Lease Options. These procedures can be substantially the same as those set out for the Acquired Interests, with the Program Operator making the "exercise recommendations" to the other parties. If a Lease Option allows for the exercise of less than all of the acreage covered thereby, each party should have the right to participate in the exercise of such Lease Option for more or less acreage than is proposed by the Program Operator.

(f) Until such time as the Program Area Leases are included within a designated Prospect Area (and thereby covered by a separate Operating Agreement), the Program Operator is often responsible for coordinating delay rental payments by submitting rental payment recommendations to the other parties. As with the exercise of Lease Options, the parties should be given the right to participate or not participate in the recommended delay rental payments. Each party should also be given the right to make an "alternative" recommendation if the Program Operator proposes to make less than all of the required delay rental payments.

8. Designation of Prospect Areas. Once the Program Data is acquired, processed and distributed to the parties for interpretation, the process of identifying and designating Prospect Areas begins. The following are some of the issues to be considered when drafting this portion of the Exploration Agreement.

(a) How is "Prospect Area" to be defined? Is it a geological or geographical concept? If it is to be defined by subsurface structures or the estimated productive limits of the target formation, will the size of the prospect be limited to a certain number of contiguous surface acres? Will the Prospect Area be limited to the base of the deepest objective formation or will it include all depths? Can the originally designated Prospect Area be expanded or contracted after additional information is obtained from drilling operations?

(b) Who will be responsible for identifying prospects, designating Prospect Areas and proposing the initial wells that will test each prospect (the "Test Wells")? Will the Program Operator identify and propose prospects on behalf of all the parties or will each party have the right to identify and propose prospects? If all parties have the right to propose prospects and Test Wells, how will these "proposal activities" be coordinated? Will the parties meet periodically to discuss their prospect ideas? If so, how often?

(c) What information must be included in the proposal to form a Prospect Area and drill a Test Well (a "Well Proposal")?

9. Participation in Test Wells/Prospect Areas.

(a) Once a Well Proposal has been submitted, what election options are available to the non-proposing parties? The non-proposing parties are usually provided at least three (3) options: (i) to participate in the Well Proposal; (ii) to propose an alternative Well Proposal (either within the originally proposed Prospect Area or within a different Prospect Area; and (iii) to not participate in the Well Proposal. In some cases, a fourth option (to participate in the Well Proposal down to a specified depth) is added so as to allow a party to preserve its rights in the shallow formations when it does not want to participate in a deep test.

(b) How long do the non-proposing parties have to respond to a Well Proposal? If a party responds to a Well Proposal by submitting an alternative Well Proposal, how will the competing Well Proposals be resolved? Will the party that made the unsuccessful Well Proposal be given a second opportunity to participate in the successful Well Proposal? If so, how much time will such party be given to make its election?

(c) A party's election to not participate in a Well Proposal usually results in such party relinquishing and assigning all of its rights in the Prospect Area to the participating parties. If the Test Well is not actually drilled to its deepest objective

formation, will the nonparticipating party retain its rights in the Prospect Area? What if the Test Well is completed in a shallower formation?

(d) A party's election to participate in a Well Proposal down to a specified depth (the "Depth Limit") usually results in such party (the "Shallow Participant") relinquishing and assigning all of its rights in the Prospect Area below the Depth Limit. In the event of such an election, will the shallow formations and deep formations be governed by a single Operating Agreement? How will Lease acquisition costs, Lease Option exercise costs, delay rental payments and other lease maintenance payments be allocated between the owners of the shallow rights and the owners of the deep rights? How will the use of and/or access to Program Data and other Prospect Area information be impacted by the horizontal severance?

(e) In order to preserve its rights in the shallow formations, the Shallow Participant is usually required to pay its proportionate share of the cost of drilling the Test Well to the Depth Limit (the "Shallow Formation Costs"). How are the Shallow Formation Costs to be calculated? If a shallow completion is warranted, but is precluded by a completion in the deeper formations, will the Shallow Participant be entitled to a refund of its share of the Shallow Formation Costs until the deep formations cease producing in commercial quantities? After the Test Well is drilled, how will the parties handle subsequent well proposals to an objective formation located above the Depth Limit?

(f) If the Test Well is not drilled within a certain period of time (*e.g.* 90 or 180 days), what happens to the Well Proposal? Does the Prospect Area designation expire and become part of the Program Area again?

(g) Are there any limitations on the number of Test Wells that can be proposed or that can be drilled at any one time? If so, are there exceptions to these limitations if a well must be drilled to comply with the terms of a Farmout Agreement or to keep a Lease from expiring?

10. Prospect Area Operations. Once a Well Proposal is approved by the requisite ownership percentage of the parties entitled to participate therein, all operations thereafter conducted on the Prospect Area are governed by the Operating Agreement, with the Prospect Area being the "Contract Area" and the Test Well being the "Initial Well" thereunder. The following issues should be addressed when considering Prospect Area operations.

(a) How is the operator of each Prospect Area (the "Prospect Area Operator") to be selected? Should it be the Program Operator? Should it be the party with the largest interest in the Prospect Area? Should it be the party with the most "expertise" in the area?

(b) Once the parties designate Prospect Areas under the Exploration Agreement, each Prospect Area should have its own AMI, as set forth in the Operating

Agreement covering such Prospect Area. The Exploration Agreement will need a mechanism for removing the Prospect Area AMI's from the coverage of the Program Area AMI.

(c) If a party elects not to participate in one or more Prospect Areas, such nonparticipating party should agree not to acquire, or attempt to acquire, any oil and gas interest within such Prospect Area(s).

(d) The exercise of Lease Options and the acquisition and maintenance of Leases within the Prospect Area are usually managed by the Prospect Area Operator. What are the consequences of a party's failure to participate in the exercise of a Lease Option or in the acquisition of a Lease? What are the consequences of a party's failure to participate in a delay rental payment or other lease maintenance payment? Should the answer be different if the election is made before the Test Well reaches the objective depth? If the nonparticipating party is required to relinquish its interest in the Prospect Area, will such nonparticipating party be entitled to any compensation for its relinquished interest? On what basis will the participating parties share the nonparticipating party's relinquished interest?

11. Audits and Dispute Resolution.

(a) Each party should have reasonable access to those records pertaining to (i) operations conducted on the Program Area and (ii) operations conducted on any Prospect Area in which such party participated. How long will the Program Operator/Prospect Area Operator be required to maintain such records? What federal or state laws, rules or regulations should be considered before determining the record retention period? How are audit discrepancies to be handled? Are the procedures set forth in the COPAS Accounting Procedure adequate?

(b) How are disputes under the Exploration Agreement to be handled? Should the parties be required to submit all disputes to non-binding mediation before resorting to litigation? What about arbitration? If the parties agree to submit disputes to arbitration, how is the arbitrator to be selected? Is one arbitrator sufficient? How can the parties ensure that the arbitrator is qualified to hear the dispute? Should the parties agree to certain "expedited" arbitration procedures to reduce costs? How will the costs of mediation/arbitration be shared?

12. Miscellaneous.

(a) How long should the Exploration Agreement remain in full force and effect? How long will it take to conduct the contemplated exploration activities, identify prospects, designate the Prospect Areas and drill the Test Wells? Are there any provisions that should survive termination? Should the Exploration Agreement automatically terminate if certain events occur or certain milestones are not achieved?

(b) Should the Exploration Agreement contain a preferential right to purchase or a right of first offer with respect to each party's interest in the Program Area? What about a restriction on the assignability of a party's interest in the Program Area? If any such provisions are contained in the Exploration Agreement, should they apply only to those lands that are not included within a designated Prospect Area?

(c) What insurance will be maintained by the Program Operator/Prospect Area Operator? Will each party be required to provide its own insurance? What about indemnities? Does the jurisdiction in which the Program Area is situated have an anti-indemnity statute? Considerable attention should be given to coordinating the insurance and indemnity provisions of the Exploration Agreement with the indemnity provisions of the various contracts that are utilized in conducting operations on the Program Area/Project Acreage.

(d) What type of confidentiality and non-compete obligations are to be imposed on the parties? How long will such obligations last? What exceptions (if any) will there be to these obligations?

B. Farmout Agreement Checklist.

1. The Parties – Capacity to Execute.

(a) Each party to the Farmout Agreement should be adequately identified and the authority of the individual executing the agreement on behalf of each such party should be verified.

(b) If a party is a corporation or limited liability company, determine the state of incorporation/organization and what authorized officer/representative will sign the Farmout Agreement on behalf of such party (e.g. President, Vice President, Member, Attorney-in-Fact). Any person that is executing as "Attorney-in-Fact" should provide a copy of the Power of Attorney under which such person is given authority to execute the document.

(c) If a party is a general partnership, all partners must execute the Farmout Agreement unless documentary proof of authority to execute on behalf of the partnership is obtained to the contrary. If a party is a limited partnership, an authorized officer of the general partner must execute the Farmout Agreement.

(d) If a party is a fiduciary (executors, administrators, guardians, trustee), determine such party's power to contract and the capacity in which such party will execute the Farmout Agreement. With respect to individuals, some states require the joinder of the wife for a contract to be binding.

2. The Parties – Ability to Perform. One should also assess each party's ability to perform its obligations under the Farmout Agreement. If a party does not have a

substantial balance sheet, consideration should be given to requiring such party to provide additional credit support for its obligations (e.g. parent guaranty or letter of credit).

3. Description of Lands Covered. The Farmout Agreement must contain a valid legal description of the lands covered thereby. The most common way to do this is to include an Exhibit that describes all of the oil and gas leases that are covered by the Farmout Agreement (the "Farmout Acreage"). Of course, this Exhibit must include either (i) a legal description of the lands covered by each of the leases or (ii) the recording information for each of the leases. If there is to be an area of mutual interest ("AMI") and the AMI covers an area larger than the Farmout Acreage, a legal description of the AMI must also be provided. If Federal lands are to be included in the AMI, one will need to consider what acreage chargeability problems (if any) may be created.

4. Description of Formations Covered.

(a) Are all formations to be covered by the Farmout Agreement? If specific formations are to be excluded, determine the name of each formation, the depth to the top of each formation and the depth to the base of each formation so that they are easily identifiable. If deep formations are to be excluded, establish and define the maximum depth to which the farmee can earn. If shallow formations are to be excluded, establish and define the maximum depth for the formations to be retained by the farmor.

(b) If deeper formations are to be retained, but the depth which the farmee may earn is open, a method for establishing the greatest depth that may be earned must be agreed upon (*i.e.* 100 feet below the deepest depth drilled; 100 feet below the deepest depth drilled in any well that establishes production; to the base of the deepest producing formation, etc.).

(c) The use of "stratigraphic equivalent" to describe the "earned depth" should provide an adequate description as long as the formation to which the earned depth is equivalent can be identified on the log of a well in the vicinity of the Farmout Acreage. If an additional depth of 100 feet below the "stratigraphic equivalent" is to be earned (for operational purposes only), reference should be made to "100 feet below the stratigraphic equivalent of _____", not "the stratigraphic equivalent of 100 feet below _____".

(d) If there is a reasonable possibility that severe folding or thrusting of the formations may be encountered, the following type of language might be utilized to describe the "earned depth":

> **"all of Farmor's right, title and interest in and to those oil, gas and mineral leases described on Exhibit A attached hereto (the "Subject Leases") INSOFAR AND ONLY INSOFAR as the Subject Leases cover (i) all depths from the surface of the earth to 100 feet below the stratigraphic equivalent of the base of the _____ Formation (the "Subject Interval") and (ii) all formations that are**

identified on the Dual Induction-SFL Log for the "Reference Well" (hereinafter defined) as being present within the Subject Interval, but that are located <u>below</u> the Subject Interval as a result of folding, faulting, thrusting or other movement of the earth's strata. For purposes of this Agreement, (i) the term "Reference Well" shall mean the Wildcat #1 Well, situated 400 feet from the north line and 2,000 feet from the west line of Section 2, Township 5 North, Range 26 West, _____ County, Texas and (ii) the base of the _____ Formation is defined as the correlative stratigraphic equivalent to that point found at the depth of ____ feet measured depth on the Dual Induction-SFL Log for the Reference Well."

5. <u>Existing Contracts and Co-Owner Issues</u>.

(a) Are the lands subject to existing Exploration Agreements, Participation Agreements, Operating Agreements or other agreements with co-owners or other third parties that must consent to the farmout?

(b) Did mineral owners retain rights to take in kind, consent to assign, etc., that must be considered?

(c) Do co-owners have preferential purchase rights to be considered before the company can enter into a Farmout Agreement with others?

6. <u>Overriding Royalty</u>.

(a) What overriding royalty, if any, is to be reserved by the farmor (the "Retained Override")? It should be made clear that any Retained Override is in addition to existing overrides, production payments or other encumbrances and it should be stated in gross (*i.e.* a percentage of 8/8ths) so that the "proportionate reduction" clause will apply. In this regard, it is important that the proportionate reduction clause relate both to the lessor's interest in the minerals as well as the farmor's interest in the leases. If the Retained Override is to attach to any extension or renewal of the leases, language should be added to express such intent.

(b) If the Retained Override is reserved in the assignment to the farmee, for tax purposes, the assignment is deemed to be a sublease. The consequence of this characterization is that any basis that the farmor has in the Farmout Acreage "attaches" to the Retained Override and is not deducted from any cash payment the farmor may receive (if any) for purposes of determining the taxable value of such cash payment.

(c) If the farmee is assuming all existing overrides and/or other burdens, such burdens should be specifically identified and the farmee's net revenue interest in the Farmout Acreage should be clearly set out in the Farmout Agreement.

7. Well Takeover.

(a) Will the farmor reserve the right to require the farmee to tender any drilling well back to the farmor prior to abandonment? This is sometimes of interest where the farmor is reserving the deep rights. If the farmor reserves this right, the Farmout Agreement should specify (i) the time limit within which the farmor must accept the well, (ii) who pays for rig stand-by time, etc., (iii) the size of the well bore and the casing program employed by the farmee and (iv) whether the farmor is required to reimburse the farmee for the net salvage value of the well.

(b) If the Farmout Agreement is a "multiple well trade", the parties will need to agree upon the amount of acreage that will be withdrawn from the Farmout Acreage if the farmor takes over the farmee's well and establishes production.

8. Lease Maintenance Payments. Consideration must be given to how to treat the various types of "lease maintenance payments". Often times the leases subject to the Farmout Agreement are held by production when the deal is made and are later renewed and require rentals in order for them to be perpetuated.

(a) *Delay Rentals*.

(1) Who will be responsible for paying delay rentals? How will delay rentals be borne? In those Farmout Agreements where the farmor retains a working interest in any formation, the farmor often pays the delay rentals and bills the farmee/assignee on a surface acre (prorated) basis for reimbursement.

(2) After an earning well is drilled and an assignment of all of the farmor's working interest in all depths is delivered to the farmee, the burden of paying delay rentals should shift to the farmee as to the portion of the lease(s) assigned, provided the lease terms allow for the division of the delay rental obligation.

(b) *Shut-In Payments*. Shut-in payments, unlike delay rentals, are normally paid by the farmee/assignee. In many instances, such payments must be made prior to or within a specified period of time after the farmee's well is shut-in and are generally payable to royalty owners, which many times are different than the delay rental recipients. Therefore, the title examination work and the job of setting up the payment decks for making such payments should be handled by the party drilling the well.

(c) *Minimum Royalty Payments*. For those leases that provide for minimum royalty payments, the following issues should be considered:

(1) Who will be responsible for administering the payments and accounting to the royalty owners?

(2) Will any minimum royalty "shortfall payment" be borne pro rata by all working interest owners or will it be borne by those owners whose royalty payments were not sufficient to meet the minimum royalty requirements?

(3) If the lease is severed horizontally and production is from only one owner's portion, do all owners share in any minimum royalty shortfall payments that may be required? If all of the owners share in such payments, on what basis do they share?

(4) The farmee/assignee should be required to timely advise (with written documentation) the amount of royalty the farmee/assignee has paid for its interest, regardless of whether or not the farmee/assignee will be required to share in any minimum royalty shortfall payments.

9. Loss/Failure of Title.

(a) Is failure of title a joint or individual loss? If the loss is because of nonpayment or an erroneous payment of rental or royalty, who will be responsible for renewing the affected lease(s)? How are the renewal costs to be borne? Are all parties entitled to participate in renewals after loss or failure of title? For how long? One year, six months?

(b) Will any Retained Override attach to a lease that is renewed as a result of a title failure?

10. Well Obligations.

(a) The Farmout Agreement should specifically address whether or not a dry hole will earn any rights.

(b) Is the drilling obligation "firm" or an option? The farmor will want the drilling requirement to be a firm obligation, especially when a loss of one or more leases or loss of a business opportunity is likely to occur if the well is not drilled by the farmee.

(c) What type of commencement is required to comply with the Farmout Agreement, operations or actual drilling? Compliance is much easier to verify if actual drilling is required.

(d) Is there a requirement to either commence or complete the well by a specified date? If so, is such requirement subject to force majeure?

(e) Is the objective depth firm?

(f) If the obligation is firm, and the farmee does not perform, what is the proper measure of damages? Since it may be very difficult to prove the actual

amount of damages that are incurred by the farmor, the parties should agree to a liquidated damage amount.

(g) If drilling the "earning well" is intended to be an option, the Farmout Agreement should expressly state such intent and provide that the penalty for the farmee's failure to perform shall be limited to the loss of the right to earn assignments under the Farmout Agreement.

11. Location and Depth of Initial Well.

(a) The location of the initial test well should be specifically identified. The parties should verify that the proposed location is a "legal location" under applicable field rules.

(b) The formation(s) to be tested or penetrated should also be specifically identified. If the formation is identified by reference to an interval in a nearby well, the Farmout Agreement should include the complete name and location of the reference well, and identify the interval by depth on a log of the reference well.

(c) If the Farmout Agreement requires only that the formation be penetrated, the Farmout Agreement should specify the amount of penetration required (*i.e.* 50 feet - 100 feet, etc.).

(d) To avoid any costly "geological surprises", the farmee will prefer that the objective depth be defined as the lesser of (i) the stratigraphic equivalent of the target formation or (ii) a stated total depth.

12. Earning Requirements.

(a) Will the establishment of production before the objective depth is reached earn for the farmee/assignee or must it continue drilling the well (or an alternate well) to the objective depth to earn?

(b) When will the farmee receive an assignment under the Farmout Agreement? Is the Farmout Agreement to be structured as an "agreement to transfer" or an "upfront conditional assignment"?

(c) If the farmee's drilling obligation is intended to be a condition and not a covenant, such intent should be expressly stated in the Farmout Agreement. The failure to clearly state that an obligation is a condition, and not a covenant, can result in the non-breaching party being relegated to an action for damages if the obligation is not performed.

(d) If the farmor retains a carried working interest, is the farmee required to carry the farmor to "casing point" or through completion of the well? If the farmor is to be carried through completion of the well, what does "completion" mean?

Does it include all costs of completing and equipping the well "through the tanks" (including the cost of all flow lines up to and including the wellhead check meter)?

(e) When a "carried party" shares any portion of the working interest before payout, the "paying party" must capitalize that portion of the IDC's that are attributable to the carried party's pre-payout working interest. To avoid this problem, (i) the interest of the farmor will need to be structured as a "back-in interest" rather than a "carried interest" or (ii) the Farmout Agreement will need to include a tax partnership.

13. Large Acreage Blocks.

(a) If the Farmout Agreement covers a single large block of acreage or several separate blocks in a trend, consideration should be given to requiring multiple "earning" wells. Under Rev. Rule 77-176, the "pool of capital" doctrine only applies to the drilling unit for the earning well. To the extent any acreage outside the drilling unit for the earning well is assigned to the farmee, it will be classified as a taxable transaction to both the farmor and the farmee.

(b) If several "initial wells" are required to be drilled, is it clear when each initial well must be commenced on each area? Is there an order of preference for drilling the separate areas? Will the same depth requirement be applicable to each separate area?

(c) If production must be established to earn rights under the Farmout Agreement, will the farmee have an option to drill successive wells on each separate area until production is established? Does this option apply as to each area separately (which might require the farmee to have several rigs running at the same time) or may the farmee hold all unearned areas by continuously drilling on a single area?

(d) If the farmor is retaining deep rights, how will the "earned depth" be determined under each separate area?

(e) If the farmee is required to establish production to earn rights under the Farmout Agreement and the farmee's first well is a deep dry hole, but production is established in a subsequent shallower well, does the farmee earn rights as to all depths explored by the deep dry hole or only those depths explored by the shallower producing well?

14. Continuous Development Provisions.

(a) If the trade calls for continuous drilling of wells until or after production is established, the Farmout Agreement should specifically state how long the farmee has between wells and the type of action that is required to be commenced for each well, either operations or actual drilling.

(b) Is the objective depth for each of the successive wells the same as for the initial well or will production at any depth earn rights under the Farmout Agreement after the initial well has reached the objective depth?

(c) Can time between wells be accumulated (*i.e.* "banked") in the event the farmee commences operations/drilling on the next required well prior to the required commencement date?

15. Substitute Wells. Most farmout trades include a "substitute well provision" that will permit the farmee to drill a new well if the initial well is lost because of impenetrable conditions, heaving shale, excessive saltwater flows, etc. The Farmout Agreement should specify how much time may elapse between abandonment of the lost well and commencement of the substitute well. The Farmout Agreement should also specify how the location of the substitute well is to be selected.

16. Alternate Wells. If the farmee discovers hydrocarbons in a shallow formation, the farmee may want to attempt a completion in such shallow formation before drilling on to the objective depth so as not to jeopardize the chances of completing in the shallower zone. Since the well is still in good condition, the substitute well clause (described above) will not apply. To cover such situations, an alternate well provision must be included.

17. Payout Provisions. Many Farmout Agreements provide that once the farmee has recouped the cost of drilling the well from the well's production (*i.e.* payout), the farmor is entitled to "back in" for a percentage of the working interest, whereupon the well becomes a "joint account" well under the attached Operating Agreement. To avoid disagreements about when "payout" occurs, it is important that the Farmout Agreement specifically provide how "payout" is to be calculated and require the farmee to account to the farmor on a monthly basis with a payout statement. The payout statement should be in sufficient detail to reflect (i) the total drilling costs to be recouped by the farmee, (ii) the items that make up such total amount (tangibles and intangibles), (iii) the total cumulative amount of production from the well during the payout period, (iv) the amount and value of production from the well since the previous statement and (v) the balance of the payout amount yet to be recouped.

18. Tax Partnership. The two most common reasons for electing to operate as a tax partnership are (i) to avoid the "carried interest rules" (See paragraph 12(e) above) by specially allocating IDC's to the paying party and (ii) to avoid the restrictions of Rev. Rule 77-176 (See paragraph 13(a) above) and permit the farmee to earn acreage outside the drilling unit for the earning well without triggering adverse tax consequences.

C. The Operating Agreement. Almost all E&P Agreements have some version of the A.A.P.L. Form 610 Model Form Operating Agreement (the "Operating Agreement") attached to them as an Exhibit. While an in depth analysis of the Operating Agreement is beyond the scope

of this paper, the following are a few issues that should be considered when integrating the terms of an E&P Agreement with the terms of the Operating Agreement.

1. Effective Time. It is not uncommon for an E&P Agreement to provide that one or more parties will not be required to pay any portion of the cost of joint operations until some future time, such as "casing point" or completion of the initial well. It is also not uncommon for the parties to assume under such circumstances that the Operating Agreement need not apply until casing point is reached or the initial well is completed, as the case may be. However, this erroneous assumption could result in the parties to the joint operations being classified as a "mining partnership", whereupon each party would become jointly and severally liable for the cost of the operation. The reason for this is that the language expressly disclaiming the creation of a mining partnership (and joint liability) is contained in the Operating Agreement. Therefore, to avoid being classified as a mining partnership, either (i) the Operating Agreement should become effective immediately or (ii) the E&P Agreement should contain the same "joint liability disclaimer" language that is found in the Operating Agreement.

2. Coordination of Agreements. It is very important to coordinate the terms and provisions of the Operating Agreement with the terms and provisions of the E&P Agreement. The potential for conflict between the two agreements is often increased by the parties' tendency to use the Operating Agreement for situations it is not designed to cover. Many of these potential conflicts (*e.g.* Contract Area vs. Program Area/Farmout Area; Interests of Parties; Subsequent Operations; Maintenance of Uniform Interest) can be avoided by making a clear distinction between (i) the geographic area covered by the E&P Agreement (*i.e.* the Program Area/Farmout Area) and (ii) the geographic area covered by the Operating Agreement (*i.e.* the Prospect Area/Contract Area). This can be accomplished by providing in the E&P Agreement that the Program Area/Farmout Area is comprised of (or has the potential of being comprised of) several different Prospect Areas/Contract Areas, each of which shall be governed by its own separate Operating Agreement. Those additional areas where conflicts usually arise (Definitions; Titles; Management of Operations; Limitation of Expenditures; Other Operations) can be addressed in Article XV (Other Provisions) of the Operating Agreement.

In an "ideal world", these modifications would result in the two agreements working together without any conflict. However, since we live in the "real world" (at least most of us), language should be added to either the E&P Agreement or the Operating Agreement that specifically provides that if any conflict arises between the terms of the E&P Agreement and the terms of the Operating Agreement, the terms of the E&P Agreement shall prevail.

3. Article XV (Other Provisions). The number of "Other Provisions" that are routinely added to Article XV of the Model Form Operating Agreement (A.A.P.L. Form 610-1982) has grown significantly over the years. While these provisions cover a variety of issues, they can all be classified as one of two types. The first type of provision is designed to correct a perceived deficiency in the way the Model Form Operating Agreement addresses, or fails to address, an issue that is common to most joint

operations. Some examples of these types of provisions are: (i) Sequence of Operations (modifying Article VII.D.); (ii) Participation in Subsequent Operations (modifying Article VI.B.); (iii) Advance Payment and Non-Payment of Costs (modifying Article VII.); (iv) Other Operations (modifying Article VII.D.3.); (v) Required Operations (modifying Article VI.B.2.); and (vi) Memorandum of Operating Agreement.

The second type of provision is designed to address those issues that arise when the Model Form Operating Agreement is (i) integrated with an E&P Agreement (as discussed above), (ii) used in a jurisdiction with "special operational considerations", or (iii) utilized for certain types of "special joint operations" not originally contemplated by the Model Form Operating Agreement (*e.g.* unconventional wells, horizontal wells, etc.).

Attached hereto as Appendix A is an example of some "Other Provisions" that may be included in Article XV of an A.A.P.L. 610-1982 form of Operating Agreement.

IV.
Putting It All Together

Now that we have identified the most important issues that should be addressed in both an Exploration Agreement and a Farmout Agreement, the only thing left to do is put the agreements together. To help illustrate how this might be done, I have described below a hypothetical oil and gas prospect (the Clampett Prospect) and two different fact scenarios relating to the prospect. The first fact scenario describes an exploration opportunity that has been identified by Jethro Exploration Company. The Exploration Agreement set out in Appendix B is an example of how this type of exploration venture might be documented. The second fact scenario describes a farmout opportunity that arises after the first two prospect wells are drilled under the referenced Exploration Agreement. The Farmout Agreement set out in Appendix C is an example of how this type of exploration venture might be documented.

The Clampett Prospect. The Clampett Prospect is a combined Arbuckle (approximately 11,000 - 13,500 ft.) and Spiro (approximately 9,500-10,500 ft.) Play. The Company pursuing the Clampett Prospect (**Jethro Exploration Company**) has performed some regional geological work in the area and discovered some temperature anomalies in the Clampett #1 Well that is situated about ½ mile east of the area of interest (the "Program Area") (See Attachment 1). The Arbuckle Formation is a fractured limestone/dolomite with low porosity and low permeability (See Attachment 2). The Spiro Formation is a deltaic sand extending down from the north (See Attachment 3). Jethro has access to one existing 2-D seismic line that traverses the eastern one-third (1/3rd) of the Program Area in a northwest to southeast direction (See Attachment 1).

The Exploration Opportunity. Jethro plans to shoot a 112 square mile 3-D Seismic Survey over the Program Area to identify both deep prospects (highly fractured areas within the Arbuckle Formation) and shallow prospects (areas of preserved porosity within the Spiro sands). Jethro has already acquired a significant land position in the southern portion of the Program Area. After conducting preliminary lease checks in the northern portion of the Program Area, Jethro discovered that **Drysdale Exploration Company** (a mid-sized independent with a good

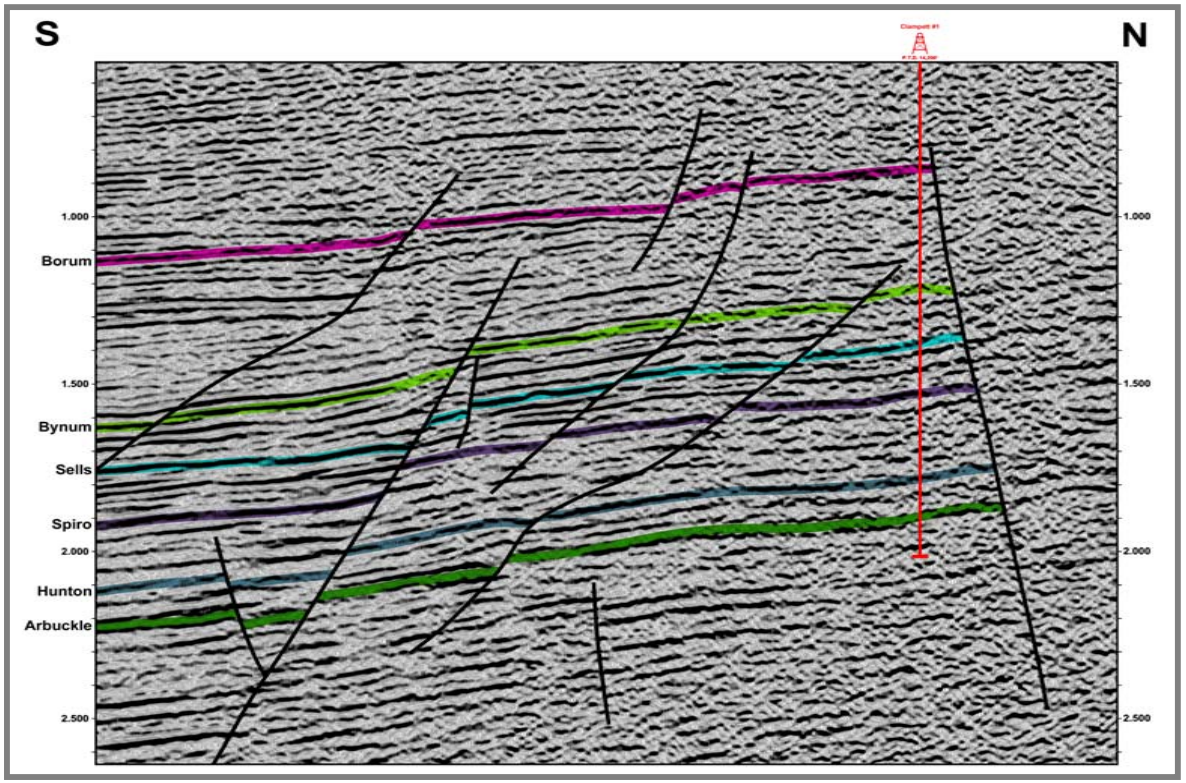
reputation) had already acquired a large acreage position in the area (See Attachment 4). While continuing to acquire acreage within the Program Area (both through the acquisition of oil and gas leases and seismic permits with the option to lease), Jethro approached Drysdale about entering into a joint exploration program covering the Program Area. Following several meetings between Jethro and Drysdale, the parties agreed to jointly explore the Program Area on a 50/50 "heads up" basis, with ½ of Drysdale's interest (i.e. 25% of 8/8ths) going to **Hathaway Energy, LLC** (a small independent with no track record) pursuant to an existing prospect sharing arrangement between Drysdale and Hathaway.

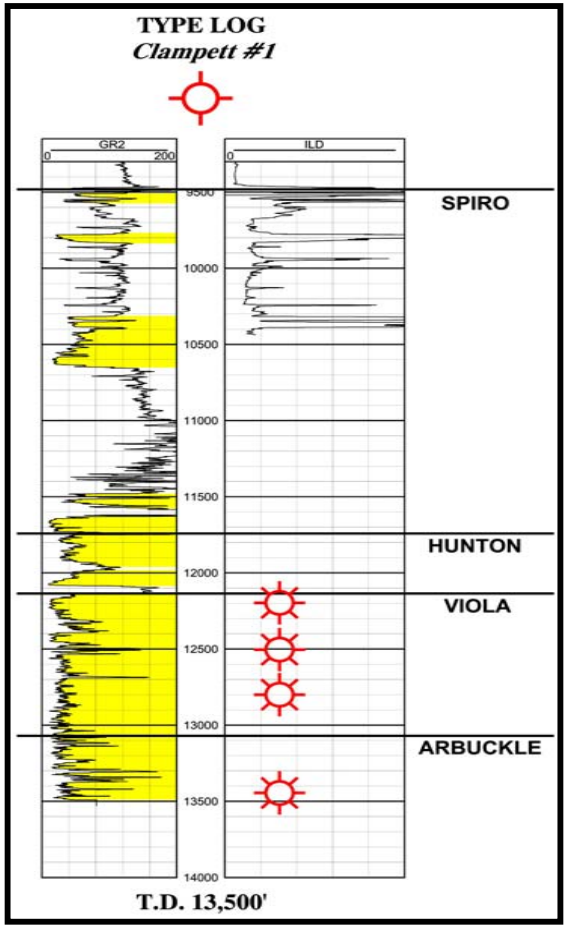
The Farmout Opportunity. The first two test wells drilled on the Program Area were successfully completed in the Spiro Formation. Based on this success (and for unrelated budgetary reasons), Jethro's management elected to focus on the development of the Spiro Formation and defer the drilling of any wells to the deeper Arbuckle Formation. At the next "prospect generation" meeting for the Program Area, Jethro advised Drysdale that it had identified three (3) new Spiro prospects that it wanted to drill in the next quarter. Although Drysdale agreed that these Spiro prospects should be drilled, Drysdale expressed its desire to drill two (2) Arbuckle tests during the same time period. Since neither party could garner the majority vote necessary to force an "up or out" election on the other party (pursuant to the terms of their Exploration Agreement), Jethro agreed to farmout to Drysdale its 50% interest in those formations located below the base of the Spiro Formation (the "Subject Intervals"). Under the terms of the farmout, Drysdale would have the right to earn one or more assignments of Jethro's interest in the Subject Intervals (on a well-by-well basis) by drilling and completing one or more wells within the Subject Intervals. Jethro would retain a 3% overriding royalty interest in each earning well, with the right to convert the override to a 12.5% of 8/8ths working interest after payout of each such earning well.

ATTACHMENT 1

Clampett Well/Seismic Line

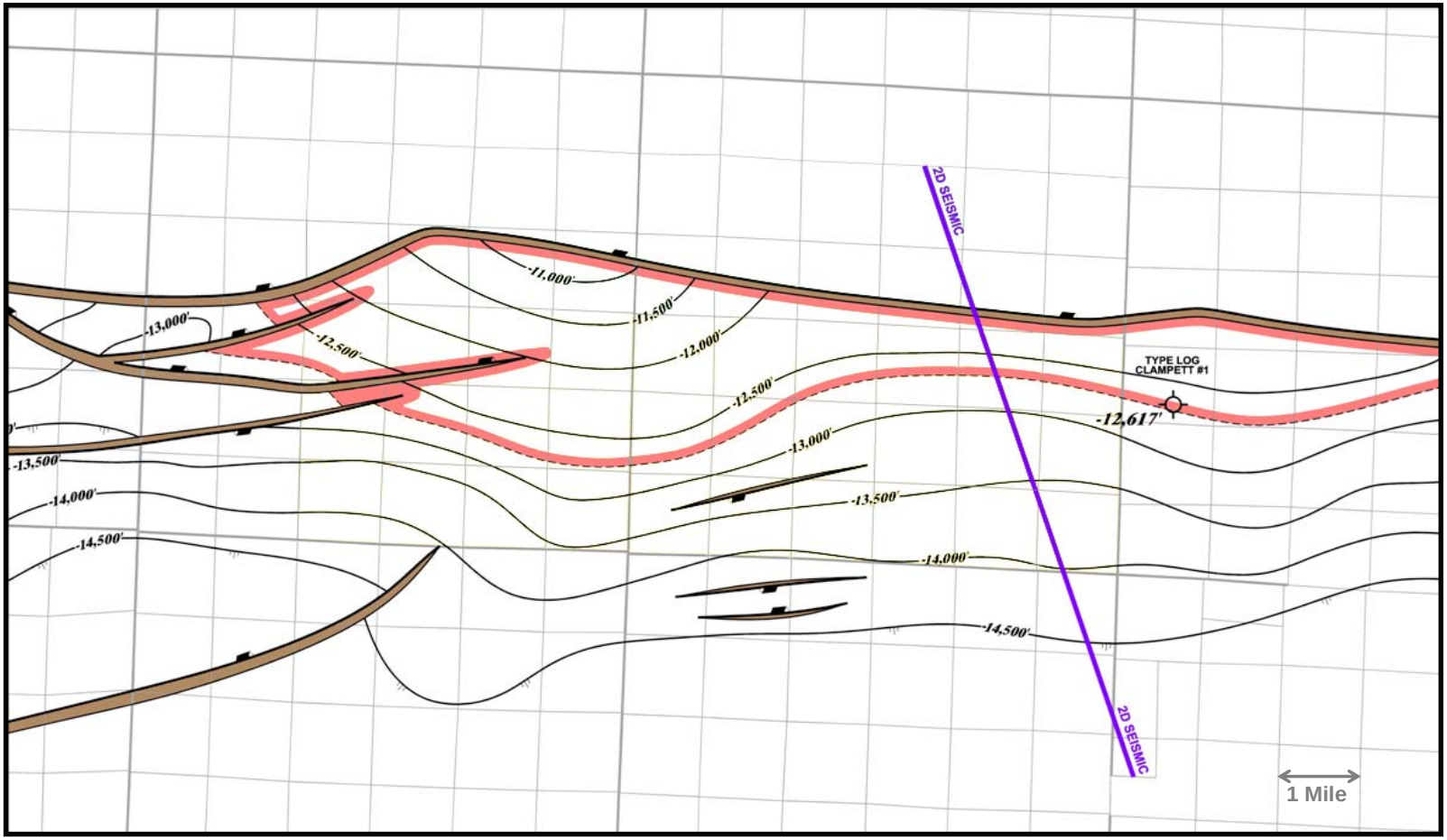
Seismic Line





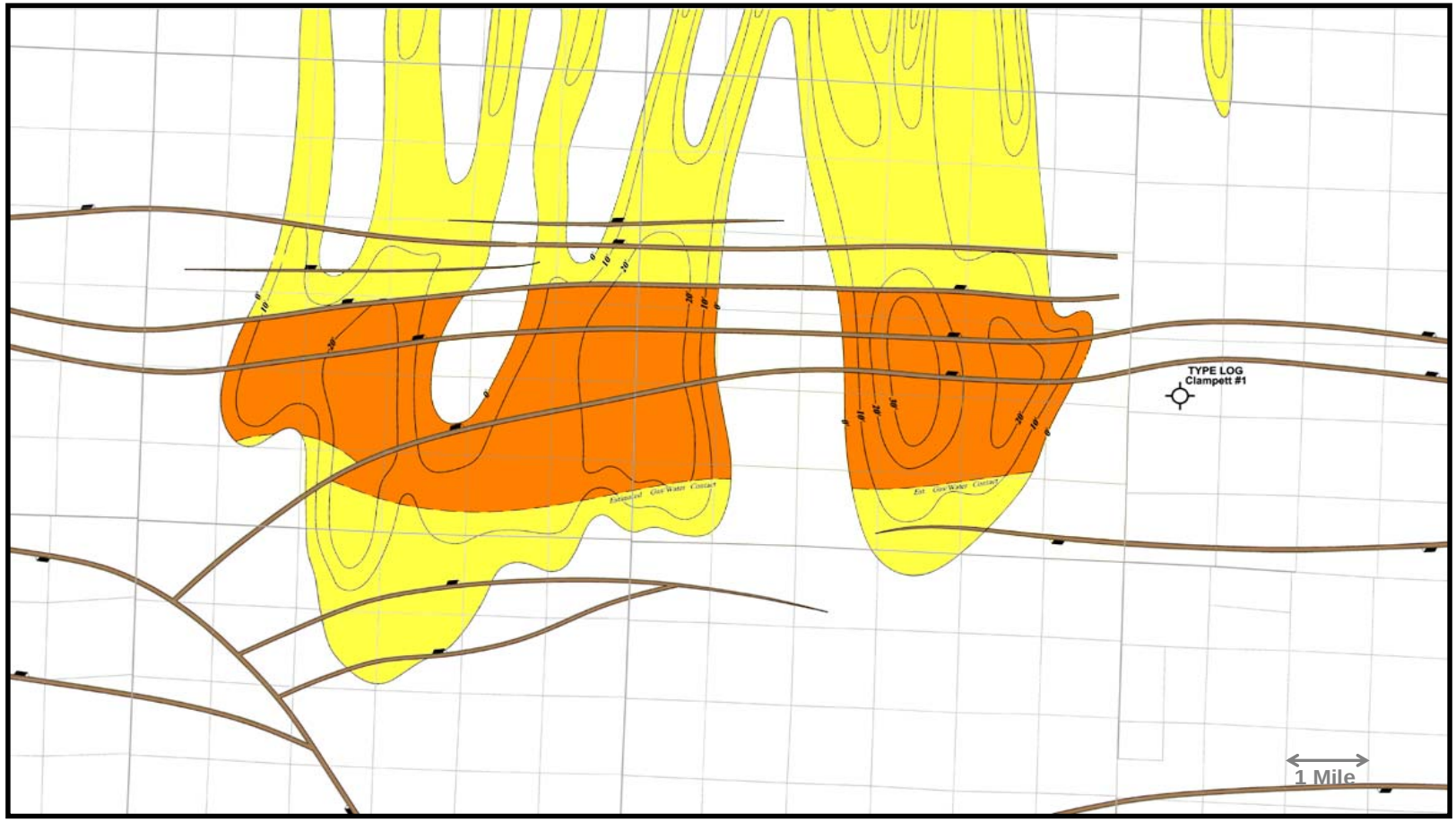
ATTACHMENT 2

Arbuckle Structure Map



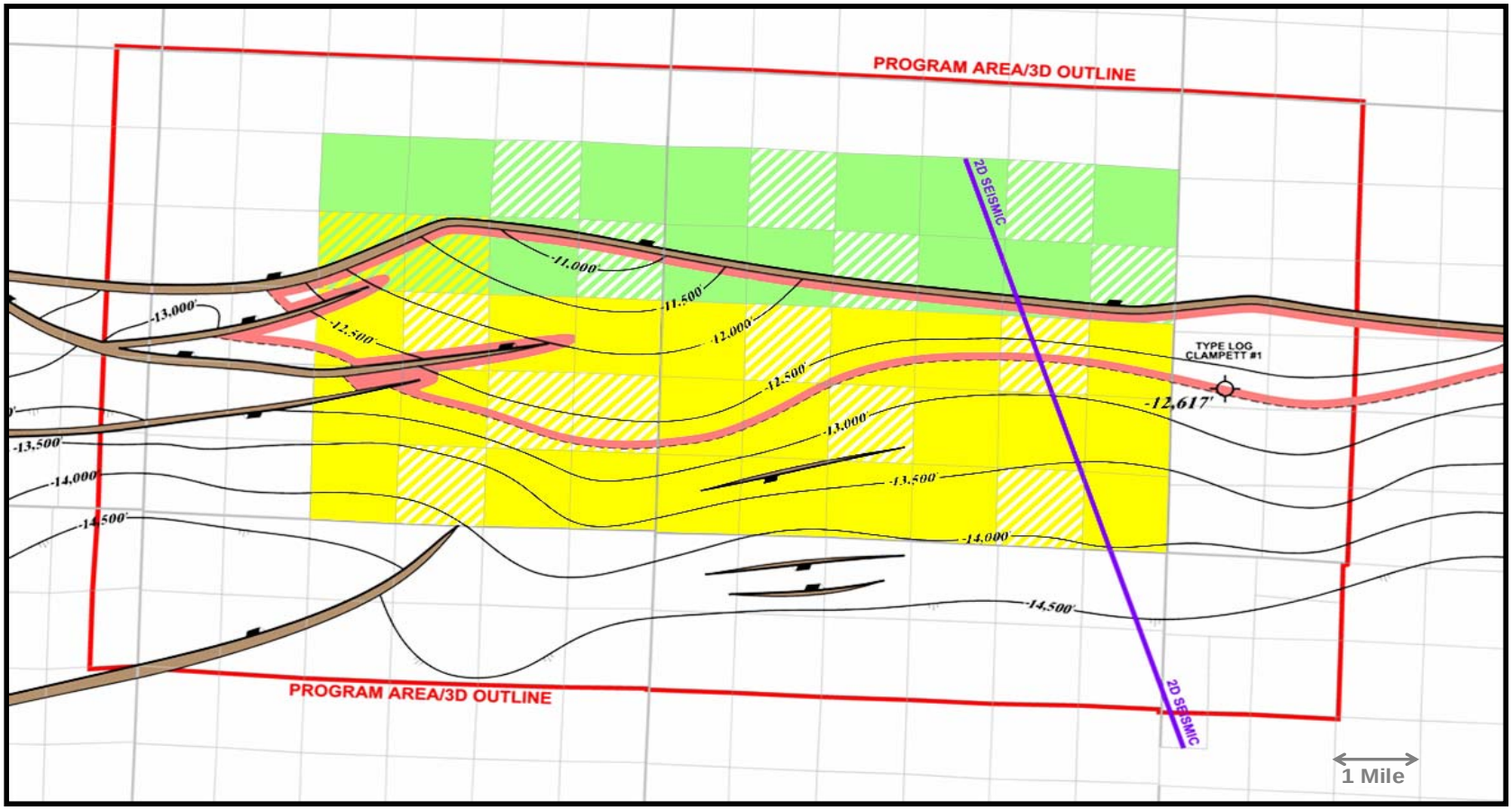
ATTACHMENT 3

Isopach of Spiro Sands



ATTACHMENT 4

Proposed 3D Outline



Drysdale Exploration Acreage

Jethro Exploration Acreage

APPENDIX A

1982 AAPL FORM – ARTICLE XV
OTHER PROVISIONS

The provisions of this Article XV shall take precedence over any provisions of the printed portion of this agreement which may be in conflict herewith.

A. Definitions.

As used in this agreement, the following terms shall have the meanings here ascribed to them:

1. The term "Commission" shall mean [_____] or any successor regulatory body having jurisdiction.

2. The term "AFE" shall mean an Authority for Expenditure prepared by a party to this agreement for the purpose of estimating the cost to be incurred in conducting an operation hereunder.

3. The term "completion" or "complete" shall mean a single operation intended to complete a well as a producer of oil and gas in one or more zones, including, but not limited to, the setting of production casing, perforating, well stimulation and production testing conducted in such operation.

4. The term "deepen" or "deepening" shall mean a single operation whereby a well is drilled to an objective zone below the deepest zone in which the well was previously drilled, or below the deepest zone proposed in the associated AFE, whichever is the lesser. The term "deepen" or "deepening" shall not be interpreted to mean further extension of a horizontal drainhole nor shall it be interpreted to pertain to any vertical stratigraphic variations within any particular formation as might be encountered while "steering" during horizontal or directional drilling operations.

5. The term "non-consent well" shall mean any well in which less than all parties have conducted an operation as provided in Article VI.B.2.

6. The term "plug back" or "plugging back" shall mean a single operation whereby a deeper zone is abandoned in order to attempt a completion in a shallower zone.

7. The term "recompletion" or "recomplete" shall mean an operation whereby a completion in one zone is abandoned in order to attempt a completion in a different zone within the existing wellbore.

8. The term “rework” or “reworking” shall mean an operation conducted in the wellbore of a well after it is completed to secure, restore, or improve production in a zone which is currently open to production in the wellbore. Such operations include, but are not limited to, well stimulation operations, but exclude any routine repair or maintenance work or drilling, sidetracking, deepening, completing, recompleting or plugging back of a well.

9. The term “sidetrack” or “sidetracking” shall have the meaning given to such term in Article VI.B.4. hereof.

10. The term “zone” shall mean a stratum of earth containing or thought to contain a common accumulation of oil and gas separately producible from any other common accumulation of oil and gas.

B. Parties to Operations.

1. Except as otherwise provided in Article XV.C.3. below, with respect to any non-consent well drilled or deepened pursuant to Article VI.B.2. for which the Consenting Parties have not been fully reimbursed for the amounts provided in Article VI.B., the right to propose and to participate in further operations under Article VI.B. for such non-consent well shall be limited as follows:

a. Only a Consenting Party in the non-consent well shall have the right to propose a reworking, plugging back, completion or recompletion operation for such non-consent well, provided that (i) all parties (including Non-Consenting Parties in such non-consent well) shall be entitled to receive notice of any such proposed operation (a “Proposal Notice”) and (ii) all Consenting Parties in such non-consent well shall have the right to participate in such operation pursuant to Article VI.B.

b. Only a Consenting Party in the non-consent well shall have the right to propose a deepening or sidetracking operation for such non-consent well, but all parties (including Non-Consenting Parties in such non-consent well) shall be entitled to receive the Proposal Notice for, and shall have the right to participate in, such sidetracking or deepening operation pursuant to the terms of Article VI.B. However, those Non-Consenting Parties that elect to participate in such deepening or sidetracking operation shall reimburse the Consenting Parties in accordance with Article VI.B.4. in the event of a sidetracking operation and in accordance with Article XV.B.(3) below in the event of a deepening operation.

2. If less than all the parties elect to participate in a drilling or deepening operation proposed pursuant to Article VI.B., the interest relinquished by the Non-Consenting Parties to the Consenting Parties under Article VI.B.2. shall relate only and be limited to the lesser of: (i) the total depth actually drilled, or (ii) the objective depth or formation of which the parties were given notice under Article

VI.B.1. (the "Initial Proposed Objective"). Such well shall not be drilled to a depth deeper than the Initial Proposed Objective without first complying with Article XV.B.(3) to afford the Non-Consenting Parties the opportunity to participate in such deeper drilling operation.

3. In the event any Consenting Party desires to drill or deepen a non-consent well to a depth below the Initial Proposed Objective, such Consenting Party shall give notice thereof, complying with the requirements of Article VI.B.1., to all parties (including Non-Consenting Parties in such non-consent well). Thereupon, Article VI.B. shall apply and all parties receiving such notice shall have the right to participate or not participate in the drilling of such well pursuant to said Article VI.B. In the event, however, any Non-Consenting Party elects to participate in the deeper drilling operation, such Non-Consenting Party shall pay or make reimbursement (as the case may be) of the following costs and expenses:

   a. If the proposal to drill deeper is made prior to the abandonment or proposed abandonment of such non-consent well as a dry hole or prior to completion of such non-consent well as a commercial well, such Non-Consenting Party shall pay (or reimburse Consenting Parties for, as the case may be) that share of all costs and expenses incurred in drilling such non-consent well from the surface to total depth, as deepened or proposed to be deepened, which such Non-Consenting Party would have paid if such non-consent well had initially been proposed to be drilled to such depth and such Non-Consenting Party had agreed to participate therein; provided, however, all costs for testing and completion or attempted completion of such non-consent well that were incurred by the Consenting Parties prior to the point of actual operations to drill deeper than the Initial Proposed Objective shall be for the sole account of the Consenting Parties.

   b. If the proposal to drill deeper is made for a non-consent well that has been previously completed as a commercial well but is no longer producing in paying quantities, such Non-Consenting Party shall, in addition to paying all costs of re-entering such non-consent well and deepening the same below its total depth, also reimburse Consenting Parties for the lesser of (i) such Non-Consenting Party's proportionate part (based on the percentage of such non-consent well the Non-Consenting Party would have owned had it previously participated in such non-consent well) of the salvable materials and equipment remaining in the hole and salvable surface equipment used in connection with such deeper drilled well or (ii) the amounts yet unrecovered under Article VI.B. that the Consenting Parties are entitled to recover from such Non-Consenting Party's relinquished interest in such non-consent well.

The foregoing shall not imply a right of any Consenting Party to propose any deeper drilling operation for a non-consent well prior to completion of the drilling

of such non-consent well to casing point for its Initial Proposed Objective without the consent of all other Consenting Parties.

The provisions of this Article XV.B. shall not apply to the takeover of a well by the Non-Consenting Parties in the event all Consenting Parties elect to permanently plug and abandon the same, but such right of the Non-Consenting Parties shall be governed by Article VI.E.3.

4. It is agreed that no reworking, deepening, plugging back, completion, recompletion or sidetracking operation shall be conducted on any well then capable of producing in paying quantities except with the consent of all parties that have not relinquished interests in the well at the time of such operation.

C. Sequence of Operations.

1. When any well authorized under the terms of this agreement, either by all parties, or by one or more but less than all parties, has been drilled to its objective depth and the parties participating therein cannot mutually agree upon the sequence and timing of further operations regarding such well, the following proposals shall control in the order hereafter enumerated:

   a. A proposal to do additional logging, coring or testing, provided that, in the event a disagreement exists as to the testing to be performed on the well at any depth, testing shall be performed as follows:

      i) Any logging, coring or testing provided in a prognosis or AFE shall be conducted for the joint account;

      ii) Any additional logging, coring or testing shall be performed by the Operator at the sole cost, risk, expense and liability, including indemnification against loss of hole, of the parties electing to participate in such additional operations, and such participating parties shall be exclusively entitled to the information obtained therefrom; provided, however, no such additional testing shall be performed on a well then producing in paying quantities unless all working interest owners in such well consent to such testing.

   b. A proposal to deepen said well to its approved objective formation, if not theretofore seen;

   c. A proposal to attempt to complete the well at its objective depth;

   d. A proposal to plug back and attempt to complete said well in prospective zones at lesser depths, with priorities given in descending order;

e. A proposal to deepen the well below the objective formation, with priorities given in ascending order.

f. A proposal to sidetrack the well to a new bottom hole location;

g. A proposal to plug and abandon the well.

2. In the event a well drilled pursuant hereto is in such a condition that, at the time the participating parties are considering any of the above proposals that, in the opinion of Operator, a reasonable, prudent operator would not conduct the operations contemplated by a particular proposal for fear of placing the hole, life or property in jeopardy of losing same prior to completing such well at its objective depth, such election shall not be given the priority hereinabove set forth.

3. If one or more, but less than all, parties elect to participate in a completion or recompletion attempt on a vertical or directional vertical well (collectively, a "vertical well") pursuant to Article VII.D.1. (Option No. 2), the provisions of Article VI.B.2. shall apply to the operations thereafter conducted by less than all parties; provided, however, that Article VI.B.2. shall apply separately to each such completion or recompletion attempt undertaken thereunder, and an election to become a Non-Consenting Party as to one completion or recompletion attempt shall not prevent a party from becoming a Consenting Party in subsequent completion or recompletion attempts on such vertical well, regardless whether the Consenting Parties as to earlier completions or recompletions have recouped their costs pursuant to Article VI.B.2. In this regard, the parties agree that any recoupment of costs by a Consenting Party in a particular completion or recompletion attempt shall be made solely from the production attributable to the zone in which the completion or recompletion attempt is made. An election by a previous Non-Consenting Party to participate in a subsequent completion or recompletion attempt shall require such party to pay its proportionate share of the cost of salvable materials and equipment installed in the well pursuant to the previous completion or recompletion attempt, insofar and only insofar as such materials and equipment benefit the zone in which such party has elected to participate in such completion or recompletion attempt. For the purpose of the preceding sentence, the term "zone" shall be limited to the interval in the wellbore that is to be perforated.

D. Conflicting Proposals.

Except as otherwise specifically provided in this agreement, if any party proposes to conduct an operation that conflicts with a proposal that has been made by a party under Article VI.B., such party shall have fifteen (15) days from delivery of the initial proposal, in the case of a proposal to drill a well or to perform an operation on a well where no drilling rig is on location, or twenty-four (24) hours, exclusive of Saturday, Sunday and legal holidays, from delivery of the initial proposal, if a drilling rig is on location for the well on which such operation is to be conducted, to deliver to all parties entitled to participate in the proposed operation such party's

alternative proposal, which alternative proposal shall contain the same information required to be included in the initial proposal. Each party receiving such proposals shall elect by delivery of notice to Operator within five (5) days after expiration of the proposal period, or within twenty-four (24) hours (exclusive of Saturday, Sunday and legal holidays) if a drilling rig is on location for a well that is the subject of one or both of the proposals, to participate in one of the competing proposals. Any party not electing within the time required shall be deemed not to have voted. The proposal receiving the vote of parties owning the largest aggregate percentage interest of the parties voting shall have priority over all other competing proposals; in the case of a tie vote, the initial proposal shall prevail. Operator shall deliver notice of such result to all parties entitled to participate in the operation within five (5) days after expiration of the election period (or within twenty-four (24) hours, exclusive of Saturday, Sunday and legal holidays, if a drilling rig is on location). Each party shall then have two (2) days (or twenty-four (24) hours if a rig is on location) from receipt of such notice to elect by delivery of notice to Operator to participate in such operation or to relinquish its interest in the affected well pursuant to the provisions of Article VI.B.2.; failure by a party to deliver notice within such period shall be deemed an election not to participate in the prevailing proposal.

E. Non-Payment.

Subject to Article XV.E.4. hereof, if any party (including the Operator) fails to pay its share of any cost, including any advance which it is obligated to make under Article VII.C or any other provision of this agreement, within the period required for such payment, then, in addition to the other remedies in this agreement, the Operator (or any Non-Operator if the Operator is the party in default) may pursue any of the following remedies:

1. Suspension of Rights. Operator (or the Non-Operators if Operator is the party in default) may deliver to the party in default by certified mail, return receipt requested a Notice of Default, which shall specify the default, and specify that action to be taken to cure the default, and specify that failure to take such action will result in the exercise of one or more of the remedies provided in this agreement. If such default is not cured within ten (10) days after the receipt by the defaulting party of such Notice of Default, Operator (or the Non-Operator if Operator is the Party in default) may suspend any or all of the rights of the defaulting party granted by this agreement until the default is cured, without prejudice to the right of any non-defaulting party to continue to enforce the obligations of the defaulting party theretofore accrued or thereafter accruing under this agreement. If Operator is the party in default, the Non-Operators shall in addition have the right, by vote of Non-Operators owning a majority in interest in the Contract Area after excluding the voting interest of Operator, to appoint a new Operator effective immediately. The rights of a defaulting party that may be suspended hereunder at the election of the non-defaulting parties shall include, without limitation, the right to receive information as to any operations conducted hereunder during the period of such default, and the right to elect to participate in an operation proposed under Article VI.B. of this agreement.

2. Suit for Damages. Operator (or the Non-Operators if Operator is the party in default) may sue to collect the amounts in default together with all documented, direct damages suffered by the non-defaulting parties as a result of the default, plus interest accruing on the amounts recovered from the date of default until the date of collection at the rate specified in Section I.(3) of the Accounting Procedure attached to this agreement as Exhibit "C".

3. Deemed Non-Consent. Operator (or any Non-Operator if the Operator is the party in default) may deliver a written Notice of Non-Consent Election by certified mail, return receipt requested or by overnight delivery with tracking confirmation, to the defaulting party at any time after the expiration of the ten-day cure period following delivery of the Notice of Default, in which event if the billing is for the drilling of a new well or the plugging back, sidetracking, reworking or deepening of a well which is to be or has been plugged as a dry hole, or for the completion or recompletion of any well, the non-paying party will be conclusively deemed to have elected not to participate in the operation and to be a Non-Consenting Party with respect thereto under Article VI.B. or VII.D.1 (Option No. 2) to the extent of the costs unpaid by such party, notwithstanding any election to participate theretofore made. If election is made to proceed under this provision, then the non-defaulting party may not elect to sue for the unpaid amount pursuant to Article XV.E.2. Until the delivery of such notice of Non-Consent Election to the non-paying party, such party shall have the right to cure its default by paying the unpaid billing plus interest at the rate set forth in Section I.(3) of the attached Accounting Procedure plus any costs or damages incurred by the non-defaulting parties as a result of the default. Any interest relinquished pursuant to this Article XV.E. shall be offered by Operator (or by the Non-Operators if Operator is the defaulting party) to the non-defaulting parties in proportion to their interests.

4. Good-Faith Disputes. In the event a party disputes in good faith the existence of a default on its part that is the subject of a Notice of Default, such party may avoid the imposition of the remedies for such default contained in this agreement by paying the disputed amount into an account at a bank requiring the signatures of both such party and the Operator (or, if the Operator is the party in default, a Non-Operator designated by the Non-Operators) in order to release such funds. Such funds shall be released to the party entitled thereto upon the resolution of the issue raised by the objecting party.

5. Costs and Attorney's Fees. In the event any party shall ever be required to bring legal proceedings in order to collect any sums due from any other party or any to enforce any other right under this agreement, then the prevailing party in such action shall also be entitled to recover all court costs, costs of collection, and a reasonable attorney's fee, which the lien provided for herein shall also secure.

6. Financing Statement. Upon request of Operator, the Non-Operators agree to execute a recordable financing statement sufficient and appropriate under the

applicable state uniform codes or the Uniform Commercial Code, as applicable, to perfect a security interest by and between the parties hereto to the same degree and covering the same properties and rights as set forth in Article VII.B. above.

F. Press Release.

No party hereto shall, directly or indirectly, make or authorize any press or public information release or announcements concerning the execution, continuation or termination of this agreement, or the results of any operation conducted hereunder, without the written approval of all parties hereto, unless such release(s) or announcement(s) refer solely and only to the party making the release or announcing such information and in no way disclose the identity or participation of any other party. Notwithstanding the foregoing, a party may make any press release or other disclosure regarding this agreement without the consent of the other parties to the extent required under any applicable law, rule or regulation.

G. Delay Rentals, Shut-in Payments & Relinquishments.

1. Operator shall use its best efforts to provide each Non-Operator of its recommendation concerning the payment of delay rentals or shut-in payments under any leases, as they may fall due, written notice at least sixty (60) days in advance of the date when such payment is due together with due dates for such payments, Operator's recommendations for the payment or non-payment thereof, and a general description of the lands covered by same. Non-Operator shall have thirty (30) days from the receipt of such notice to respond in writing to such recommendation. The failure of Non-Operator to timely respond shall be deemed its election to participate as to Operator's recommendation.

2. In the event any party having the right to make an election elects to relinquish its interest in any lease subject hereto or not participate in a delay rental or shut-in payment which one or more of the parties elects to make, and such payment is actually made, then each party electing to so relinquish its interest and/or not participate in such payment ("Relinquishing Party") shall promptly execute and deliver to the parties electing to participate therein and/or who made such payment, an assignment of all the Relinquishing Party's right, title and interest in and to the lease for which such payment was made. Such assignment shall be free and clear of any overriding royalty interests, net profits interests, or other burdens or encumbrances other than the lessor's royalty and any burdens listed on Exhibit "A" and Article VI.B. hereof. Such leases shall no longer be deemed subject to this Agreement, but shall be deemed subject to an agreement identical to this Operating Agreement reflecting the proper owners and interests in such leases. Operator shall not be liable to Non-Operators for failure to timely or properly make any delay rental or shut-in royalty payment.

3. If any party elects to become a Relinquishing Party (as described above), then such Relinquishing Party shall use its best efforts to notify the other parties hereto

of same not less than forty-five (45) days prior to such proposed relinquishment. Within 15 days after receipt of such notice, each party shall notify the Relinquishing Party in writing if it elects to accept an assignment of the interest to be relinquished, in the proportion that its interest herein bears to the total interest of the parties who also elect to accept such an assignment, which such assignment shall be made free and clear of any and all burdens other than those specifically provided for herein.

4. The failure of a notified party to timely respond in writing to any notice from a Relinquishing Party, as herein provided, shall be deemed such party's election not to accept any such relinquished interest. Promptly after expiration of the 15 day election period, the Relinquishing Party shall either assign its relinquished leases or release same of record, as appropriate.

H. Substitute Wells.

If, prior to reaching the proposed depth in any well drilled pursuant hereto, any condition, including but not limited to, loss or partial loss of circulation, water flow, domal formation, abnormal pressure, heaving shale, impenetrable substances or mechanical/material failures are encountered which preclude further drilling using normal economic and prudent procedures, the parties participating in such well shall have the option, but not the obligation, to drill a substitute well therefor, at a mutually agreeable location between the parties participating in such well, but in no event having a proposed bottomhole location greater than 300' from the preceding well. Any such substitute well must be commenced within ninety (90) days after abandonment of the preceding well and same shall be deemed, for all purposes, as the well for which it is a substitute.

I. Termination of Operations.

Upon the commencement of an operation for the drilling, reworking, sidetracking, plugging back, deepening, testing, completion, recompletion or plugging of any well hereunder, including but not limited to the Initial Well, such operation shall not be terminated without consent of parties bearing 75% of the costs of such operation; provided, however, that in the event granite or other practically impenetrable substance or condition in the hole is encountered which renders further operations impractical, Operator may discontinue operations and give notice of such condition in the manner provided in Article VI.B.1, and the provisions of Article VI.B or VII.D. or VI.E. shall thereafter apply to such operation, as appropriate subject to the other provisions hereof. In such event, it shall be conclusively deemed that the subject well has reached its authorized depth as provided in the applicable AFE for purposes of this agreement and an election is thereby due as provided hereinabove.

J. Advance Payments and Defaults.

1. In addition to the rights and obligations contained in Article VII.C., when the operations contemplated hereunder and set forth in an AFE involve the drilling of

any well, Operator shall have the right to demand and receive from time to time from each Non-Operator, as provided for in this agreement, payment in advance for their respective shares of the estimated amount of financial liability to be incurred during the drilling of such well as follows:

a. If the proposed well is a vertical well or a directional vertical well (as contemplated by Article VII.D.1. Option No. 2), each Non-Operator shall be required to fund its proportionate share of the total estimated cost to drill (or deepen) and test the well (collectively, the "Dry Hole Costs"), as such Dry Hole Costs are set forth in the AFE for such vertical or directional vertical well; and

b. If the proposed well is a horizontal well (as contemplated by Article VII.D.1. Option No. 1), each Non-Operator shall be required to fund its proportionate share of the total estimated cost to drill (or deepen), test and complete the well, (collectively, the "Completed Well Costs"), as such Completed Well Costs are set forth in the AFE for such horizontal well.

Except as otherwise provided in the last sentence of this Article XV.J.1, if the advance payment is for the Dry Hole Costs of a vertical or directional vertical well or the Completed Well Costs for a horizontal well, then the invoice for such advance payment shall not be issued more than thirty (30) days prior to the anticipated spud date for the applicable well. If the advance payment relates to a horizontal well for which Operator elects to (i) drill all or a portion of the vertical section of such horizontal well with a drilling rig that is not capable of drilling the horizontal section of such horizontal well (a "Surface Rig") and (ii) commence the drilling of the horizontal section of such horizontal well later than thirty (30) days following the rig release date for the Surface Rig, then the invoice for such advance payment shall not be issued more than sixty (60) days prior to the date that a drilling rig capable of drilling the horizontal section of such horizontal well is scheduled to commence drilling operations on such horizontal well. If any such vertical or horizontal well is not spud within thirty (30) days of the date of Operator's advance invoice, Operator will refund the advance payment upon written request of Non-Operator.

2. Notwithstanding anything herein to the contrary, in addition to all other rights and remedies, if Operator does not receive Non-Operator's payment of the relevant invoiced amount within fifteen (15) days after the delivery by Operator of such invoice, Operator may then notify the relevant Non-Operator by certified mail, return receipt requested, or by overnight delivery with tracking information, of the unpaid invoice. In the event such invoiced amount is not paid and delivered to Operator within ten (10) days of Operator's above notice by certified mail, or such overnight delivery, then Operator may, at its election, regard such Non-Operator as a Non-Consenting party and such party shall be subject to the non-consent provisions set forth in Article VI.B.2 with respect to any such sums unpaid by said Non-Operator.

K. Horizontal Wells.

1. Notwithstanding anything contained herein to the contrary, (i) the provisions of Article VII.D.1 Option No. 1 shall apply to any "horizontal well" (hereinafter defined) proposed hereunder, and (ii) the provisions of Article VII.D.1. Option No. 2 shall apply to all other wells proposed hereunder that are not expressly proposed as "horizontal wells". To be effective as a "horizontal well proposal", such proposal must include an AFE and other accompanying documents that clearly stipulate that the well being proposed is a horizontal well. For purposes of this agreement, a "horizontal well" is defined as a well drilled, completed or recompleted in a manner in which the horizontal component of the completion interval in the objective formation(s) exceeds the vertical component thereof and which horizontal component exceeds a minimum of one hundred feet (100') in the objective formation(s). As to any possible conflicts that may arise during the completion phase of a horizontal well, priority shall be given first to a lateral drain hole of the authorized depth, and then to objective formations in ascending order above the authorized depth, and then to objective formations in descending order below the authorized depth.

2. Operator shall have the right to cease drilling a horizontal well at any time, for any reason, and such horizontal well shall be deemed to have reached its objective depth so long as Operator has drilled such horizontal well to the objective formation and has drilled laterally in the objective formation for a distance which is at least equal to fifty percent (50%) of the length of the total horizontal drainhole displacement (displacement from true vertical) proposed for the operation.

L. Non-Drilling Operations.

Notwithstanding any provision to the contrary contained in this agreement, Operator shall have the right to undertake, on behalf of the joint account, the installation of production facilities, gathering lines, compression facilities and other transportation or marketing facilities, and to conduct additional work with respect to a well drilled hereunder or other similar project reasonably estimated to require an expenditure in excess of the amount first set forth above in Article VII.D.3. (except in connection with an operation required to be proposed under Article VI.B.1., which shall be governed exclusively by that Article) so long as Operator first delivers such proposal to all parties entitled to participate therein and, within thirty (30) days thereof, secures the written consent of one or more Consenting Parties owning at least a majority in interest of the oil and gas leasehold interests affected by such proposal. In the event such consent is obtained by Operator, each Consenting Party shall bear its proportionate share of all costs associated with such project, including each such Consenting Party's proportionate share of the costs that would otherwise be attributable to the party or parties who elect, or are deemed to have elected, not to participate therein. Each such non-participating party shall be considered a Non-Consenting Party as to such project and shall release and relinquish forever to the Consenting Parties, proportionately, all of such Non-Consenting Party's interest in, and right to

utilize, the facilities included within such project (the "Subject Facilities"), unless and until such Non-Consenting Party and the Consenting Parties execute a mutually agreeable form of Facilities Sharing Agreement that permits the Non-Consenting Party to utilize the Subject Facilities for an agreed upon fee.

M. Operator as Independent Contractor; Duties of the Parties.

1. In its performance of services hereunder for the Non-Operators, Operator shall be an independent contractor not subject to the control or direction of the Non-Operators as to the means or manner of such performance but only as to the type of operation to be undertaken in accordance with the election procedures contained in this agreement. Operator shall not be deemed, or hold itself out as, the agent of the Non-Operators with authority to bind them to any obligation or liability assumed or incurred by Operator vis-à-vis any third party.

2. In their relations with each other under this agreement and any other agreement relating to the Contract Area, the parties shall not be considered fiduciaries or to have a fiduciary relationship, but rather shall be free to act on an arm's-length basis in accordance with their own perceptions of their respective self interests. NO PARTY SHALL BE LIABLE TO ANY OTHER PARTY HERETO FOR ANY LOST OR PROSPECTIVE PROFITS OR ANY OTHER SPECIAL, PUNITIVE, EXEMPLARY, CONSEQUENTIAL, INCIDENTAL OR INDIRECT LOSSES OR DAMAGES (IN TORT, CONTRACT OR OTHERWISE) UNDER OR IN RESPECT OF THIS AGREEMENT OR ANY OTHER AGREEMENT RELATING TO THE CONTRACT AREA OR FOR ANY FAILURE OF PERFORMANCE THEREUNDER, HOWSOEVER CAUSED, WHETHER OR NOT ARISING FROM SUCH PARTY'S SOLE, JOINT OR CONCURRENT NEGLIGENCE, STRICT LIABILITY, BREACH OF CONTRACT, OR OTHER FAULT OR RESPONSIBILITY.

N. Services Performed by an Affiliate:

Operator shall have the right (without the consent of the Non-Operators) to employ affiliates of Operator in connection with any of the operations conducted hereunder, so long as the rates charged by any such affiliate do not exceed the then current prevailing rates in the area for comparable equipment and/or services.

O. Data to be Provided by Operator:

In addition to the information provided under Article VI.D. above, Operator shall provide to all Consenting Parties in each well drilled on the Contract Area weekly reports of the daily production of oil, gas and other hydrocarbons produced from each such well, together with the tubing pressure, choke size, casing pressure, water production volumes, hour/days down and line pressure associated therewith. These weekly production reports shall commence the first week following the date of first production and shall continue for a period of ____ (__) months following the date of first production. It is understood that each Consenting Party shall own and

have rights to all data for which it has paid its proportionate share of costs, and Operator shall not preclude any party from participating in any joint account operation that would generate such data.

P. Billing Additional Interests:

Notwithstanding the provisions of this agreement and of the Accounting Procedure attached as Exhibit "C", the parties agree that in no event during the term of this agreement shall Operator be required to make more than one billing for the entire interest credited to each party on Exhibit "A". It is further agreed that if any party to this agreement (hereinafter referred to as "Selling Party") disposes of part of the interest credited to it on Exhibit "A", the Selling Party will be solely responsible for billing its assignee(s), and shall remain primarily liable to the other parties for the interest(s) assigned and shall make prompt payment to Operator for the entire amount of statements and billings rendered to it. It is further understood and agreed that if Selling Party disposes of all of its interest as set out on Exhibit "A", whether to one or several assignees, Operator shall continue sending statements and billings to the Selling Party for the interest conveyed until such time as Selling Party has designated and qualified one assignee to receive the billing for the entire interest. In order to qualify one assignee to receive the statements and billings for the entire interest credited to the Selling Party on Exhibit "A", Selling Party shall furnish to Operator the following:

1. Written notice of the conveyance and photostatic or certified copies of the assignments by which the transfer was made; and

2. The name of the assignee to be billed and, if there are two (2) or more assignees, a written statement signed by one such assignee in which it consents to (i) receive statements and billings for the entire interest credited to the Selling Party on Exhibit "A" hereof, (ii) handle any necessary sub-billings in the event it does not own the entire interest credited to the Selling Party on Exhibit "A" and (iii) remain primarily liable to the other parties for any portion of such interest that is owned by another party.

Q. Disbursement of Royalties:

If a purchaser of any oil, gas or other hydrocarbons produced from the Contract Area declines to make disbursements of all royalties, overriding royalties, working interests and other payments out of, or with respect to, production revenues attributable to such production, Operator may, at its option, or if required by state law, make disbursements of royalties on behalf of any Non-Operator who requests in writing that Operator do so. Each Non-Operator for whom such disbursement is made shall furnish Operator with the following:

1. Such documents as may be necessary in the opinion of Operator to enable Operator to receive all payments for oil, gas, or other hydrocarbons directly from the purchaser thereof; and

2. An initial list of names, addresses, and interests (to an eight place decimal), on a tract, drilling unit, purchase contract or other basis as, in the opinion of Operator, is necessary for efficient administration, for all royalty, overriding royalty and other interest owners who are entitled to proceeds from the sale of production attributable to such Non-Operator's interest. Any changes to the initial list shall be furnished promptly to Operator in writing.

Operator shall use its best efforts to make disbursements and shall not be liable for any underpayment or failure to pay unless it is the result of gross negligence or willful misconduct. Any Non-Operator for whom such disbursements are made hereby agrees to indemnify and hold harmless Operator for any loss, including court costs and attorney's fees, which may be incurred as a result of Operator's making such disbursements in the manner prescribed by Non-Operator.

R. Article VIII.B. Continued:

Notwithstanding anything to the contrary contained herein, each party committing a lease or leases to this agreement shall have the option, upon the expiration of each lease, to renew or extend such lease and to bear the renewal or extension costs and expenses and thereby retain its original interest and title in the lands covered by said lease. By exercising such option, the parties' working interest shall remain unchanged. If the original lease owner does not exercise its option within sixty (60) days after the expiration date of any such lease, the renewal or extension lease will then be subject to the terms of this Article as written above. If any working interest owner other than the original lease owner renews or extends the lease, the renewing or extending party shall furnish the original lease owner an itemized statement of the complete renewal or extension costs and expenses of such renewal or extension lease. The original lease owner shall have sixty (60) days after the receipt of such itemized statement to reimburse the renewing or extending party in full. Failure of the original lease owner to do so shall result in the forfeiture of its option hereunder. The provisions hereof shall only apply to leases or portions of leases located in the Contract Area.

APPENDIX B

EXPLORATION AGREEMENT

AMONG

JETHRO EXPLORATION COMPANY,

DRYSDALE EXPLORATION COMPANY

AND

HATHAWAY ENERGY, LLC

TABLE OF CONTENTS

EXPLORATION AGREEMENT

This Exploration Agreement (this "Agreement"), dated and effective as of the 31st day of January, 2007, is made and entered into by and among JETHRO EXPLORATION COMPANY, a Texas corporation ("Jethro"), whose address is 1234 Alamo Street, Suite 1500, Houston, Texas 77002, DRYSDALE EXPLORATION COMPANY, a Delaware corporation ("Drysdale"), whose address is 3456 Travis Street, Suite 4900, Dallas, Texas 75203, and HATHAWAY ENERGY, LLC, a Texas limited liability company ("Hathaway"), whose address is 789 Washington Street, Suite 200, Houston, Texas 77032. Drysdale and Hathaway are hereinafter collectively called "Participants" and Jethro and the Participants are sometimes hereinafter individually referred to as a "Party" and collectively referred to as the "Parties".

W I T N E S S E T H:

WHEREAS, Jethro has identified an area in Clampett County, Texas that Jethro believes is prospective for oil and gas production, which area is more particularly described on Exhibit A attached hereto (the "Program Area"); and

WHEREAS, Jethro and Drysdale have obtained certain oil and gas leases (the "Existing Leases"), seismic permits with the option to acquire oil and gas leases (the "Existing Options") and farmout or other agreements to obtain oil and gas leases (the "Existing Farmouts") covering portions of the Program Area, which Existing Leases, Existing Options and Existing Farmouts (collectively, the "Existing Land Agreements") are described on Exhibit B attached hereto; and

WHEREAS, the Parties anticipate that additional oil and gas leases (the "Additional Leases"), additional seismic permits with the option to acquire oil and gas leases (the "Additional Options") and additional farmout or other agreements to obtain oil and gas leases (the "Additional Farmouts") will be obtained in the future covering portions of the Program Area (the Additional Leases, the Additional Options and the Additional Farmouts are hereinafter collectively called the "Additional Land Agreements"); and

WHEREAS, the Parties desire to evidence their agreement to jointly explore and develop the Program Area in accordance with the terms of this Agreement.

NOW, THEREFORE, for and in consideration of the mutual covenants contained herein and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree as follows:

ARTICLE I.

PARTICIPATION INTERESTS AND PROGRAM DATA

Section 1.1. ***Participation Interests***. Each Party's interest in the Program Area (collectively, the "Participation Interests") is set forth on Exhibit C hereto.

Section 1.2. ***Program Data***. (a) Jethro has entered into a Seismic Contract with Flat & Scruggs Seismic Company ("F&S Seismic") dated January 15, 2007 (the "Seismic Contract"), under the terms of which F&S Seismic has agreed to conduct a three-dimensional geophysical survey (the "Geophysical Survey") across the Program Area. The technical parameters of the Geophysical Survey are set out on Exhibit D hereto. Each Participant acknowledges receipt of a copy of the Seismic Contract and severally agrees (to the extent of its Participation Interest only) to be bound by the terms and conditions of the Seismic Contract. All data, including tapes, discs, surveying maps, and other reproducibles, resulting from the Geophysical Survey shall be hereinafter collectively referred to as the "Program Data".

(b) **JETHRO MAKES NO REPRESENTATION OR WARRANTY OF ANY KIND AS TO THE PROGRAM DATA INCLUDING, WITHOUT LIMITATION, ANY WARRANTY OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE OR ACCURACY AND JETHRO HEREBY DISCLAIMS ANY AND ALL SUCH REPRESENTATIONS AND WARRANTIES. NEITHER JETHRO NOR ITS SUCCESSORS OR ASSIGNS SHALL BE LIABLE OR RESPONSIBLE TO THE PARTICIPANTS FOR ANY LOSS, COST, DAMAGE OR EXPENSE OF WHATSOEVER NATURE, INCLUDING INCIDENTAL OR CONSEQUENTIAL DAMAGES, INCURRED OR SUSTAINED AS A RESULT OF THE USE OF OR RELIANCE UPON THE PROGRAM DATA.**

Section 1.3. ***Ownership of Data***. (a) The Program Data shall be owned jointly by the Parties in accordance with their respective Participation Interests. Each Party shall receive one U.S.T. 8mm cartridge, one load sheet, one color fold map and two color shot point maps of the processed data within ten (10) days after Jethro's receipt of the final brute stack, and one U.S.T. 8mm cartridge of the processed data within ten (10) days after Jethro's receipt of post-stack and pre-stack migration iterations. Copies of the final surveying map, observer notes (in an Excel spreadsheet format) and field tapes will be forwarded on a request basis only with each requesting Party being responsible for any and all reproduction and other costs associated with the same.

(b) Each Party shall have the right to use the Program Data in connection with the joint exploration and development of the Program Area. Except as provided in Section 1.3(c) below, no Party shall have the right to sell, trade, share or exchange the Program Data for a period of five (5) years from the effective date of this Agreement without the prior written consent of all the Parties. Any proceeds or other economic benefit resulting from any sale, trade, sharing or exchange of the Program Data during such five (5) year period (specifically

excluding, however, any proceeds or other economic benefit resulting from a permitted disclosure under Section 1.3(c) below) shall be divided among the Parties in accordance with their Participation Interests.

(c) Each Party may disclose the Program Data (i) to third parties in connection with bona fide negotiations with such parties interested in entering into farmout or farm-in agreements covering all or a portion of the Program Area, (ii) to third parties interested in entering into agreements to purchase all or a portion of a Party's Participation Interest or otherwise participate in the exploration and/or development of all or a portion of the Program Area, (iii) to consultants retained by a Party to evaluate the Program Data, (iv) to third parties having any existing contractual right to obtain or review such Program Data (or interpretations thereof), (v) to third parties in connection with bona fide negotiations with a Party for the sale of substantially all the assets of or the merger or consolidation of such Party to/with any such third parties and (vi) as required by law. All third parties to which the Program Data is to be disclosed prior to the expiration of the five (5) year period described in Section 1.3(b) above shall first execute a Confidentiality and Non-Circumvention Agreement substantially in the form attached hereto as Exhibit E.

Section 1.4. ***Payments for Geophysical Costs***. (a) Jethro has previously incurred and will continue to incur certain costs in connection with the conduct of the Geophysical Survey. All such costs (collectively, the "Geophysical Costs") shall be borne and paid by the Parties in accordance with their respective Participation Interests. The Geophysical Costs shall include, but not be limited to, those costs associated with 3-D seismic permitting, surface damages, data acquisition, initial processing and reproduction, but shall specifically exclude interpretation costs. For purposes hereof, "initial processing" shall mean such processing that is required in order for Jethro to deliver the final stack and migrated processed sections to each Participant as more particularly described in Section 1.3(a) above (the "Final Stack and Migration Data").

(b) Contemporaneously with the execution of this Agreement, Participants shall reimburse Jethro for their respective Participation Interest percentage of those Geophysical Costs incurred through January 1, 2007. Thereafter, Jethro shall submit billings monthly to each Participant for all additional Geophysical Costs incurred in connection with the conduct of the Geophysical Survey. To the extent billings for Geophysical Costs include third party charges, Jethro shall supply copies of invoices (or other support) for such third party charges and indicate its approval of such charges. Each Participant shall, except as otherwise provided for herein, pay Jethro its proportionate share of such costs within thirty (30) days of billing. A Participant may withhold that portion of any invoice about which there is a bona fide dispute, but shall pay all other amounts described therein. If Jethro does not receive full payment from a Participant within thirty (30) days of billing, it shall deliver a notice of such failure to pay (a "Late Payment Notice") to the nonpaying Participant in the manner described in Section 7.4 hereof. Furthermore, if payment is not made within such 30-day period, the unpaid balance shall bear interest monthly at the lesser of (i) the prime rate in effect at JPMorgan Chase Bank, New York, on the first day of the month in which delinquency occurs plus 4% or (ii) the maximum lawful nonusurious rate of interest that may be charged under applicable law. Upon giving a Late

Payment Notice, Jethro may withhold copies of the Program Data from such nonpaying Participant until such time as full payment (including all accrued interest) is received by Jethro from such nonpaying Participant.

(c) If any Participant fails to pay the full amount due within ten (10) days of receiving a Late Payment Notice, the nonpaying Participant shall not be entitled to participate further in the Program Area until all unpaid amounts (including all accrued interest) are paid in full. During the period that the nonpaying Participant is not entitled to participate further in the Program Area, the nonpaying Participant shall be deemed to be a nonconsenting Party to all proposals made during such period.

(d) Notwithstanding the foregoing, if a Participant (a "Withholding Participant") withholds a portion of an invoice about which there is a bona fide dispute (the "Disputed Amount"), during the pendency of such dispute, the provisions of Sections 1.4(b) and (c) above shall not be applicable to the Disputed Amount. To the extent it is determined that the Withholding Participant owes all or a portion of the Disputed Amount, the Withholding Participant shall promptly pay such portion of the Disputed Amount which is owed (the "Owed Funds") plus an amount equal to the interest that would have accrued on the Owed Funds pursuant to Section 1.4(b) above during the period commencing on the date the Owed Funds would have been due and payable but for the dispute and ending on the date on which the Owed Funds were actually paid.

ARTICLE II.

PROGRAM OPERATOR

Section 2.1. ***Designation of Operator***. Jethro shall act as operator for the Program Area ("Program Operator"), and in such capacity shall manage and be responsible for conducting, or supervising third parties in conducting, all activities on the Program Area as contemplated by the terms of this Agreement. In its capacity as Program Operator, Jethro shall be an independent contractor. Program Operator shall conduct its activities under this Agreement [*as a reasonable prudent operator*,] in a good and workmanlike manner, with due diligence and dispatch, and in compliance with all applicable laws and regulations, but in no event shall Jethro have any liability to the other Parties as Program Operator for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

Section 2.2. ***Resignation or Removal***. Program Operator may resign at any time by giving written notice thereof to each Participant. If Program Operator terminates its legal existence, no longer owns a Participation Interest in the Program Area of at least 25%, or is no longer capable of serving as Program Operator, Program Operator shall be deemed to have resigned without any action by the Participants, except the selection of a successor. Program Operator may be removed for good cause by the affirmative vote of one or more Participant(s) owning a majority of the Participation Interests remaining after excluding the Participation Interest of Program Operator, provided that such vote shall not be deemed effective until (i) a

written notice has been delivered to Program Operator detailing the alleged default and (ii) Program Operator has failed to cure such default within thirty (30) days from its receipt of such written notice. For purposes hereof, "good cause" shall mean (i) the gross negligence or willful misconduct of Program Operator, (ii) the material breach of or inability to meet the standards of operation contained in Section 2.1 above, or (iii) the failure or inability of Program Operator to perform its obligations under this Agreement.

Section 2.3. ***Successor Program Operator***. Upon the resignation or removal of Program Operator under any provision of this Agreement, a successor Program Operator shall be selected by the Parties. The successor Program Operator must own at least a 25% Participation Interest in the Program Area and shall be selected from the Parties owning an interest in the Program Area at the time such successor is selected. The successor Program Operator shall be selected by the affirmative vote of two (2) or more Parties owning a majority Participation Interest; provided however, if a Program Operator which has been removed or is deemed to have resigned fails to vote or votes only to succeed itself, the successor Program Operator shall be selected by the affirmative vote of one or more Participant(s) owning a majority Participation Interest remaining after excluding the voting Participation Interest of the Program Operator that was removed or resigned. The former Program Operator shall promptly deliver to the successor Program Operator all records and data relating to the operations conducted by the former Program Operator. Any cost of obtaining or copying the former Program Operator's records and data shall be charged to the joint account of all the Parties.

Section 2.4. ***Program Area Expenses***. Program Operator shall promptly pay and discharge all expenses incurred in the operation of the Program Area and charge each of the Parties hereto with their respective Participation Interest shares of all such expenses. Program Operator shall also pay, or cause to be paid, as and when they become due and payable, all accounts of contractors and suppliers for services performed and for materials supplied on, to or in respect of the Program Area or any operations for the joint account thereof, and shall keep the Program Area free from liens and encumbrances resulting therefrom, except for those resulting from a bona fide dispute. Program Operator shall have the right, at any time and from time to time, to require each Participant to pay in advance its Participation Interest share of the estimated cost of conducting operations on the Program Area during the succeeding calendar month. Each Participant shall advance its share of such estimated costs within fifteen (15) days of receipt of a request for payment from Program Operator.

Section 2.5. ***Advancing of Funds***. All funds advanced to Program Operator shall be held for the account of the advancing Party and such funds shall remain the funds of the advancing Party until used for their intended purpose or otherwise delivered to the advancing Party. Nothing in this paragraph shall be construed to establish a fiduciary relationship between Program Operator and the other Parties for any purpose other than to account for funds of the other Parties as herein provided. Nothing in this paragraph shall require the maintenance by Program Operator of separate accounts for the funds of the other Parties.

ARTICLE III.

PROGRAM AREA OPERATIONS

Section 3.1. ***Area of Mutual Interest***. The Parties hereby establish an area of mutual interest that shall encompass all of the lands located within the Program Area. The area of mutual interest shall remain in force for a period of five (5) years from the effective date of this Agreement (the "AMI Term"), unless sooner terminated by mutual agreement of the Parties.

Section 3.2. ***Existing Land Agreements***. Program Operator and Drysdale have each expended certain sums, including bonus consideration, paid-up delay rentals, option payments, legal fees, brokerage payments, recording fees and related expenses in connection with the acquisition of the Existing Land Agreements (collectively, the "Land Costs"). All such Land Costs shall be borne and paid by the Parties in accordance with their respective Participation Interests. Contemporaneously with the execution of this Agreement, each Participant shall pay to Program Operator the amount that is required to cause each Party to pay its Participation Interest percentage of the Land Costs (the "Reimbursement Amount"). Upon receipt of the Reimbursement Amount, Program Operator and Drysdale shall assign to each other Party its respective Participation Interest in and to the Existing Land Agreements.

Section 3.3. ***Participation in Acquired Interests***. (a) If at any time during the AMI Term, a Party should acquire (other than from another Party hereto) an interest in (i) an Additional Land Agreement covering lands any part of which are located within the Program Area, (ii) any other oil and gas interest within the Program Area, including, but not limited to, a royalty interest, overriding royalty interest, fee mineral interest, net profits interest, carried working interest or production payment, or (iii) any interest in a producing or producible well, injection well, disposal well, pipeline gathering system or production processing facilities, easement, right-of-way or surface use agreement affecting or within the Program Area (collectively, an "Acquired Interest"), such Party (the "Acquiring Party") shall provide written notice of such acquisition to the other Parties (the "Acquisition Notice") no later than ten (10) days following the date of such acquisition. Each Acquisition Notice shall specify the exact nature of the Acquired Interest, the consideration paid or to be paid for the Acquired Interest and any other obligations (including, without limitation, drilling obligations) undertaken or to be undertaken as a part of such acquisition. Each Acquisition Notice shall also include a copy of the acquisition agreement and all other instruments of acquisition, including, but not limited to, copies of the Additional Land Agreements, the assignments and all other agreements affecting the Acquired Interest. Within thirty (30) days after receipt of an Acquisition Notice, each of the Parties shall notify the Acquiring Party, in writing, whether or not such Party desires to participate for its Participation Interest percentage of such acquisition. The failure of a Party to respond within the time and in the manner set forth above shall be deemed to be an election not to participate in such acquisition. If less than all the Parties acquire their proportionate share of any Acquired Interest, the other Acquiring Parties shall have the option to (i) share the non-acquiring Party's interest pro rata or (ii) limit their participation in the Acquired Interest to their respective Participation Interest.

(b) If the Acquired Interest covers lands both within the Program Area (the "Inside Acreage") and outside the Program Area (the "Outside Acreage"), the Acquiring Party shall offer each other Party that portion of the Acquired Interest that covers the Inside Acreage. If the Acquired Interest covers lands that are included within a "Prospect Area" (as defined in Section 4.1 below), that portion of the Acquired Interest that covers Prospect Area acreage shall be offered only to those Parties participating in such Prospect Area pursuant to the terms of the Operating Agreement for such Prospect Area.

(c) Should a Party elect to participate in the acquisition of an Acquired Interest, such Party shall (i) pay (or to the extent not yet due, agree to pay when due) its proportionate part of the direct costs incurred by the Acquiring Party in making such acquisition and (ii) agree to assume its proportionate part of any other obligations which are undertaken as part of such acquisition (all such direct costs and obligations being hereinafter collectively called the "Acquisition Costs"). Within thirty (30) days following the Acquiring Party's receipt of such payment from a participating Party, the Acquiring Party shall assign to such participating Party its proportionate part of the Acquired Interest. The Acquisition Costs for an Acquired Interest that includes both Inside Acreage and Outside Acreage shall be allocated between the Inside Acreage and the Outside Acreage on the basis that the amount of acreage contained within the Inside Acreage (or the Outside Acreage, as the case may be) bears to the total amount of acreage included within the entire Acquired Interest.

(d) If, after electing to participate in the acquisition of an Acquired Interest, a Party fails to pay its proportionate share of the Acquisition Costs within thirty (30) days of receipt of an invoice therefor, such Party shall be deemed to have elected not to participate in such acquisition.

(e) The only effect under the terms of this Agreement of an election (or a deemed election) by a Party not to participate in the acquisition of an Acquired Interest shall be the loss by that Party of any rights or interest in such acquisition.

Section 3.4. ***Exercise of Options***. (a) If at any time, and from time to time, Program Operator shall propose to exercise one or more Existing Options or Additional Options (collectively, the "Options") with respect to some or all of the lands covered thereby, Program Operator shall notify the other Parties owning an interest in such Options in the same manner provided for in Section 3.3 above with respect to acquisitions of Acquired Interests. Each such other Party shall elect to participate or not participate in the exercise of such Options in the same manner as provided in such Section 3.3 with respect to elections to participate or not participate in the acquisition of Acquired Interests. The effect of elections to participate or not participate in the exercise of an Option, and the payment of costs and the ownership of interests in the Lease(s) acquired pursuant to such exercise, shall be handled in the same manner as provided in Section 3.3 with respect to elections to participate or not participate in acquisitions of Acquired Interests, except that if the Lease(s) acquired pursuant to such exercise covers lands outside the Program

Area, all Parties participating in such exercise shall nevertheless acquire their interest in the entirety of the Lease(s) and pay their part of all costs of exercising the Option(s).

(b) If an Option provides for specific lease acreage requirements, the Parties agree to comply with such terms. If an Option has no acreage requirements, any Party may elect to exercise such Option for more or less acreage than that proposed by Program Operator. In the event a Party elects to exercise an Option as to less than its proportionate share of the acreage proposed by Program Operator, the other exercising Parties shall have the opportunity to divide the remaining interest on a pro rata basis. If such remaining interest is not all divided on a pro rata basis, such remaining interests may be divided among the Parties by mutual agreement. If such remaining interest is not completely distributed among the exercising Parties, the applicable Option will not be exercised.

Section 3.5. ***Rentals, Shut-in Well Payments and Minimum Royalties***. (a) During the period that the Existing Leases and the Additional Leases (collectively, the "Leases") are not subject to an Operating Agreement that is executed pursuant to this Agreement, Program Operator shall pay all delay rentals which may be required under the terms of such Leases. Program Operator shall submit a rental recommendation letter for each delay rental payment which shall set forth Program Operator's recommendation as to which delay rental payments should be made and which delay rental payments should not be made. Each such recommendation letter shall be submitted to the other Parties at least sixty (60) days prior to the applicable payment date.

(b) Each rental recommendation letter shall be considered an invoice for delay rentals. Each Participant shall pay to Program Operator its proportionate share of any delay rental payment within thirty (30) days of receipt of the applicable rental recommendation letter. If Program Operator does not receive full payment within such thirty (30) day period, Program Operator shall deliver a notice of failure to pay to such nonpaying Participant in accordance with Section 7.4 below (the "Relinquishment Notice"). Failure of a Participant to tender its proportionate share of the delay rentals within five (5) business days of receiving a Relinquishment Notice (the "Response Period") shall constitute an election by that Participant to relinquish its share of the Lease or Leases covered by such delay rental payment. The Parties who have tendered their delay rentals shall have the opportunity to share the relinquishing Participant's interest on a pro rata basis. If they fail to share all the relinquishing Participant's share on a pro rata basis, they may divide the interest of the relinquishing Participant by mutual agreement. If the Parties who have tendered their delay rentals do not elect to share all the relinquishing Participant's interest within ten (10) days of the expiration of the Response Period, the delay rentals will not be paid and the applicable Lease or Leases will be allowed to expire.

(c) If Program Operator's recommendation letter recommends that a certain delay rental payment not be paid and any Participant desires that such payment be made, such Participant must provide written notice of such desire to Program Operator within fifteen (15) days of the Participant's receipt of Program Operator's recommendation letter. Promptly following Program Operator's receipt of such notice, Program Operator shall submit

Participant's recommendation (the "Participant Recommendation") to the remaining Parties, and the provisions of subsection (b) shall apply to the Participant Recommendation in the same manner as if Program Operator had initially sent a recommendation letter in favor of paying such delay rental payment.

(d) Program Operator shall diligently attempt to make proper payment of delay rentals, but shall not be held liable in damages for the loss of any Lease or interest therein, if through mistake or oversight any rental is not paid or is erroneously paid. The loss of any Lease or interest therein which results from a failure to pay or from an erroneous payment shall be a joint loss and there shall be no readjustment of interests in the remaining portion of the Program Area. If any Party secures a new Lease or Leases covering the terminated interest, such acquisition shall be subject to Section 3.3 above.

(e) All shut-in well payments and minimum royalties shall be governed by the applicable provisions of the Operating Agreement for each Prospect Area that is formed pursuant to Section 4.1 below.

Section 3.6. ***Title to Land Agreements/Records***. Title to all Land Agreements may be acquired and remain, until assigned, in the name of the Party acquiring same, it being understood, however, that Program Operator shall have direct supervision of all acquisitions within the Program Area and the Parties shall coordinate all of their leasing activities within the Program Area through Program Operator. Subject to the provisions of Sections 4.8 and 7.3 hereof, each of the Parties not in default under the terms of this Agreement shall have the right to receive copies of any and all Land Agreement files, title information and other relevant data in a Party's possession ("Records"), so long as such Party owns an interest in the area to which such Records relate. Due to the volume of the Records, reproduction costs shall be borne by the Party receiving said copies.

ARTICLE IV.

PROSPECTS AND TEST WELLS

Section 4.1. ***Prospect Areas and Test Wells***. For purposes hereof, a "Prospect Area" means an area that appears to be prospective for oil and/or gas exploration, as defined by subsurface structures, faults, water contacts and other productive limits of the target area identified by the Parties. Unless otherwise agreed by all the Parties, each Prospect Area shall contain no more than [*1,920*] contiguous surface acres and shall be limited to those depths from the surface to the base of the deepest objective formation in the Prospect Area. The term "Test Well" shall mean the initial well that is to be drilled to test a proposed Prospect Area.

Section 4.2. ***Initial Prospect Meeting***. Not less than thirty (30) days and not more than sixty (60) days after Program Operator has delivered copies of the Final Stack and Migration Data to each Participant, Program Operator shall convene an initial meeting of the Parties (the "Initial Meeting"). The purpose of the Initial Meeting shall be to allow the Parties to present and

discuss their preliminary interpretation of the Program Data and begin delineating prospects for the exploration of the Program Area. After the Initial Meeting, the Parties shall meet no less often than [*monthly/quarterly*] to: (i) update each other on their respective interpretations of the Program Data, (ii) further delineate prospects and/or propose modifications to earlier proposed prospects, (iii) discuss budgets and schedules for drilling wells, and (iv) discuss all other matters relevant to the Program Area.

Section 4.3. ***Prospect Area and Test Well Proposals***. (a) At any time after fifteen (15) days following the Initial Meeting, any Party may propose one or more Test Wells within the Program Area by written notice to the other Parties (a "Well Proposal"). Each Well Proposal shall be dated and include, at a minimum, the following:

(1) the surface location, bottom hole location, and proposed well and casing program for such Test Well;

(2) the proposed objective formation(s) to be tested;

(3) a map which depicts the outline of the lands to be included within (i) the proposed Prospect Area and (ii) the proposed "Minimum Required Acreage" (hereinafter defined) for such Test Well, along with a written description of both the Prospect Area and the Minimum Required Acreage that follows applicable lease lines, section lines or other legally identifiable boundary lines. Except as otherwise provided in Section 4.6 below, a proposed Prospect Area shall not include any lands within a previously designated and approved Prospect Area;

(4) geophysical structure maps (in time and/or depth) that are generated on a work station and that depict the deepest objective horizon and any other prospective formations, with interpreted faults, water contacts, shale barriers or other reservoir boundaries included, along with the location (both surface and subsurface) of any wells in the vicinity of the Prospect Area that have penetrated such formation(s);

(5) log(s) or log cross-section(s) from nearby wells depicting the prospective formations;

(6) a topographic map of the lands to be included within the proposed Prospect Area;

(7) any interpretative data upon which the Well Proposal is based, including any related information and/or data in the possession of the proposing Party;

(8) an itemized estimate of the drilling and completion cost of the Test Well; and

(9) if the proposed Prospect Area includes acreage not then under lease, the estimated cost of acquiring such acreage, or the anticipated terms of any Additional Land Agreement that is required.

For purposes of this Agreement, the term "Minimum Required Acreage" shall mean that portion of the Prospect Area that is required to be under lease in order to have a legal location for drilling the proposed Test Well. If the Parties cannot agree upon the boundaries of the Minimum Required Acreage, it shall be determined by two (2) or more Parties comprising a majority in interest of the Parties entitled to participate in such Prospect Area.

(b) Each nonproposing Party shall have thirty (30) days after receipt of each such Well Proposal within which to give Program Operator written notice that such nonproposing Party has elected to either:

(1) participate in the drilling of the proposed Test Well as to all depths;

(2) propose an alternative Test Well within the originally proposed Prospect Area and/or an alternatively proposed Prospect Area by providing all the other Parties with an appropriate Well Proposal (containing all the information described in Section 4.3(a)) for such alternative Test Well;

[*(3) participate in the drilling of the Test Well, but limited to all depths at or above 100 feet below the stratigraphic equivalent of the base of the deepest formation in which such Party elects to participate (the "Depth Limit"), as specified by such Party in its written notice to Program Operator*;] or

(4) not participate in the drilling of the Test Well.

Failure to respond to the Well Proposal within such thirty (30) day period shall be considered an election not to participate in the drilling of the Test Well under Section 4.3(b)(4). In the event a Party elects not to participate in the Test Well as proposed but proposes an alternative Test Well and/or an alternative Prospect Area which covers all or a portion of the originally proposed Prospect Area, within thirty (30) days following each Party's receipt of the alternative Well Proposal, two (2) or more Parties comprising a majority in interest of the Parties entitled to participate in the Prospect Area shall decide which Test Well is to be drilled and/or which Prospect Area is to be designated. Once it is determined which Test Well is to be drilled and which Prospect Area is to be designated, the Party or Parties that made the unsuccessful Well Proposal shall have ten (10) days thereafter in which to make an election under subparagraphs (1), (3) or (4) of Section 4.3(b) above with respect to the Test Well to be drilled.

Section 4.4. ***Participation in Test Wells/Prospect Areas***. (a) If [*two (2) or more Parties comprising*] a majority in interest of the Parties entitled to participate in a Prospect Area elect to drill a proposed Test Well, all operations on the Prospect Area established for such Test Well shall be governed by an operating agreement in the form attached hereto as Exhibit F (the

"Operating Agreement"), with the Test Well being the "Initial Well" thereunder. Appropriate insertions and exhibits reflecting the participation percentages and the agreements hereunder with respect to the exploration and development of the Prospect Area shall be included in the Operating Agreement, and this Agreement shall no longer have any application to such Prospect Area (with the Prospect Area being the Contract Area under the Operating Agreement), except (i) with respect to the ownership of Program Data under Section 1.3 above and (ii) for matters provided for in this Article IV or Article V. In the event of a conflict between the provisions identified in subclauses (i) and (ii) above (the "Applicable Provisions") and the provisions of the Operating Agreement, the Applicable Provisions shall control.

(b) An election not to participate in any part of the drilling of a proposed Test Well under Section 4.3(b)(4) above shall result in a forfeiture by the nonparticipating Party of all rights and interests such nonparticipating Party had in the Prospect Area for such Test Well (other than rights to related Program Data), including, without limitation, all rights and interests under Existing Land Agreements and Additional Land Agreements (collectively, the "Land Agreements"), insofar as they cover lands included within such Prospect Area (collectively, the "Released Interests"). The nonparticipating Party(ies) shall assign the Released Interests (with special warranty of title) to the Parties electing to participate in such Test Well in proportion to the percentages in which such participating Parties participate in such Test Well. A Party that elects not to participate in the Prospect Area shall have no right to participate in any subsequent wells drilled within such Prospect Area. Notwithstanding anything contained herein to the contrary, no forfeiture (whether of all rights in a Prospect Area or as to certain depths as provided in Section 4.4(c) below) of the rights of a nonparticipating Party shall occur unless the proposed Test Well (or any substitute well therefor) is actually drilled to its deepest objective formation.

(c) If an election is made by a Party not to participate in a Test Well below certain depths, as specified in Section 4.3(b)(3), the nonparticipating Party shall relinquish and assign to the Parties that participated in the drilling of such Test Well (in proportion to the percentages in which such participating Parties participate in such Test Well) all of such nonparticipating Party's rights and interests in and to the entire Prospect Area for such Test Well limited, however, to all depths and formations below the Depth Limit for the Test Well (collectively, the "Deep Formations"), it being agreed that the Depth Limit shall be determined from the logs of the Test Well. The assignment from the nonparticipating Party shall expressly reserve unto such nonparticipating Party all rights to those formations encountered in the Test Well above the Depth Limit (collectively, the "Shallow Formations"). Both the Deep Formations and the Shallow Formations shall be governed by a single Operating Agreement identifying the rights of the Parties to certain depths. A Party that elects to participate in only the Shallow Formations shall have no right to participate in any subsequent wells drilled to the Deep Formations within the Prospect Area. The drilling to, completion in and production from any Deep Formations shall have priority over completion and production of any Shallow Formation.

(d) The Operator under the Operating Agreement shall prepare and furnish to each Party participating in only the Shallow Formations (the "Shallow Participant") an AFE covering

the costs of drilling the Test Well to the Depth Limit. These costs shall include all costs and expenses reasonably determined by the Operator to be allocable to the drilling of the Test Well to the Depth Limit (collectively, the "Shallow Formation Costs"), including the cost of all surface and in-hole equipment associated therewith, without regard to whether or not such costs or expenses would have been incurred if the Test Well had only been proposed to be drilled to the Depth Limit. Each Shallow Participant shall tender the Operator its share of the Shallow Formation Costs in accordance with Article VII.C. of the Operating Agreement. If, however, the logs of any Shallow Formation indicate that a shallow completion attempt is warranted and such completion is precluded until some later date by a completion in the Deep Formations, the Operator shall refund to the Shallow Participant all of the Shallow Formation Costs it previously paid until such time as the Deep Formation(s) cease(s) to produce in commercial quantities in the Test Well and such Deep Formation(s) is (are) abandoned. Within five (5) days following the Shallow Participant's receipt of written notice from the Operator that such Deep Formation(s) has (have) been abandoned, the Shallow Participant shall pay the Shallow Formation Costs to the Operator. Upon final receipt of the Shallow Formation Costs, the Operator shall credit the joint account of each Party participating in the Deep Formations with each such Party's proportionate share of the Shallow Formation Costs (based on the percentages in which each such Party participated in the Deep Formations).

(e) If a Test Well is drilled to a Deep Formation and there are Shallow Participants in such Test Well, appropriate well cost adjustments shall be made between the Parties on the following basis: all costs attributable to drilling the Test Well to the Depth Limit (as described in Section 4.4(d) above), shall be borne by the Parties participating in the Shallow Formations; all costs attributable solely to the drilling of the Test Well below the Shallow Formations (including casing or other costs attributable solely to such deeper drilling) shall be borne by the Parties participating in the Deep Formations.

Section 4.5. ***Shallow Formations Proposal***. Any Party (including a Shallow Participant) may propose the drilling of a well within the Prospect Area to any objective formation located above the Depth Limit (a "Shallow Well"). Any Well Proposal for a Shallow Well shall be proposed under Article VI.B. of the Operating Agreement and must comply with the requirements of Section 4.3.(a) hereof.

Section 4.6. ***Initial Well in Prospect Area***. If actual drilling operations for a Test Well are not commenced within one hundred eighty (180) days after the Well Proposal for such Test Well is approved, then the Prospect Area for such Test Well shall be deemed to no longer exist and any Party may thereafter propose a new Test Well that includes all or any portion of such expired Prospect Area. In such case, the rights of the Parties as to such newly proposed Test Well (and its related Prospect Area) shall be as though the prior Prospect Area did not exist.

Section 4.7. ***Drilling Schedule***. There shall be no more than a total of [*two (2)*] Test Wells either proposed or being drilled at any one period of time, except as necessary to meet drilling deadlines under applicable Land Agreements. If more than one Test Well is proposed at one time, the participating Parties shall meet to design and agree upon a drilling program to

coordinate the Test Well proposals. The drilling program shall be determined by a majority in interest of the participating Parties.

Section 4.8. ***Additional Seismic Evaluation***. If two or more Parties representing [*75%*] of the Participation Interests in the Program Area consent to an AFE proposal for additional seismic acquisition or seismic processing work covering any portion of the Program Area not included within a Prospect Area, then each Party having the right to participate in such AFE proposal shall be bound by the terms thereof and shall be obligated to pay its proportionate share of the costs thereof as if it had consented to such proposal. If the requisite percentage of the Parties do not consent to an AFE proposal for such additional seismic acquisition or seismic processing work, and certain Parties decide to nevertheless conduct such activities at their own expense, the Parties who proceed with such activities shall not be obligated to share the results of such activities with the other Parties.

ARTICLE V.

PROSPECT AREA OPERATIONS

Section 5.1. ***Operator for Prospect Areas***. Program Operator shall be designated as operator of each Prospect Area in which it participates (the "Operator"). For any Prospect Area in which Program Operator does not participate, the Party that owns the largest interest in the Prospect Area that is prepared and qualified to operate by any regulatory agency having jurisdiction, shall be designated as Operator for such Prospect Area.

Section 5.2. ***Area of Mutual Interest for Prospect Areas***. (a) Commencing with the establishment of a Prospect Area, such Prospect Area shall no longer be subject to the area of mutual interest provisions provided for in Article III hereof and shall thereafter be considered covered instead by a new area of mutual interest provided for in the applicable Operating Agreement, which area of mutual interest shall be such Prospect Area. Any portion of the Program Area not designated as a Prospect Area shall continue to be subject to the area of mutual interest provisions provided for in Article III hereof.

(b) Any Party that does not participate in a Prospect Area hereby agrees that, for a period of five (5) years from the date of designation of such Prospect Area, such Party shall not acquire or attempt to acquire, either directly or indirectly, any Land Agreement or other interest described in Section 3.3 within the boundaries of such Prospect Area.

(c) It is recognized that certain of the Land Agreements may include the right on the part of the grantors to participate in the drilling of well(s) proposed to be drilled in any Prospect Area that includes their acreage, which participation may be limited to certain formations or depths included in such Prospect Area. The effect of any such participation shall be shared proportionately by the Parties participating in such Prospect Area.

Section 5.3. ***Exercise of Options and Acquisitions of Leases in Prospect Area***. (a) Each Option, to the extent it covers lands within a particular Prospect Area, may be exercised by the Operator of such Prospect Area, and the Leases acquired by such exercise shall be owned (and paid for) by the Parties participating in such Prospect Area in the proportions that they participate therein. It is recognized that some Options may have a limitation on the number of times they may be exercised and, in such event, several Prospect Areas may have to be combined in a single exercise of such an Option (and such exercise may have to be deferred until such a consolidated exercise is practical).

(b) If, prior to reaching the objective depth in the Initial Well on a Prospect Area, a Party that is a participant in such Prospect Area elects not to participate in the exercise of an Option or in the acquisition or maintenance of a Lease, such Party shall be deemed to have elected not to participate further in such Prospect Area. A Party deemed under this paragraph not to participate further in a Prospect Area shall continue to be bound by this Agreement, but shall automatically forfeit and assign all rights, titles and interests within the Prospect Area to the other Parties participating in such Prospect Area, which assignment shall be made free and clear of any burdens placed upon the interest of such non-participating Party. Any Party subject to such forfeiture and assignment shall not be entitled to compensation therefor. Such forfeited interests shall be assigned to the other Parties participating in such Prospect Area in the proportion that each participating Party's interest in such Prospect Area bears to the sum of the interests of all parties participating in such Prospect Area, provided that in no event shall a participating Party in a Prospect Area be required to participate for a percentage greater than the interest it owned as of the date of the exercise of the applicable Option. To the extent that any participating Party does not want to participate for a percentage greater than its then current interest in the Prospect Area, the forfeited interests shall be assigned to the other Parties participating in such Prospect Area in the proportion that such participating Parties otherwise agree.

(c) If, after the drilling of the Initial Well on a Prospect Area, a Party that is a participant in such Prospect Area elects not to participate in the exercise of an Option or in the acquisition or maintenance of a Lease to the extent it covers lands within such Prospect Area, the only effect of such election shall be the loss by that Party of all rights and interests acquired as a result of the exercise of such Option or through the acquisition or maintenance of such Lease, as the case may be.

ARTICLE VI.

AUDITS AND DISPUTE RESOLUTION

Section 6.1. ***Audits***. (a) Except as otherwise expressly provided herein, each Party shall, at such Party's sole risk and expense, have full access at all reasonable times to (i) all operations being conducted on the Program Area and (ii) the records of all such operations, including, but not limited to, the Program Operator's records of operations on the Program Area and each Operator's records of operations on each Prospect Area, to the extent in each case that such Party is or was a participant in such operations or is otherwise entitled to such access under the terms of this Agreement.

(b) Each Party shall maintain a true and correct set of records pertaining to all activities relating to their performance under this Agreement, all of which records shall be retained for a period of not less than two (2) years after completion of performance under this Agreement. Subject to the provisions of Section 6.1(a) above, each Party shall have the right at any and all times during such two (2) year period to audit the other Parties' accounts and records hereunder. Any discrepancies found in such audits shall be promptly reconciled by the Parties in accordance with the procedures set forth in the form of Accounting Procedure attached to the Operating Agreement.

(c) Notwithstanding the retention period described in Section 6.1(b), all records maintained by any Party shall be retained for such longer period of time as may be required under applicable law to allow for audit of such records by the Internal Revenue Service, any state taxing agency and any other governmental agency having jurisdiction over the activities of the Parties.

Section 6.2. ***Mediation of Disputes***. Any dispute arising out of or relating to this Agreement that cannot be settled by good faith negotiation among or between the Parties shall be submitted to non-binding mediation. The Parties agree that no causes of action shall be filed regarding the matter in dispute prior to mediation. In the event the mediation is not successful, the Parties agree that no cause of action shall be filed regarding the matter in dispute until thirty (30) days after the mediation has terminated. The costs of mediation shall be shared equally among all Parties participating in the mediation.

ARTICLE VII.

MISCELLANEOUS

Section 7.1. ***Preferential Right to Purchase***. Should any Party desire to sell all or any part of its interests under this Agreement, or its rights and interests in the Program Area, it shall promptly give written notice to the other Parties (the "Pref Right Notice"), with full information concerning its proposed disposition, which shall include the name and address of the prospective transferee, the purchase price, a legal description sufficient to identify the interest(s) being sold

(the "Subject Interest"), and all other terms of the offer. The other Parties shall then have an optional prior right, for a period of thirty (30) days after the Pref Right Notice is delivered, to purchase the Subject Interest for the same consideration and on the same terms and conditions as the other Party proposes to sell the Subject Interest. If this optional right is exercised, the purchasing Parties shall share the Subject Interest in the proportions that the Participation Interest of each purchasing Party bears to the total Participation Interest of all purchasing Parties. However, there shall be no preferential right to purchase in those cases where any Party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or by sale of all or substantially all of its assets to any third party, or by transfer of its interests to an affiliate of such Party.

Section 7.2. ***Investor Qualifications***. Hathaway hereby represents to Jethro and Drysdale as follows:

(a) Both immediately prior to Jethro and Drysdale making an offer to sell and immediately prior to the sale of an interest in the Leases to Hathaway, Hathaway had such knowledge and experience in financial and business matters, particularly oil and gas matters, that allowed Hathaway to evaluate the merits and risks of this particular investment, and Hathaway is able to bear the economic risks of this investment. Hathaway hereby acknowledges that no assurances of profit and/or profitability of its investment in the Program Area have been made by Jethro or Drysdale. Hathaway realizes that this investment is very speculative and may result in the entire loss of said investment. Hathaway has substantial financial means, no need for liquidity of its investments, and can afford to lose substantially all or all of its investment herein.

(b) Hathaway has reviewed all documents and has received such information as Hathaway deemed necessary or advisable in order to make an informative decision relating to its investment and participation in the development of the Program Area. Jethro and Drysdale have made available to Hathaway or Hathaway's personal advisors the opportunity to obtain additional information to verify the accuracy of the information contained in this Agreement and to evaluate the merits and risks of this investment. In making its decision to invest in the Leases, Hathaway has not relied upon any oral representation by any representative of Jethro or Drysdale or anyone acting on their behalf. Neither Jethro nor Drysdale have made any representations, warranties or guarantees as to the accuracy or validity of the geological and/or geophysical information, interpretations or other information relating to the Leases or the Program Area. Hathaway has relied solely upon its own independent investigations in making a decision to purchase an interest in the Leases and participate in the development of the Program Area.

(c) Hathaway has had an opportunity to ask questions of and receive satisfactory answers from Jethro and Drysdale, and any person or persons acting on their behalf, concerning the terms and conditions of this investment, and all such questions have been answered to Hathaway's full satisfaction.

(d) No assurances are or have been made regarding the tax advantages which may inure to the benefit of Hathaway, nor have any assurances been made that existing tax laws and regulations will not be modified in the future, which could deny all or a portion of any tax benefits which may presently be available under existing tax laws and regulations. Hathaway acknowledges that it has been advised to satisfy itself as to the income and other tax consequences of its investment in the Leases and the Program Area by obtaining advice from its attorney, CPA or other tax counsel.

(e) Hathaway is aware that no federal or state agency has made any finding or determination as to the fairness of an investment in the Leases or the Program Area, nor any recommendation or endorsement with respect thereto. Hathaway acknowledges that in reliance upon its representations made herein, neither Jethro nor Drysdale has registered the fractional undivided interest made the subject hereof under the Securities Act of 1933, as amended (the "Act"), or under the securities laws of any state. Hathaway understands Jethro and Drysdale have no obligation to register such interest under the Act or under any state's securities laws in the future, and that in the absence of such registration, the interest may only be sold by Hathaway pursuant to an exemption from the registration requirements of applicable federal and state securities laws. Hathaway therefore warrants and represents that (i) Hathaway and each of Hathaway's members, partners, shareholders and/or investors is an "accredited investor", as such term is defined in Regulation D of the Act, and (ii) Hathaway is acquiring an interest in the Leases and the Program Area for its own account for use in Hathaway's trade or business, and not with a view toward or for sale in connection with any distribution thereof, nor with any present intention of making a distribution thereof within the meaning of the Act. Hathaway agrees to indemnify and hold Jethro and Drysdale harmless against all losses, costs, damages, liabilities and expenses of any nature arising out of or relating to the resale or distribution by Hathaway of any portion of its interest in derogation of these representations.

(f) Hathaway recognizes that its representations herein are material inducements to Jethro's and Drysdale's acceptance of Hathaway's purchase of said interest, and without such representations, Hathaway's purchase would not be accepted.

Section 7.3. ***Securities Disclaimer***. THIS EXPLORATION AGREEMENT HAS NOT BEEN FILED AND THE INTERESTS IN THE PROJECT DESCRIBED HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION (THE "COMMISSION") OR ANY OTHER STATE SECURITIES REGULATORY COMMISSION (THE "STATE AUTHORITIES") AND WILL NOT BE QUALIFIED FOR SALE IN ANY STATE OR TERRITORY OF THE UNITED STATES. THE INTEREST ACQUIRED BY THE PARTIES HEREUNDER MAY NOT BE SOLD, PLEDGED, HYPOTHECATED OR OTHERWISE TRANSFERRED AT ANY TIME EXCEPT PURSUANT TO EITHER AN EFFECTIVE REGISTRATION STATEMENT UNDER THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS, OR PURSUANT TO APPLICABLE EXEMPTIONS FROM

THE REGISTRATION PROVISIONS OF THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS. NEITHER THE COMMISSION NOR ANY STATE SECURITIES LAW ADMINISTRATOR HAS PASSED UPON, OR ENDORSED THE MERITS OF, THE LEASES OR THE PROJECT DESCRIBED HEREIN, OR THE ACCURACY OR ADEQUACY OF THE MATTERS DESCRIBED HEREIN. ANY REPRESENTATION CONTRARY TO THE ABOVE IS UNLAWFUL.

Section 7.4. ***Elections***. Each Party shall have the right to make separate and independent elections regarding all aspects of this Agreement including, but not limited to, elections relating to Acquired Interests and participation in Well Proposals.

Section 7.5. ***Assignments***. (a) Subject to Section 7.1 above, any Party may assign all or any part of its interest under the terms of this Agreement, provided that such assignment shall in no event relieve the assigning Party from any of its obligations hereunder. This Agreement shall be binding upon and inure to the benefit of the Parties hereto and their respective successors and assigns.

(b) If at any time the interest of an original Party is divided among and owned by three (3) or more co-owners, such co-owners must appoint a single trustee or agent with full authority to receive notices (including maps and data), approve expenditures, receive billings for and approve such parties' share of expenses, and to deal generally with, and with power to bind, the co-owners of such Party's interest within the scope of this Agreement.

(c) All assignments made among the Parties pursuant to the provisions of this Agreement (including Articles III and IV and this Section 7.5) shall be made free and clear of any and all charges, encumbrances and burdens of any kind or character placed thereon by the assigning Party and shall be made specifically subject to this Agreement. Furthermore, all such assignments shall be executed and delivered promptly, but in no event later than thirty (30) days after written request for such assignment is made by the Party or Parties entitled thereto.

Section 7.6. ***Notices***. All notices and other communications required or permitted under this Agreement shall be in writing and shall be delivered personally, by mail, telecopier or delivery service, to the addresses set forth opposite the signatures of the Parties below. All notices shall be considered delivered upon the date of receipt. Each Party may specify its proper address or any other post office address within the continental limits of the United States by giving notice to other Parties, in the manner provided in this section, at least ten (10) days prior to the effective date of such change of address.

Section 7.7. ***No Partnership***. The liabilities of the Parties hereunder shall be several, not joint or collective. It is not the intention of the Parties to create, nor shall this Agreement be construed as creating, a mining or other partnership or association or to render the Parties liable as partners.

Section 7.8. ***Counterparts***. This Agreement may be executed in multiple counterparts, each of which shall be binding upon the signing Party or Parties thereto as fully as if all Parties had executed one instrument, and all of such counterparts shall constitute one and the same instrument. Execution of this Agreement via facsimile shall be effective, and signatures received via facsimile shall be binding upon the parties hereto and shall be effective as originals.

Section 7.9. ***Term***. Unless otherwise mutually agreed by the Parties hereto, this Agreement shall remain in effect for five (5) years from the date hereof and for so long thereafter as any Operating Agreement executed under the terms of this Agreement remains in effect.

Section 7.10. ***Exhibits***. All exhibits and schedules attached hereto are incorporated and made a part hereof as if they were set out verbatim in the body of this Agreement.

Section 7.11. ***Governing Law***. This Agreement and the transactions contemplated hereby shall be governed by, and construed in accordance with, the laws of the State of Texas, without regard for the provisions thereof relating to choice of law.

Section 7.12. ***Amendments***. This Agreement may not be amended nor any rights hereunder waived except by an instrument in writing signed by the Party to be charged with such amendment or waiver and delivered by such Party to the Party claiming the benefit of such amendment or waiver.

Section 7.13. ***Severability***. If any term or provision of this Agreement is determined to be invalid, illegal or incapable of being enforced in whole or in part by any rule of law or public policy, all other terms and provisions of this Agreement shall nevertheless remain in full force and effect.

Section 7.14. ***Headings***. The headings of the articles and sections of this Agreement are for guidance and convenience of reference only and shall not limit or otherwise affect any of the terms or provisions of this Agreement.

Section 7.15. ***Parties in Interest***. Except as expressly stated herein, nothing contained in this Agreement is intended to confer any benefits, rights or remedies upon any person or entity other than the Parties hereto.

IN WITNESS WHEREOF, this Agreement is executed by the Parties on the date set forth above.

ADDRESS	PARTY
1234 Alamo Street Suite 1500 Houston, Texas 77002 Attention: Jethro Bodine, President Fax: 713-212-1234 Phone: 713-212-3456	JETHRO EXPLORATION COMPANY By: _____ Name: _____ Title: _____
	"Program Operator"
3456 Travis Street Suite 4900 Dallas, Texas 75203 Attention: Wilburn Drysdale, President Fax: 214-848-1234 Phone: 214-848-3456	DRYSDALE EXPLORATION COMPANY By: _____ Name: _____ Title: _____
789 Washington Street Suite 200 Houston, Texas 77032 Attention: Jane Hathaway, President Fax: 713-281-1234 Phone: 713-281-3456	HATHAWAY ENERGY, LLC By: _____ Name: _____ Title: _____
	"Participants"

SCHEDULE 1

DEFINED TERMS

"Acquired Interest" defined in Article III, Section 3.3(a).

"Acquiring Party" defined in Article III, Section 3.3(a).

"Acquisition Costs" defined in Article III, Section 3.3(c).

"Acquisition Notice" defined in Article III, Section 3.3(a).

"Additional Farmouts" defined in recitals.

"Additional Land Agreements" defined in recitals.

"Additional Leases" defined in recitals.

"Additional Options" defined in recitals.

"Agreement" defined in introductory paragraph.

"AMI Term" defined in Article III, Section 3.1.

"Applicable Provisions" defined in Article IV, Section 4.4(a).

"Deep Formations" defined in Article IV, Section 4.4(c).

"Depth Limit" defined in Article IV, Section 4.3(b)(3).

"Disputed Amount" defined in Article I, Section 1.4(d).

"Existing Farmouts" defined in recitals.

"Existing Land Agreements" defined in recitals.

"Existing Leases" defined in recitals.

"Existing Options" defined in recitals.

"F&S Seismic" defined in Article I, Section 1.2(a).

"Final Stack and Migration Data" defined in Article I, Section 1.4(a).

“Geophysical Costs” defined in Article I, Section 1.4(a).

“Geophysical Survey” defined in Article I, Section 1.2(a).

“Good Cause” defined in Article II, Section 2.2.

“Initial Processing” defined in Article I, Section 1.4(a).

“Initial Meeting” defined in Article IV, Section 4.2.

“Inside Acreage” defined in Article III, Section 3.3(b).

“Land Agreements” defined in Article IV, Section 4.4(b).

“Land Costs” defined in Article III, Section 3.2.

“Late Payment Notice” defined in Article I, Section 1.4(b).

“Leases” defined in Article III, Section 3.5(a).

“Minimum Required Acreage” defined in Article IV, Section 4.3(a).

“Operating Agreement” defined in Article IV, Section 4.4(a).

“Operator” defined in Article V, Section 5.1.

“Options” defined in Article III, Section 3.4(a).

“Outside Acreage” defined in Article III, Section 3.3(b).

“Owed Funds” defined in Article I, Section 1.4(d).

“Participant Recommendation” defined in Article III, Section 3.5(c).

“Participants” defined in introductory paragraph.

“Participation Interests” defined in Article I, Section 1.1.

“Party or Parties” defined in introductory paragraph.

“Pref Right Notice” defined in Article VII, Section 7.1.

“Program Area” defined in recitals.

“Program Data” defined in Article I, Section 1.2(a).

“Program Operator” defined in Article II, Section 2.1.

“Prospect Area” defined in Article IV, Section 4.1.

“Records” defined in Article III, Section 3.6.

“Reimbursement Amount” defined in Article III, Section 3.2.

“Released Interests” defined in Article IV, Section 4.4(b).

“Relinquishment Notice” defined in Article III, Section 3.5(b).

“Response Period” defined in Article III, Section 3.5(b).

“Seismic Contract” defined in Article I, Section 1.2(a).

“Shallow Formation Costs” defined in Article IV, Section 4.4(d).

“Shallow Formations” defined in Article IV, Section 4.4(c).

“Shallow Participant” defined in Article IV, Section 4.4(d).

“Shallow Well” defined in Article IV, Section 4.5.

“Subject Interest” defined in Article VII, Section 7.1.

“Test Well” defined in Article IV, Section 4.1.

“Well Proposal” defined in Article IV, Section 4.3(a).

“Withholding Participant” defined in Article I, Section 1.4(d).

APPENDIX C

FARMOUT AGREEMENT

BETWEEN

JETHRO EXPLORATION COMPANY

AND

DRYSDALE EXPLORATION COMPANY

TABLE OF CONTENTS

FARMOUT AGREEMENT

This Farmout Agreement is entered into effective as of the 1st day of September, 2008 (this "Agreement"), by and between JETHRO EXPLORATION COMPANY, a Texas corporation ("Farmor"), and DRYSDALE EXPLORATION COMPANY, a Texas corporation ("Farmee").

W I T N E S S E T H:

WHEREAS, Farmor is the owner of an undivided fifty percent (50%) interest in and to those oil, gas and mineral leases more particularly described on Exhibit A attached hereto (collectively, the "Subject Leases"); and

WHEREAS, Farmee desires to drill one or more wells on the Subject Leases in search of oil and/or gas and earn one or more assignments of the "Subject Interests" (hereinafter defined); and

WHEREAS, Farmor is willing to grant Farmee the right to drill one or more wells on the Subject Leases and earn one or more assignments of the Subject Interests pursuant to the terms and conditions of this Agreement.

NOW, THEREFORE, KNOW ALL MEN BY THESE PRESENTS:

That, for and in consideration of the premises and the mutual covenants and agreements contained herein, Farmor and Farmee hereby agree as follows:

ARTICLE I
SUBJECT INTERESTS; WELL UNITS

1.1 **Definition of Subject Interests**. This Agreement shall cover all of Farmor's right, title and interest in and to the Subject Leases INSOFAR AND ONLY INSOFAR as the Subject Leases cover those formations located below the base of the Spiro Formation, which is defined for purposes of this Agreement as the stratigraphic equivalent to that point found at 10,700 feet logged depth in the Clampett #1 Well, located in the C. H. Travis Survey, A-37, Clampett County, Texas. The formations located below the base of the Spiro Formation are hereinafter collectively called the "Subject Intervals" and all of Farmor's right, title and interest in and to the Subject Leases, insofar and only insofar as they cover the Subject Intervals, is hereinafter called the "Subject Interests".

1.2 **Retained Intervals**. There is hereby excluded from this Agreement, and Farmor hereby reserves and retains unto itself, all of Farmor's right, title and interest in and to (i) the Subject Leases INSOFAR AND ONLY INSOFAR as the Subject Leases cover the Spiro Formation and all other formations situated above the base of the Spiro Formation (collectively, the "Retained Intervals"), (ii) all existing wells, well equipment, gathering facilities, rights of way, easements, permits, roads, electric lines and other surface facilities relating to Farmor's interest in the Retained Intervals, and (iii) all agreements relating to Farmor's interest in the Retained Intervals.

1.3 **Well Units**. As used in this Agreement, the term "Well Unit" shall mean a tract of land surrounding a well producing or capable of producing oil and/or gas in paying quantities and that consists of the total number of acres established by the spacing order or applicable field rules of the Texas Railroad Commission (or other governmental authority having jurisdiction) as the amount of acreage that must be included in the proration unit for such well in order for such well to receive or be assigned its maximum allowable amount of production. If no such spacing order or field rules have been issued, such tract of land shall consist of not more than 40 acres, plus a tolerance of 10%, if for the production of oil, and not more than 320 acres, plus a tolerance of 10%, if for the production of gas or gas and condensate. The acreage to be included in each Well Unit shall be selected by Farmee [*in as nearly square form as practicable and*] in conformity with any such spacing order or field rules.

1.4 **Warranties**. Farmor warrants to Farmee, as to matters arising by, through or under Farmor, that as of the date hereof and as of the date each "Partial Assignment" (hereinafter defined) is delivered to Farmee, Farmor is and will be vested with and shall have good and marketable title to the Subject Interests, free and clear of all liens and encumbrances other than the Permitted Encumbrances (as defined in the Partial Assignment). Further, Farmor represents and warrants that Farmor has not conveyed or contracted to convey, any of Farmor's right, title and interest in and to the Subject Leases to anyone other than Farmee, and Farmor has not created any overriding royalties, reversionary rights or similar burdens on the Subject Leases.

ARTICLE II
TEST WELL; SUBSEQUENT WELLS

2.1 **Test Well**. Farmee shall have the right, but not the obligation, to commence or caused to be commenced, on or before December 1, 2008, (the "Commencement Date"), actual drilling operations on a well (the "Test Well") in search of oil and/or gas at [*any legal location on the Subject Interests/at the location specified on Exhibit hereto*]. Thereafter, Farmee shall continue to drill the Test Well with due diligence and in a good and workmanlike manner to [*such depth within the Subject Intervals as Farmee, in its sole discretion, determines/the objective depth identified on Exhibit hereto (the "Objective Depth"); provided that Farmee shall not be precluded from drilling deeper than the Objective Depth*]. When Farmee has completed drilling operations on the Test Well, Farmee agrees that (i) if the Test Well can be completed at any depth within the Subject Intervals as a well capable of producing oil and/or gas in paying quantities (a "Commercial Well"), Farmee shall diligently prosecute the completion of the Test Well without unreasonable delays, or (ii) if the Test Well cannot be completed as a Commercial Well, Farmee shall plug and abandon the Test Well in accordance with the terms of the Subject Leases and all applicable laws and regulations. If Farmee does not commence, or cause to be commenced, the actual drilling of the Test Well prior to the Commencement Date, Farmee's right to earn Partial Assignments hereunder shall terminate and, except as otherwise expressly provided herein, neither party shall have any further rights or obligations hereunder.

2.2 **Continuous Development Rights**. (a) If Farmee completes the Test Well as a Commercial Well, or abandons the same as a dryhole in accordance with the terms hereof, Farmee

shall have the right to earn additional Partial Assignments of the Subject Interests by commencing or causing the commencement of actual drilling operations on additional wells situated on the Subject Interests [*or lands pooled therewith*] (individually, a "Subsequent Well" and collectively, the "Subsequent Wells") within ninety (90) days after the date of completion or abandonment of the Test Well or the immediately preceding Subsequent Well, as the case may be (the "Drilling Option Period"), all in accordance with the procedures and requirements applicable to the Test Well. The Test Well and the Subsequent Wells are sometimes hereinafter individually called a "Project Well" and collectively called the "Project Wells."

(b) If Farmee commences or causes the commencement of actual drilling operations on a Subsequent Well prior to the expiration of the Drilling Option Period for such Subsequent Well, the drilling of the next Subsequent Well under this continuous development program may be deferred for an additional period equal to the number of days that remain between the date that actual drilling operations commence on the previous Subsequent Well and the date the Drilling Option Period for such previous Subsequent Well would have otherwise expired. In no event, however, shall the cumulative amount of time that elapses between the completion or abandonment of any Subsequent Well and the commencement of actual drilling operations on the next Subsequent Well exceed one hundred twenty (120) days. For purposes of this Agreement, the date of completion of any Project Well as a Commercial Well shall be the earlier to occur of (i) the date on which the potential test for such Project Well is conducted pursuant to the rules and regulations of the Texas Railroad Commission, or (ii) thirty (30) days after the drilling rig is removed from the well site. The date of abandonment of any Project Well as a dry hole shall be the earlier to occur of (i) the date on which such Project Well is plugged, or (ii) thirty (30) days after the drilling rig is removed from the well site. "Commencement of actual drilling operations" shall mean the spudding of a new well or the reentry of an existing well with a rig sufficient to drill to the [*Subject Intervals/Objective Depth*].

(c) If Farmee fails to commence actual drilling operations on a Subsequent Well on or before the required commencement date therefor, or in the event Farmee fails to reasonably prosecute such drilling operations to the [*Subject Intervals/Objective Depth*], then Farmee's right to continue drilling Subsequent Wells and earn additional Partial Assignments of the Subject Interests shall automatically terminate.

2.3 **Substitute Well or Wells**. If, during the drilling of a Project Well, Farmee suffers mechanical difficulties or encounters an impenetrable formation, cavity, excessive pressure or water flow, loss of circulation or any other formation, substance or condition, similar or dissimilar, which cannot reasonably or economically be overcome by ordinary drilling methods, Farmee shall have the option, but not the obligation, within sixty (60) days following the cessation of drilling operations on such Project Well, to commence actual drilling operations on a substitute well, at any legal location on the Subject Interests [*no more than ___ feet from the location of the original Project Well*], and such substitute well, if drilled in the manner and to the depth herein required for the drilling of the original Project Well, shall be considered and treated for all purposes herein as though the same were the original Project Well. Farmee shall have the right to drill any number of substitute wells pursuant to the foregoing, each of which shall be considered and treated for all purposes hereof as though the same was the original Project Well for which such substitute well is being drilled; provided, however, not more than sixty (60) days shall elapse between the time

drilling operations for one substitute well are terminated and actual drilling operations on another substitute well have commenced.

2.4 **Surface Use Matters**. Farmee agrees to conduct its operations hereunder so as not to unreasonably interfere with Farmor's operations with respect to the Retained Intervals. Farmee further agrees that Farmee shall build and use only such roads as are reasonably necessary to conduct its operations hereunder. No later than thirty (30) days prior to the construction of any road or location, Farmee shall furnish to Farmor (i) a map or plat showing the proposed location thereof and (ii) an executed Road Use Agreement for such road (in the form attached hereto as Exhibit D), and Farmee shall consult with Farmor with respect to (i) above. Farmor shall execute and return the Road Use Agreement to Farmee within thirty (30) days of receipt thereof by Farmor. Farmor and its employees, agents, servants and assigns shall have the right in common with Farmee to use any such roads constructed by Farmee in such manner as not to interfere unreasonably with Farmee's operations. Likewise, Farmee and its employees, agents, servants and assigns shall have the right in common with Farmor to use any existing roads or any roads constructed by Farmor in such manner as not to interfere unreasonably with Farmor's operations. Farmor and Farmee agree to share the cost of maintaining any roads used in common by Farmor and Farmee (the "Common Roads") based on each party's respective usage of the Common Roads, as more particularly described in the Road Use Agreement.

2.5 **Indemnification of Farmor. FARMEE AGREES TO INDEMNIFY FARMOR AND SAVE AND HOLD FARMOR HARMLESS FROM AND AGAINST ANY AND ALL CLAIMS OF ANY CHARACTER RESULTING FROM OR ARISING OUT OF THE OPERATIONS CONDUCTED OR CAUSED OR PERMITTED TO BE CONDUCTED BY FARMEE PURSUANT TO THIS AGREEMENT. FARMEE, AT ITS OWN EXPENSE, SHALL DEFEND ANY SUIT OR ACTION BROUGHT AGAINST FARMOR BASED ON ANY SUCH CLAIMS, AND SHALL PAY ALL DAMAGES, COSTS AND EXPENSES, INCLUDING ATTORNEYS' FEES IN CONNECTION THEREWITH OR IN ANY MANNER RESULTING THEREFROM. IN THE EVENT FARMOR ELECTS TO CONVERT ITS "RETAINED OVERRIDE" (DEFINED BELOW) IN A PROJECT WELL TO AN "OPTIONAL WORKING INTEREST" (DEFINED BELOW) THEREIN, FARMEE'S INDEMNIFICATION OF FARMOR UNDER THIS SECTION 2.5 SHALL TERMINATE WITH RESPECT TO ALL OPERATIONS CONDUCTED ON THE WELL UNIT FOR SUCH PROJECT WELL FROM AND AFTER THE EFFECTIVE DATE OF SUCH CONVERSION.**

2.6 **Insurance**. Farmee covenants and agrees that Farmee and its contractors and subcontractors shall maintain the insurance coverages described on Exhibit D to the "Operating Agreement" (hereinafter defined) during the performance of all operations hereunder. All such insurance shall be carried with a company or companies reasonably satisfactory to Farmor, shall be endorsed to name Farmor as an additional insured party thereunder and shall provide for a waiver of subrogation in favor of Farmor. Prior to commencing any operations on the Subject Leases, Farmee shall furnish Farmor with certificates of insurance evidencing the coverages described above. Each such certificate shall reflect that Farmor shall be provided with at least sixty (60) days prior written notice of any material change or termination of any coverage described therein.

ARTICLE III
INTEREST TO BE EARNED

3.1 **Designation of Well Unit**. In the event a Project Well is drilled and completed as a Commercial Well, Farmee shall designate a Well Unit therefor. The location of a Project Well within the Well Unit shall comply with the then prevailing rules and regulations (or exceptions thereto) of the Texas Railroad Commission or other lawful governmental authority relative to well location and spacing. Farmee shall designate the Well Unit for each Project Well by executing and recording an instrument setting forth the location of the well, the completion date thereof, and a valid legal description of that portion of the Subject Leases to be included therein (the "Unit Designation"). Within ninety (90) days after the completion of each such Project Well, Farmee shall record the Unit Designation in the appropriate records of real property of Clampett County, Texas. A copy of each Unit Designation shall be mailed to Farmor within thirty (30) days after the date such Unit Designation is recorded.

3.2 **Partial Assignments**. If Farmee drills and completes a Project Well as a Commercial Well, and has complied with the provisions of Section 3.1 above, Farmee shall have earned the Subject Interests to the extent of the Well Unit for such Project Well, whereupon Farmor shall execute, acknowledge and deliver to Farmee a Partial Assignment of Oil, Gas and Mineral Leases in the form attached hereto as Exhibit B (the "Partial Assignment"). The Partial Assignment shall assign unto Farmee that portion of the Subject Interests that are included within such Well Unit, together with a like interest in the Project Well and all downhole, surface and other equipment (up to and including the wellhead check meter) associated with such Project Well (collectively, the "Assigned Interests"), but saving, excepting and reserving therefrom, a 3% of 8/8ths overriding royalty interest in and to all oil, gas and other hydrocarbons produced and saved from or attributable to the Assigned Interests (the "Retained ORRI"). The Retained ORRI shall be proportionately reduced in the event the entire working interest ownership in a Project Well is reduced because the Assigned Interests cover less than fifty percent (50%) of the entire leasehold working interest in such Project Well. The Retained ORRI shall not bear any of the costs of developing or operating the Subject Interests, but shall bear its proportionate share of ad valorem taxes, severance taxes and other taxes measured by production. Farmor shall have the option to take the Retained ORRI in kind.

3.3 **Farmor's Conversion Option**. (a) Upon "Payout" (as defined below) of each Project Well, Farmor shall have the right, but not the obligation, to convert the Retained ORRI to an undivided leasehold working interest (the "Optional Working Interest") equal to twenty-five percent (25%) of the Assigned Interests (i.e. twelve and one-half percent (12.5%) of the entire leasehold working interest in each Project Well). The Optional Working Interest shall be proportionately reduced in the event the entire working interest ownership in a Project Well is reduced because the Assigned Interests cover less than fifty percent (50%) of the entire leasehold working interest in such Project Well.

(b) Within sixty (60) days after completion of each Project Well, Farmee shall furnish Farmor with an itemized statement of the cumulative cost of drilling, testing, completing and equipping each such Project Well. In addition, promptly after the closing of the first calendar month

after the completion of a Project Well through and including the calendar month in which Payout occurs with respect to such Project Well, Farmee shall furnish Farmor with a statement setting forth (i) all operating costs incurred for such Project Well during such month, (ii) the cumulative cost of operating such Project Well during the Payout period and (iii) the current status of Payout for such Project Well. Each such statement shall also reflect the total volume of oil, gas and other hydrocarbon production from such Project Well, and the value received for such production before and after the payment of all taxes, royalties and other burdens allowed to be deducted in calculating Payout for such Project Well.

(c) Within thirty (30) days following Farmor's receipt of the itemized statement reflecting that Payout has occurred for a particular Project Well, Farmor shall notify Farmee in writing as to whether Farmor has elected to convert its Retained ORRI to an Optional Working Interest in such Project Well. The failure of Farmor to respond within such thirty (30) day period shall be deemed an election not to convert the Retained ORRI to an Optional Working Interest. At such time as an election is made (or is deemed made) by Farmor, Farmor and Farmee shall execute and deliver each to the other such instrument or instruments (in recordable form) as may be necessary or appropriate to set forth the respective interests in the Project Well that are then owned by Farmor and Farmee. Any election to convert a Retained ORRI to an Optional Working Interest shall be effective as of 7:00 a.m. local time on the first day of the month following the month in which Payout occurs.

3.4 **Payout**. As used herein, the term "Payout" shall mean the point in time when Farmee shall have recouped from the proceeds of oil, gas and/or other hydrocarbon production from a Project Well, after deducting (i) severance, production, windfall profit and other taxes payable on such share of production, and (ii) lessor's royalties, overriding royalties (including the Retained ORRI) and like burdens with which the Subject Interests are burdened as of the date hereof, an amount equal to the aggregate costs to Farmee of drilling, testing, completing and equipping such Project Well with necessary production equipment (including the installation of flow lines up to and including the wellhead check meter for such Project Well) and operating the same during the period of such recoupment. Payout shall be computed on a well by well basis in accordance with the terms of the Accounting Procedure attached as Exhibit C to the Operating Agreement.

ARTICLE IV
OPERATIONS

In the event Farmor elects to convert its Retained ORRI in a Project Well to an Optional Working Interest, all subsequent operations on the Well Unit for such Project Well shall be in accordance with the terms of the Operating Agreement attached hereto as Exhibit C (the "Operating Agreement"). If there are any conflicts between the terms of this Agreement and the terms of the Operating Agreement, the terms of this Agreement shall control.

ARTICLE V
LEASE MAINTENANCE

Farmor shall maintain the Subject Leases in full force and effect by the payment of delay rentals, minimum annual royalties, or any other lease maintenance payments that may come due under the terms of the Subject Leases. Farmor shall give written notice of any such payment to Farmee within thirty (30) days after any such payment is made. Farmee shall then have a period of thirty (30) days after receipt of such notice in which to elect to participate or not participate in the perpetuation of any such Subject Lease by reimbursing Farmor for fifty percent (50%) of such delay rentals, minimum annual royalties and other lease maintenance payments attributable to the Subject Interests. In the event that Farmee fails to make any such payment to Farmor within such thirty (30) day period, then the Subject Leases perpetuated by such payment shall no longer be subject to this Agreement. In the event that Farmor elects not to maintain any Subject Lease by the payment of delay rentals, minimum annual royalties or any other lease maintenance payments, Farmor shall give Farmee written notice thereof at least thirty (30) days prior to the date any such payment shall become due, and Farmee, at its sole election, may make any such payment, and thereafter, Farmor shall have no interest in any such Subject Lease. Farmor agrees to use reasonable care and diligence in making the payments described in this Article V, provided that Farmor shall incur no liability to Farmee for the failure to make any such payment, or any failure to make the same properly, timely, in the correct amount, to the proper party or otherwise, for whatever reason such failure may occur.

ARTICLE VI
OFFSET WELL OBLIGATION

If Farmor reasonably believes that the Subject Interests are being drained by a well drilled on lands other than lands covered by the Subject Leases or land pooled therewith (a "Draining Well"), Farmor may deliver written notice to Farmee requesting that Farmee drill a well on the Subject Interests off-setting the Draining Well (an "Offset Well"). If Farmee fails to commence the drilling of such Offset Well within ninety (90) days after receipt of such written notice from Farmor (the "Offset Period") and, within ninety (90) days after the expiration of the Offset Period, Farmor commences actual drilling operations on such Offset Well, then sufficient acreage for a Well Unit for such Offset Well shall be automatically released from the terms of this Agreement, insofar and only insofar as such Well Unit covers the formation(s) being drained by the Draining Well. If Farmor elects to drill such Offset Well, the same shall be drilled pursuant to the terms of the Existing Operating Agreement and Farmee shall be deemed to be a Nonconsenting Party under the Existing Operating Agreement with respect to the Offset Well.

ARTICLE VII
REASSIGNMENT OF SUBJECT INTERESTS

If production from any portion of the Subject Interests that is covered by a Partial Assignment (the "Affected Acreage") ceases under circumstances where such cessation of production will result in the termination of the interest of Farmor in the Affected Acreage unless additional drilling or reworking operations are conducted thereon or a shut-in well payment is made,

Farmee shall immediately provide Farmor written notice of such event, and with such notice, advise Farmor whether or not Farmee intends to attempt to reestablish production on or attributable to the Affected Acreage by additional drilling or reworking operations or to pay applicable shut-in well payments. If Farmee advises Farmor that it does not intend to reestablish production or to pay the applicable shut-in well payment, then at the request of Farmor, Farmee shall reassign to Farmor all of Farmee's right, title and interest in and to the Affected Acreage no later than ten (10) days following the date Farmee receives such reassignment request from Farmor. If Farmee advises Farmor that it intends to attempt such reestablishing of production but fails to commence additional drilling or reworking operations within _____ (__) days after the cessation of said production, then at the request of Farmor, Farmee shall reassign to Farmor all of Farmee's right, title and interest in and to the Affected Acreage no later than ten (10) days following the date that Farmee should have commenced such additional drilling or reworking operations. Should Farmee commence such additional drilling or reworking operations within _____ (__) days and if such operations fail to result in production from the Affected Acreage, or such operations cease for more than _____ (__) days, then at the request of Farmor, Farmee shall reassign within ten (10) days thereof all of Farmee's right, title and interest in and to the Affected Acreage. It is understood and agreed that should the Affected Acreage be reassigned to Farmor as herein provided, such assignment or assignments shall be warranted to be free and clear of all liens, claims and encumbrances created by or against Farmee and shall be free and clear of any overriding royalties, production payments and other similar burdens other than those burdens existing as of the time Farmor assigned same to Farmee. It is understood and agreed that the provisions for reassignment as contained in this Article VII shall continue to apply regardless of the number of times production from the Subject Interests may cease and thereafter be re-established by Farmee.

ARTICLE VIII
MISCELLANEOUS

8.1 **Access and Information**. During the drilling of all Project Wells, Farmee shall (i) permit Farmor's authorized representatives to have access to the rig floor at all reasonable times, at Farmor's sole risk and expense, (ii) furnish to Farmor at the address indicated in the notice provisions hereof, daily drilling reports covering the preceding 24 hours operations, and giving the depth drilled, formations penetrated and any shows of oil or gas encountered, (iii) provide Farmor with sufficient prior notice of any log being run, any core samples being taken or any drillstem or production test being made so that Farmor may have a representative present, and (iv) upon request by Farmor, furnish Farmor with a copy of core samples, results of drillstem tests and field prints of any and all logs or surveys which may be run or made during drilling of any and all Project Wells.

8.2 **Regulations and Agreements**. This Agreement is entered into subject to all applicable laws, rules, regulations and orders of all governmental authorities having jurisdiction over the Subject Interests and to all applicable provisions, conditions, covenants and obligations, express or implied, of the Subject Leases. Subject to the terms of this Agreement, Farmee assumes and agrees to fully comply with and timely perform each and every duty, obligation, covenant, provision and condition, both express and implied, arising under the Subject Leases and any intermediate assignments thereof (if any), to the extent the same are imposed upon the lessee and/or assignee thereunder.

8.3 **Confidentiality**. The parties agree that all geophysical, geological, engineering, technical, production test or other information obtained by Farmee with respect to all Project Wells drilled hereunder shall be the property of Farmee. All such information shall be maintained by Farmor as confidential information for a period of three (3) years from the date hereof, unless both parties agree in writing to a lesser period of time.

8.4 **Termination and Survival**. The failure of Farmee to commence the drilling of the Test Well as required under Section 2.1 above shall cause the forfeiture of all rights, privileges and benefits of Farmee hereunder without the necessity of any action or notice by Farmor, and Farmee shall not be entitled to any Partial Assignment hereunder. This Agreement shall survive Farmor's execution and delivery of any Partial Assignment(s) hereunder and shall be binding upon Farmor and Farmee and their respective successors and assigns.

8.5 **Approval of Assignment**. If a Partial Assignment of all or any part of the Subject Interests requires approval of any party who is not a party to this Agreement, including, but not limited to, any state or federal authority having jurisdiction, Farmor agrees to cooperate with Farmee in Farmee's efforts to obtain all such approvals. If any such approval cannot be obtained, Farmor and Farmee shall execute an instrument or instruments containing provisions reflecting the terms and conditions of this Agreement which, in all other respects, effectuate the provisions contained herein, but which do not violate any restrictions on assignment.

8.6 **Renewals, Extensions and Acquisitions**. If during the term of this Agreement, Farmor (i) renews or extends any of the Subject Leases, or (ii) acquires any oil or gas leasehold interest or the right to earn any such interest within the AMI (collectively, the "New Leases"), then all such renewals or extensions of the Subject Leases and all of Farmor's interest in any such New Leases shall be covered by this Agreement, insofar and only insofar as the same cover the Subject Intervals. For purposes of this Agreement, the term "AMI" shall mean the area outlined on Exhibit A to the that certain Exploration Agreement dated January 31, 2007 by and among Farmor, Farmee and Hathaway Energy, LLC.

8.7 **Force Majeure**. Should either party be prevented or hindered from complying with any obligation created hereunder, other than the obligation to pay money, by reason of fire, flood, storm, act of God, act of governmental authority, labor disputes, war, or any other cause not enumerated herein but which is beyond the reasonable control of the party whose performance is affected, then the performance of any such obligation shall be suspended during the period of such prevention or hindrance, provided the affected party exercises all reasonable diligence to remove the cause of force majeure. The requirement that any force majeure shall be remedied with all reasonable diligence shall not require the settlement of strikes, lockouts, or other labor difficulties by the party involved.

8.8 **Notices**. Any notice required or permitted to be given under or in connection with this Agreement shall be in writing and shall be mailed by postage prepaid certified mail, return receipt requested or sent by facsimile or other electronic transmission. No notice shall be deemed to have been given to a party until it is actually received by such party at the address set forth below or

until receipt of a facsimile or other electronic transmission. All such notices shall be mailed, sent or delivered to:

Farmor: _____
_____
_____

Farmee: _____
_____
_____

No change of address, facsimile number or email address shall become effective until written notice of such change shall have been given by the party desiring its address, facsimile number or e-mail address changed, and same has been received by the other party.

8.9 **Relationship of the Parties**. Each party shall have the right to take in kind and separately dispose of its share of production from the Subject Interests. The respective obligations and liabilities of the parties hereto shall be separate and each party shall be responsible only for its own obligations. It is not the purpose or intention of this Agreement to create, and this Agreement shall never be construed as creating, a joint venture, agency, general partnership, mining partnership or other relationship whereby either of the parties shall be liable for the acts, either of commission or omission, of the other party hereto.

8.10 **Income Tax Election**. **[Alternative A – No Tax Partnership]** If, for federal income tax purposes, this Agreement and the operations hereunder are regarded as a partnership, Farmor and Farmee each elects to be excluded from the application of the provisions of Subchapter "K", Chapter 1, Subtitle "A" of the Internal Revenue Code of 1986, as amended (the "Code"), as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Farmee, as Operator under the Operating Agreement, is authorized and directed to execute on behalf of Farmor and Farmee such evidence of this election as may be required. In addition, Farmor shall execute such documents and furnish such other evidence as may be required to reflect this election. In making the foregoing election, Farmor and Farmee each acknowledge that the income derived by each from the operations hereunder can be adequately determined without the computation of partnership taxable income. If the income tax laws of the state in which the Subject Interests are located contain, or may hereafter contain, provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A" of the Code, under which a similar election is permitted, Farmor and Farmee each agree that such election shall be made.

8.10 **Income Tax Election**. **[Alternative B – Tax Partnership]** Except as provided in the last sentence of this Section 8.10, for federal income tax purposes (and for purposes of those state income tax laws that follow federal income tax rules relating to tax partnerships), this Agreement and the operations hereunder shall be deemed a tax partnership. Therefore, unless the Test Well is determined not to be a Commercial Well before the date upon which the partnership return for the first taxable year of this tax partnership is due (including extensions thereof), then (i) neither Farmor nor Farmee shall elect to be excluded from the application of the provisions of

Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1986, as amended (the "Code") or any comparable provisions of any state income tax statutes that may be applicable, and (ii) the results of operations hereunder shall be reported as a partnership for federal and state income tax purposes only, which tax partnership shall be on the basis of the provisions contained in Exhibit G to the Operating Agreement. Farmor and Farmee each agree to execute such documents and elections as may be required to evidence the foregoing. If the Test Well is determined not to be a Commercial Well before the date upon which the partnership return for the first taxable year of this tax partnership is due (including extensions thereof), Farmor and Farmee shall make such election as is necessary to be excluded from the application of Subchapter "K", Chapter 1, Subtitle "A" of the Code and any comparable provisions of any state income tax statutes that may be applicable.

8.11 **Memorandum of Farmout Agreement**. Upon execution of this Agreement, Farmor and Farmee shall execute, acknowledge and deliver to each other a memorandum of this Agreement in the form of Exhibit E attached hereto (the "Memorandum"), which Memorandum shall be filed in the appropriate records of real property of Clampett County, Texas.

8.12 **Further Assurances**. Farmor and Farmee hereby agree to execute or perform, or cause to be executed or performed, any and all further documents and things which may be necessary or appropriate to give effect to this Agreement. Without limiting the generality of the foregoing, Farmor agrees, upon request from Farmee, to execute and deliver any and all Partial Assignments or other instruments, in recordable form, as may be necessary or appropriate to confirm title to the interests to be assigned to Farmee pursuant to the provisions of Section 3.2 hereof.

8.13 **Assignment**. The terms hereof shall be binding upon and shall inure to the benefit of Farmor and Farmee and their respective successors and assigns.

8.14 **Entire Agreement**. This Agreement and the Exhibits hereto embody the entire agreement between the parties and supersede any and all prior written or oral understandings or agreements relative to the subject matter hereof. No amendment, modification, extension or change to this Agreement shall be binding upon any party hereto unless and until a written instrument evidencing such amendment, modification, extension or change has been duly executed by a duly authorized representative of both parties.

8.15 **Captions**. Captions for the Sections in this Agreement are used only for identification purposes and shall have no effect upon the construction or interpretation of any part of this Agreement.

8.16 **Governing Law**. This Agreement shall be governed by, and construed and enforced in accordance with, the laws of the State of Texas, without regard to the conflicts of law provisions thereof.

8.17 **Time of the Essence**. Time is of the essence with respect to the performance of all provisions of this Agreement.

8.18 **Severability**. If any provision of this Agreement is held to be illegal, invalid or unenforceable under applicable law, such provision shall be fully severable; this Agreement shall be construed and enforced as if such illegal, invalid or unenforceable provision had never comprised a part hereof; and the remaining provisions hereof shall remain in full force and effect and shall not be affected by the illegal, invalid or unenforceable provision or by its severance herefrom. Furthermore, in lieu of such illegal, invalid or unenforceable provision, there shall be added automatically as part of this Agreement a provision as similar in terms to such illegal, invalid, or unenforceable provision as may be possible and be legal, valid and enforceable.

EXECUTED as of the date first above written.

JETHRO EXPLORATION COMPANY

Address:

1234 Alamo Street
Suite 1500
Houston, Texas 77002
Attention: Jethro Bodine, President
Fax: 713-212-1234
Phone: 713-212-3456

By: _____
Name: _____
Title: _____

"FARMOR"

DRYSDALE EXPLORATION COMPANY

Address:

3456 Travis Street
Suite 4900
Dallas, Texas 75203
Attention: Wilburn Drysdale, President
Fax: 214-848-1234
Phone: 214-848-3456

By: _____
Name: _____
Title: _____

"FARMEE"

EXHIBIT A

SUBJECT LEASES

EXHIBIT B

TO FARMOUT AGREEMENT BY AND BETWEEN
JETHRO EXPLORATION COMPANY, "FARMOR,"
AND
DRYSDALE EXPLORATION COMPANY, AS "FARMEE"

PARTIAL ASSIGNMENT OF OIL, GAS AND MINERAL LEASES

THE STATE OF TEXAS §
§
COUNTY OF CLAMPETT §

THIS PARTIAL ASSIGNMENT OF OIL, GAS AND MINERAL LEASES (this "Partial Assignment") is executed and entered into by and between JETHRO EXPLORATION COMPANY, a Texas corporation, whose address is 1234 Alamo Street, Suite 1500, Houston, Texas 77002 (hereinafter called "Assignor"), and DRYSDALE EXPLORATION COMPANY, a Texas corporation, whose address is 3456 Travis Street, Suite 4900, Dallas, Texas 75203 (hereinafter called "Assignee").

ARTICLE I

Partial Assignment; Reservations

Section 1.1 *Partial Assignment.* Assignor, for Ten Dollars ($10.00) and other good and valuable consideration in hand paid by Assignee, the receipt and sufficiency of which consideration are hereby acknowledged and confessed, does hereby GRANT, BARGAIN, SELL, CONVEY, ASSIGN AND DELIVER unto Assignee, all of Assignor's right, title and interest in and to those oil, gas and mineral leases described on Exhibit A attached hereto (the "Subject Leases"), INSOFAR AND ONLY INSOFAR as the Subject Leases (i) cover the Subject Intervals (hereinafter defined), and (ii) cover those lands included within that certain Well Unit Designation dated (the "Well Unit"), filed for record in Volume _____, Page _____ of the _____ Records of Clampett County, Texas, together with a like interest in the well located on such Well Unit (the "Subject Well") and all downhole, surface and other equipment (up to and including the wellhead check meter) associated with the Subject Well (collectively, the "Assigned Interests"). For purposes of this Partial Assignment, the term "Subject Intervals" shall mean those formations located below the base of the Spiro Formation, which is defined as the stratigraphic equivalent to that point found at 10,700 feet logged depth in the Clampett #1 Well, located in the C. H. Travis Survey, A-37, Clampett County, Texas.

Section 1.2 R*eservations and Exceptions from Partial Assignment.* Assignor hereby excepts and reserves from the Assigned Interests, a three percent (3%) of 8/8ths overriding royalty

interest in and to all oil, gas and other hydrocarbons produced and saved from or attributable to the Assigned Interests (the "Retained ORRI"), which Retained ORRI may be converted to an undivided leasehold working interest (the "Optional Working Interest") equal to twenty-five percent (25%) of the Assigned Interests (i.e. twelve and one-half percent (12.5%) of the entire leasehold working interest), which Optional Working Interest shall become effective, at Assignor's option, if at all, when the Subject Well achieves "Payout" (hereinafter defined). As used herein, "Payout" shall mean the point in time when Assignee shall have recouped from the proceeds of oil, gas and/or other hydrocarbon production from the Subject Well, after deducting (i) severance, production, windfall profit and other taxes payable on such share of production and (ii) lessor's royalties, overriding royalties (including the Retained ORRI) and like burdens with which the Subject Leases are burdened as of the date hereof, an amount equal to the aggregate costs to Assignee of drilling, testing, completing and equipping the Subject Well with necessary production equipment (including the installation of flow lines up to and including the wellhead check meter for the Subject Well) and operating the same during the period of such recoupment.

TO HAVE AND TO HOLD the Assigned Interests unto Assignee, its successors and assigns forever, subject, however, to the matters set forth herein.

ARTICLE II

Warranty of Title; Limitation of Warranties

Section 2.1 *Warranty of Title*. Assignor hereby binds itself to warrant and forever defend, all and singular, the Assigned Interests unto Assignee, its successors and assigns, against every person whomsoever lawfully claiming or to claim the same or any part thereof, by, through or under Assignor, but not otherwise, subject, however, to the matters set forth herein.

Section 2.2 *Limitation of Warranties*. Except for the warranty of title set forth in Section 2.1 above, the Assigned Interests are assigned to Assignee without warranty of any kind, express, implied or statutory.

Section 2.3 *Permitted Encumbrances*. The Assigned Interests are assigned and conveyed by Assignor and accepted by Assignee expressly subject to the following (the "Permitted Encumbrances"): (i) the terms, conditions, restrictions and limitations contained in the Subject Leases and any intervening assignments through which Assignor acquired its interest in the Subject Leases; and (ii) the terms, conditions, restrictions and limitations set forth in that certain Farmout Agreement dated as of September 1, 2008 (the "Farmout Agreement"), by and between Assignor and Assignee.

ARTICLE III

Miscellaneous

Section 3.1 *Additional Agreements*. Assignor and Assignee each covenant and agree to execute and deliver to the other party such other and additional instruments and documents as may be necessary to evidence of record the respective interests of Assignor and Assignee in and to the Assigned Interests.

Section 3.2 *Taxes*. All ad valorem, property, production, severance and similar taxes and assessments relative to the Assigned Interests shall be apportioned and prorated between Assignor and Assignee as of the effective date hereof.

Section 3.3 *Successors and Assigns*. All of the provisions hereof shall inure to the benefit of and be binding upon the respective successors and assigns of Assignor and Assignee. All references herein to either Assignor or Assignee shall include their respective successors and assigns.

Section 3.4 *Counterparts*. This Assignment may be executed in any number of counterparts, and each counterpart hereof shall be deemed to be an original instrument, but all such counterparts shall constitute but one and the same assignment.

Section 3.5 *No Ratification*. The reference herein to the Permitted Encumbrances is for the purposes of defining the nature and extent of Assignor's warranty and shall not be deemed to ratify or create any rights in third parties.

IN WITNESS WHEREOF, the parties hereto have executed this Assignment on the dates of the acknowledgments set forth below, to be effective, however, for all purposes, as of the ____ day of_____, 200__.

JETHRO EXPLORATION COMPANY

Address:

1234 Alamo Street
Suite 1500
Houston, Texas 77002

By: _____
Name: _____
Title: _____

"ASSIGNOR"

DRYSDALE EXPLORATION COMPANY

Address:

3456 Travis Street
Suite 4900
Dallas, Texas 75203

By: _____
Name: _____
Title: _____

"ASSIGNEE"

THE STATE OF TEXAS §
§
COUNTY OF _____ §

This instrument was acknowledged before me on the ____ day of _____, 200___, by , _____ of JETHRO EXPLORATION COMPANY, a Texas corporation, on behalf of said corporation.

(SEAL)

_____
Notary Public in and for the State of Texas

My commission expires:_____

THE STATE OF TEXAS §
§
COUNTY OF _____ §

This instrument was acknowledged before me on the ____ day of _____, 200___, by , _____ of DRYSDALE EXPLORATION COMPANY, a Texas corporation, on behalf of said corporation.

(SEAL)

_____
Notary Public in and for the State of Texas

My commission expires:_____

EXHIBIT C

OPERATING AGREEMENT

EXHIBIT D

TO FARMOUT AGREEMENT BY AND BETWEEN
JETHRO EXPLORATION COMPANY, AS "FARMOR,"
AND
DRYSDALE EXPLORATION COMPANY, AS "FARMEE"

ROAD USE AGREEMENT

This Road Use Agreement entered into effective as of the ____ day of _____, 200__ (this "Agreement"), by and between JETHRO EXPLORATION COMPANY, a Texas corporation ("Jethro"), and DRYSDALE EXPLORATION COMPANY, a Texas corporation ("Drysdale").

W I T N E S S E T H:

WHEREAS, Jethro and Drysdale are the owners of undivided working interests in and to various oil, gas and mineral leases covering lands located in Clampett County, Texas (collectively, the "Subject Properties"); and

WHEREAS, Jethro and Drysdale desire to jointly utilize the roads more particularly described on Exhibit A attached hereto and made a part hereof for all purposes (the "Common Roads") in the development of their respective rights in and to the Subject Properties; and

WHEREAS, Jethro and Drysdale desire to share the cost of maintaining the Common Roads pursuant to the terms and conditions of this Agreement.

NOW, THEREFORE, KNOW ALL MEN BY THESE PRESENTS:

That, for and in consideration of the premises and the mutual covenants and agreements contained herein, Jethro and Drysdale hereby agree as follows:

1. Sharing of Maintenance Costs. Jethro and Drysdale shall share the cost of maintaining the Common Roads based on each party's respective usage of the Common Roads. In this regard, Jethro and Drysdale agree that for a period of [twelve (12)] months following the execution of this Agreement (the "Initial Period"), the parties shall share such costs based on the following formula (the "Sharing Formula"):

$$C_F = C_T \, x \, \frac{W_F}{W_T}$$

Where:

C_F is each party's share of the cost of maintaining the Common Road in question;

C_T is the total cost of maintaining such Common Road;

W_F is the total number of "active wells" (i.e., wells that are either being drilled or completed or wells that are producing oil or gas) that (i) are operated by the party for whom C_F is being calculated (or its successors or assigns) and (ii) are accessed by such Common Road; and

W_T is the total number of active wells that are accessed by such Common Road.

Prior to the expiration of the Initial Period, the parties shall meet to determine if the Sharing Formula used during the Initial Period achieved the objective of allocating costs based on the relative usage of the Common Roads by the parties. If either party reasonably believes that this Sharing Formula does not achieve this objective, the parties shall negotiate in good faith to agree upon a new formula for sharing such costs. Until the parties agree upon a new formula, the costs shall continue to be shared in accordance with the Sharing Formula used during the Initial Period.

The parties recognize that the Sharing Formula is intended to allocate maintenance costs associated with normal wear and tear of the Common Roads. In the event that either party uses a Common Road to move in or out a drilling rig and such rig move causes damage to a Common Road in excess of normal wear and tear, then such party shall be solely responsible for the cost of repairing such excess damages.

2. Maintenance of Common Roads. If a Common Road is a public road, then in order to minimize the costs incurred by the parties with respect to the maintenance of such Common Road, Jethro and Drysdale shall meet and agree with respect to (i) the manner in which negotiations with the applicable governmental body shall be conducted, and (ii) the amount that Jethro and Drysdale shall contribute for such maintenance. If a Common Road is a private road, then either party may take such actions and expend such sums as are reasonably necessary to maintain such Common Road.

3. Accounting. If a party incurs costs in maintaining the Common Roads, then such party shall be entitled to reimbursement from the other party in an amount determined in accordance

with the Sharing Formula. When a party desires to be reimbursed for costs incurred in maintaining the Common Roads, such party shall submit to the other party a written statement (i) detailing the work performed and the costs incurred in performing such work, along with copies of supporting invoices, and (ii) setting forth the calculation of the amount due from the other party as determined in accordance with the Sharing Formula. All amounts due hereunder shall be paid within thirty (30) days after a party's receipt of the written statement described above.

4. Notices. Any notice required or permitted to be given under or in connection with this Agreement shall be in writing and shall be mailed by postage prepaid certified mail, return receipt requested or sent by facsimile or other electronic transmission. No notice shall be deemed to have been given to a party until it is received at the address of such party set forth below or until receipt of a facsimile or other electronic transmission. All such notices shall be mailed, sent or delivered to:

Jethro: Jethro Exploration Company
1234 Alamo Street, Suite 1500
Houston, Texas 77002
Attention: Jethro Bodine, President
Telephone: 713-212-3456
Facsimile: 713-212-1234
E-mail: _____

Drysdale: Drysdale Exploration Company
3456 Travis Street, Suite 4900
Dallas, Texas 75203
Attention: Wilburn Drysdale, President
Telephone: 214-848-3456
Facsimile: 214-848-1234
E-mail: _____

No change of address, facsimile number or e-mail address by a party shall become effective until written notice of such change shall have been received by the other party.

5. Assignment. The terms hereof shall be binding upon Jethro and Drysdale and their respective successors and assigns, and shall be deemed covenants running with the land, insofar as this Agreement relates to the Subject Properties.

6. Entire Agreement. This Agreement and the Exhibits hereto embody the entire agreement between the parties and supersede any and all prior written or oral understandings or agreements relative to the subject matter hereof. No amendment, modification, extension or change hereto shall be binding upon any party hereto unless and until a written instrument evidencing such amendment, modification, extension or change has been duly executed by a duly authorized representative of both parties.

7. Captions. Captions for the Sections in this Agreement are used only for identification purposes and shall have no effect upon the construction or interpretation of any part of this Agreement.

8. Governing Law. This Agreement shall be governed by, and construed and enforced in accordance with, the laws of the State of Texas, without regard to the conflicts of law provisions thereof.

9. Severability. If any provision of this Agreement is held to be illegal, invalid or unenforceable under applicable law, such provision shall be fully severable; this Agreement shall be construed and enforced as if such illegal, invalid or unenforceable provision had never comprised a part hereof; and the remaining provisions of this Agreement shall remain in full force and effect and shall not be affected by the illegal, invalid or unenforceable provision or by its severance herefrom. Furthermore, in lieu of such illegal, invalid or unenforceable provision, there shall be added automatically as part of this Agreement a provision as similar in terms to such illegal, invalid or unenforceable provision as may be possible and be legal, valid and enforceable.

EXECUTED as of the date first above written.

JETHRO EXPLORATION COMPANY

By: _____
Name: _____
Title: _____

DRYSDALE EXPLORATION COMPANY

By: _____
Name: _____
Title: _____

THE STATE OF TEXAS §
§
COUNTY OF _____ §

This instrument was acknowledged before me on the ____ day of _____, 200___, by , _____ of JETHRO EXPLORATION COMPANY, a Texas corporation, on behalf of said corporation.

(SEAL)

_____
Notary Public in and for the State of Texas

My commission expires:_____

THE STATE OF TEXAS §
§
COUNTY OF _____ §

This instrument was acknowledged before me on the ____ day of _____, 200___, by , _____ of DRYSDALE EXPLORATION COMPANY, a Texas corporation, on behalf of said corporation.

(SEAL)

_____
Notary Public in and for the State of Texas

My commission expires:_____

EXHIBIT E

TO FARMOUT AGREEMENT BY AND BETWEEN
JETHRO EXPLORATION COMPANY, AS "FARMOR,"
AND
DRYSDALE EXPLORATION COMPANY, AS "FARMEE"

MEMORANDUM OF FARMOUT AGREEMENT

THE STATE OF TEXAS §
§
COUNTY OF CLAMPETT §

This Memorandum of Farmout Agreement (this "Memorandum")is made and entered into as of the _____ day of _____, 200__, by and between JETHRO EXPLORATION COMPANY, a Texas corporation ("Jethro"), and DRYSDALE EXPLORATION COMPANY, a Texas corporation ("Drysdale").

W I T N E S S E T H:

WHEREAS, Jethro, as "Farmor," and Drysdale, as "Farmee," entered into that certain Farmout Agreement dated as of September 1, 2008 (the "Farmout Agreement"), covering and describing Jethro's interest in and to those oil, gas and mineral leases described on Exhibit A attached hereto and made a part hereof for all purposes (collectively, the "Subject Leases"), INSOFAR AND ONLY INSOFAR as the Subject Leases cover those formations located below the base of the Spiro Formation, which is defined for purposes of this Memorandum as the stratigraphic equivalent to that point found at 10,700 feet logged depth in the Clampett #1 Well, located in the C. H. Travis Survey, A-37, Clampett County, Texas; and

WHEREAS, Jethro and Drysdale desire to evidence of record the existence of the Farmout Agreement.

NOW, THEREFORE, KNOW ALL MEN BY THESE PRESENTS:

This Memorandum is given to place every person on notice of the existence of the Farmout Agreement, to which reference is here made for all purposes, and the respective rights and obligations of Jethro and Drysdale in and to the Subject Leases by virtue of the Farmout Agreement. This Memorandum is not intended in any way to alter, amend or change any of the terms and conditions of the Farmout Agreement.

IN WITNESS WHEREOF, this instrument is executed in multiple counterpart copies as of the date first hereinabove set forth.

JETHRO EXPLORATION COMPANY

Address:

1234 Alamo Street
Suite 1500
Houston, Texas 77002

By:_____
Name:_____
Title:_____

DRYSDALE EXPLORATION COMPANY

Address:

3456 Travis Street
Suite 4900
Dallas, Texas 75203

By:_____
Name: _____
Title: _____

THE STATE OF TEXAS §
§
COUNTY OF _____ §

This instrument was acknowledged before me on the ___ day of _____, 200__, by _____, _____ of JETHRO EXPLORATION COMPANY, a Texas corporation, on behalf of said corporation.

(SEAL)

_____
Notary Public in and for the State of Texas

My commission expires:_____

THE STATE OF TEXAS §
§
COUNTY OF _____ §

This instrument was acknowledged before me on the ___ day of _____, 200__, by _____, _____ of DRYSDALE EXPLORATION COMPANY, a Texas corporation, on behalf of said corporation.

(SEAL)

_____
Notary Public in and for the State of Texas

My commission expires:_____

SCHEDULE 1

DEFINED TERMS

"Affected Acreage" defined in Article VII.

"Agreement" defined in the introductory paragraph.

"Code" defined in Article VIII, Section 8.10.

"Commercial Well" defined in Article II, Section 2.1.

"Common Roads" defined in Article II, Section 2.4.

"Draining Well" defined in Article VI.

"Drilling Option Period" defined in Article II, Section 2.2.

"Farmee" defined in the introductory paragraph.

"Farmor" defined in the introductory paragraph.

"Memorandum" defined in Article VIII, Section 8.11.

"New Leases" defined in Article VIII, Section 8.6.

"Offset Period" defined in Article VI.

"Offset Well" defined in Article VI.

"Operating Agreement" defined in Article IV.

"Optional Working Interest" defined in Article III, Section 3.3.

"Partial Assignment" defined in Article III, Section 3.2.

"Payout" defined in Article III, Section 3.4.

"Retained Intervals" defined in Article I, Section 1.2.

"Retained ORRI" defined in Article III, Section 3.2.

"Subject Interests" defined in Article I, Section 1.1.

“Subject Intervals” defined in Article I, Section 1.1.

“Subject Leases” defined in the recitals.

“Subsequent Well” defined in Article II, Section 2.2.

“Subsequent Wells” defined in Article II, Section 2.2.

“Test Well” defined in Article II, Section 2.1.

“Unit Designation” defined in Article III, Section 3.1.

“Well Unit” defined in Article I, Section 1.3.