

203 West Wall Street  
Suite 1201 (Zip 79701)  
P.O. Box 10187  
Midland, Texas 79702

**CAPSTONE OIL & GAS COMPANY, L.P.**  
*Exploration and Development*

Area Code: 432  
Phone : 682-5565  
Fax: 682-4498  
E-Mail: mark@capstoneoil.com

**SENT CERTIFIED MAIL—RETURN RECEIPT REQUESTED NO.70022410000013737966**

January 13, 2004

Murchison Oil & Gas, Inc.  
1100 Mira Vista Blvd.  
Plano, Texas 75093  
Attn: Mr. Mike Daugherty, CPL

Re: AFE to drill Roughneck Red "29" Com #1  
1480' FNL & 1980' FWL of Section 29,  
T17S, R26E, NMPM  
Palms Prospect  
Eddy County, New Mexico

Dear Mike:

Pursuant to our telephone conversations this week, please find enclosed for your review and execution, two (2) copies of our AFE for the captioned well. Capstone is the owner of leasehold in the N/2 N/2 of said Section 29 and we are proposing to operate the proposed well as a N/2 proration unit.

If Murchison is prepared to participate with its 15.51739065% working interest in this well, please execute and forward one (1) of the enclosed AFE to the undersigned at your earliest convenience.

If you do not want to participate in the drilling of this well, Capstone would like to negotiate the purchase of a term assignment of your leasehold rights under the S/2 N/2 of said Section 29.

Should you have any questions, please feel free to contact me.

Sincerely,

  
Mark Wheeler, CPL  
Senior Landman

/cmw: RR 29#1 AFE letter to Murchison O&G(1m)  
xc: Jim Geitgey / Dale Douglas / Jerry Elger

NMOCD CASE NO. 13236  
MAY 27, 2004  
PRESTON EXPLORATION, LLC  
EXHIBIT NO. 3

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**SENT CERTIFIED MAIL—RETURN RECEIPT REQUESTED NO.70022410000013737942**

January 13, 2004

Cactus Energy, Inc.  
P. O. Box 2412  
Midland, Texas 79702

Re: AFE to drill Roughneck Red "29" Com #1  
1480' FNL & 1980' FWL of Section 29,  
T17S, R26E, NMPM  
Palms Prospect  
Eddy County, New Mexico

Gentlemen:

Please find enclosed for your review and execution, two (2) copies of our AFE for the captioned well. Capstone is the owner of leasehold in the N/2 N/2 of said Section 29 and we are proposing to operate the proposed well as a N/2 proration unit.

If Cactus Energy is prepared to participate with its 0.483038% working interest in this well, please execute and forward one (1) of the enclosed AFE to the undersigned at your earliest convenience.

If you do not want to participate in the drilling of this well, Capstone would like to negotiate the purchase of a term assignment of your leasehold rights under the S/2 N/2 of said Section 29.

Should you have any questions, please feel free to contact me.

Sincerely,



Mark Wheeler, CPL  
Senior Landman

/cmw: RR 29#1 AFE letter to Cactus(1m)  
xc: Jim Geitgey / Dale Douglas / Jerry Elger

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**SENT CERTIFIED MAIL-RETURN RECEIPT REQUESTED NO.70022410000013738000**

January 13, 2004

Caza Energy LLC  
Robert C. Chase  
Richard L. Chase  
Gerene Diane Chase Crouch  
P. O. Box 1767  
Artesia, NM 88211

Re: AFE to drill Roughneck Red "29" Com #1  
1480' FNL & 1980' FWL of Section 29,  
T17S, R26E, NMPM  
Palms Prospect  
Eddy County, New Mexico

Gentlemen:

Please find enclosed for your review and execution, two (2) copies of our AFE for the captioned well. Capstone is the owner of leasehold in the N/2 N/2 of said Section 29 and we are proposing to operate the proposed well as a N/2 proration unit.

If you are prepared to participate with your combined 16.666667% working interest in this well, please execute and forward one (1) of the enclosed AFE to the undersigned at your earliest convenience.

If you do not want to participate in the drilling of this well, Capstone would like to negotiate the purchase of a term assignment of your leasehold rights under the S/2 N/2 of said Section 29.

Should you have any questions, please feel free to contact me.

Sincerely,

  
(Mark Wheeler, CPL  
Senior Landman

/cmw: RR 29#1 AFE letter to Caza Energy LLC, et al (1m)  
xc: Jim Geitgey / Dale Douglas / Jerry Elger

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**SENT CERTIFIED MAIL—RETURN RECEIPT REQUESTED NO.70022410000013737980**

January 13, 2004

Mr. Thomas R. Smith  
1409 S. CR 1130  
Midland, Texas 79706

Re: AFE to drill Roughneck Red "29" Com #1  
1480' FNL & 1980' FWL of Section 29,  
T17S, R26E, NMPM  
Palms Prospect  
Eddy County, New Mexico

Dear Tom:

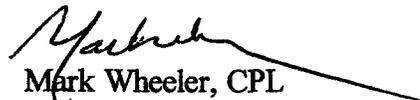
Please find enclosed for your review and execution, two (2) copies of our AFE for the captioned well. Capstone is the owner of leasehold in the N/2 N/2 of said Section 29 and we are proposing to operate the proposed well as a N/2 proration unit.

If you are prepared to participate with your 1.33101665% working interest in this well, please execute and forward one (1) of the enclosed AFE to the undersigned at your earliest convenience.

If you do not want to participate in the drilling of this well, Capstone would like to negotiate the purchase of a term assignment of your leasehold rights under the S/2 N/2 of said Section 29.

Should you have any questions, please feel free to contact me.

Sincerely,

  
Mark Wheeler, CPL  
Senior Landman

/cmw: RR 29#1 AFE letter to Tom Smith(1m)  
xc: Jim Geitgey / Dale Douglas / Jerry Elger

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**SENT CERTIFIED MAIL-RETURN RECEIPT REQUESTED NO.70022410000013737973**

January 13, 2004

MEC Petroleum Corp.  
414 W. Texas, Suite 410  
Midland, Texas 79702

Re: AFE to drill Roughneck Red "29" Com #1  
1480' FNL & 1980' FWL of Section 29,  
T17S, R26E, NMPM  
Palms Prospect  
Eddy County, New Mexico

Gentlemen:

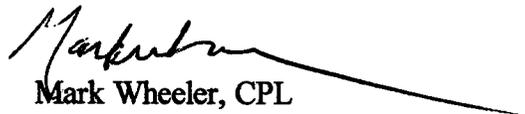
Please find enclosed for your review and execution, two (2) copies of our AFE for the captioned well. Capstone is the owner of leasehold in the N/2 N/2 of said Section 29 and we are proposing to operate the proposed well as a N/2 proration unit.

If MEC is prepared to participate with its 0.81670475% working interest in this well, please execute and forward one (1) of the enclosed AFE to the undersigned at your earliest convenience.

If you do not want to participate in the drilling of this well, Capstone would like to negotiate the purchase of a term assignment of your leasehold rights under the S/2 N/2 of said Section 29.

Should you have any questions, please feel free to contact me.

Sincerely,

  
Mark Wheeler, CPL  
Senior Landman

/cmw: RR 29#1 AFE letter to MEC Pet. Corp.(1m)  
xc: Jim Geitgey / Dale Douglas / Jerry Elger

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**SENT CERTIFIED MAIL-RETURN RECEIPT REQUESTED NO.70022410000013737997**

January 13, 2004

Mr. Wendell W. Iverson, Jr.  
P. O. Box 205  
Midland, Texas 79702

Re: AFE to drill Roughneck Red "29" Com #1  
1480' FNL & 1980' FWL of Section 29,  
T17S, R26E, NMPM  
Palms Prospect  
Eddy County, New Mexico

Dear Wendell:

Please find enclosed for your review and execution, two (2) copies of our AFE for the captioned well. Capstone is the owner of leasehold in the N/2 N/2 of said Section 29 and we are proposing to operate the proposed well as a N/2 proration unit.

If you are prepared to participate with your 1.33101665% working interest in this well, please execute and forward one (1) of the enclosed AFE to the undersigned at your earliest convenience.

If you do not want to participate in the drilling of this well, Capstone would like to negotiate the purchase of a term assignment of your leasehold rights under the S/2 N/2 of said Section 29.

Should you have any questions, please feel free to contact me.

Sincerely,

  
Mark Wheeler, CPL  
Senior Landman

/cmw: RR 29#1 AFE letter to Wendell Iverson, Jr. (1m)  
xc: Jim Geitgey / Dale Douglas / Jerry Elger

**Capstone Oil & Gas Company, LP  
AUTHORITY FOR EXPENDITURE**

WELL NAME: Roughneck Red "29" #1	PROSPECT NAME: Roughneck Red
LOCATION: 1980' FNL & 1980' FEL	COUNTY & STATE: Eddy, New Mexico
Section 29 - T17S - R26E	OBJECTIVE: 8,400' Morrow Gas Well
N/2 Sec. 29 Proration Unit	AFE CODE: New Drill and Complete

<u>INTANGIBLE COSTS</u>		<u>BCP</u>		<u>ACP</u>		<u>TOTAL</u>
PERMITS	502	2,500	702	0		2,500
TITLE OPINION & CURATIVE	504	3,000	704	0		3,000
SURVEYING / STAKE LOCATION	506	3,000	706	0		3,000
DAMAGES & R-O-W'S	508	0	708	0		0
ROADS, LOCATION, PITS, LINERS, ETC.	510	20,000	710	1,000		21,000
DRILLING - FOOTAGE	512	0		0		0
DRILLING - DAYWORK: 21 days @ \$7500/day	514	157,500	714	0		157,500
DRILLING MUD & CHEMICALS	516	50,000	716	0		50,000
WATER	518	25,000	718	0		25,000
BITS, REAMERS, ETC.	520	25,000	720	0		25,000
FUEL	522	15,000		0		15,000
CEMENTING SURFACE	524	12,000		0		12,000
CEMENTING 1st & 2nd INTERMEDIATE CASINGS	526	0		0		0
CEMENTING PRODUCTION LINER		0	728	35,000		35,000
TUBULAR SERVICES AND TOOLS	530	15,000	730	2,235		17,235
CASING CREWS / PU LD MACHINE	532	8,000	732	2,500		10,500
FLOAT EQUIPMENT & LINER HANGER	534	18,100	734	15,000		33,100
TESTING; DST & COMPLETION	536	0	736	6,000		6,000
OPEN HOLE LOGGING / CASED HOLE LOGS	538	25,000		0		25,000
MUD LOGGING	540	10,000		0		10,000
WELDING & HOURLY LABOR	542	3,500	742	12,500		16,000
EQUIPMENT RENTAL	544	15,000	744	6,530		21,530
RIG MOBILIZATION, TRANSPORTATION, ETC.	546	35,000	746	1,875		36,875
COMPLETION UNIT		0	748	10,000		10,000
FORMATION STIMULATION: Breakdown & Frac		0	750	85,000		85,000
WIRELINE SERVICES / TCP SERVICES	552	2,500	752	8,600		11,100
GEOLOGIC / ENGINEERING	554	15,000	754	5,000		20,000
CONTRACT LABOR	556	30,000	756	13,000		43,000
DRILLING WELL RATE (A/O)	558	5,400	758	4,000		9,400
INSURANCE	560	8,000	760	0		8,000
MISCELLANEOUS	562	1,500	762	750		2,250
CONTINGENCY (10%)	564	84,200	764	0		84,200
<b>TOTAL INTANGIBLES</b>		<b>589,200</b>		<b>188,990</b>		<b>778,190</b>

<u>TANGIBLE COSTS</u>						
CONDUCTOR CASING	602	4,235		0		4,235
SURFACE CASING	604			0		0
500' of 13 3/8", 68#, J-55, 8rd STC new API		7,000		0		7,000
INTERMEDIATE CASING	608	0		0		0
2900' of 9 5/8", 43.5# & 47#, N-80, 8rd LTC/BTC new		37,700		0		37,700
DEEP INTERMEDIATE CASING	612	0		0		0
of 7", 29#, P-110, 8rd LTC new API		0		0		0
PRODUCTION CASING / LINER	616	0	816			0
8,450' of 5 1/2", 15.10#, P-110, FL4S, new API		57,120		24,720		81,840
TUBING: 8,450' 2 7/8", 4.70#, P110, 8rd ABM, API	620	27,300	820	37,450		64,750
WELLHEAD EQUIPMENT	622	6,000	822	18,000		24,000
SURFACE LIFT & ELECTRICITY	624	0	824	0		0
RODS AND PUMP	626	0	826	0		0
PACKERS, BPS, DOWNHOLE EQUIPMENT	628	0	828	7,100		7,100
GAS PRODUCTION EQUIPMENT	630	0	830	17,000		17,000
SEPARATOR, TREATER	632	0	832	2,000		2,000
FLOWLINES, VALVES, CONNECTIONS	634	0	834	8,500		8,500
TANKS (Water and Production)	636	0	836	2,500		2,500
MISCELLANEOUS	638	1,500	838	1,000		2,500
CONTINGENCY (10%)	640	14,086	840	5,914		19,999
<b>TOTAL TANGIBLES</b>		<b>154,941</b>		<b>124,184</b>		<b>279,124</b>
<b>TOTAL WELL COSTS</b>		<b>744,141</b>		<b>313,174</b>		<b>1,057,314</b>

PLUGGING COST 566 23,366

ACCEPTED THIS \_\_\_\_\_ DAY OF \_\_\_\_\_, 2003.

Prepared By: Capstone Oil & Gas Co., L.P.  
Midland, Texas

Date of Final Preparation: September 1, 2003