

# Sovereign Exploration, LLC

P.O. Box 968

Roswell, NM 88202-0968

Phone: (575) 622-1127

Fax: (575) 623-3533

August 21, 2014

Yates Brothers, a Partnership  
ATTN: Jim Ball, Landman  
PO Box 1394  
Artesia, NM 88211

Re: Township 2 South, Range 29 East  
Section 26: N/2, SE/4  
Containing 480 gross acres, more or less  
Roosevelt County, New Mexico

Dear Mr. Ball:

Pursuant to our previous telephone conversation, Sovereign Exploration, LLC would like to lease your mineral interest in the above described land for oil and all gas. Enclosed please find the following:

- A W9 for our records and tax purposes
- An Oil and Gas Lease, and one (1) copy thereof for your file, providing for a five (5) year primary term and 1/6th royalty

We are offering \$592.73 representing the consideration for a five (5) year paid up lease calculated as follows: 23.7092 net acres [(your 0.0493942308 mineral interest 480.00 gross acres) x \$25.00.

If this offer is acceptable to you, please do the following:

- Sign a copy of the Oil and Gas Lease in the presence of a notary public at your earliest convenience and send back to the following address:  
Sovereign Exploration Company, LLC  
ATTN: Grace Charboneau  
P.O. Box 968  
Roswell, NM 88202
- Fill out the provided W9 and include it with the signed and notarized lease.

This offer is made subject to approval of title. Upon receipt of the signed agreement a check will be mailed to you. If you have any questions or concerns, please feel free to call me at (575) 622-1127 Extension 20.

Sincerely,

Grace Charboneau  
Division Order Analyst

Enclosures: Two (2) Oil and Gas Lease

Oil Conservation Division  
Case No. 15224  
Exhibit No. 1

YB

## OIL AND GAS LEASE

THIS LEASE AGREEMENT is made as of the 21th day of August 2014, between Yates Brothers, a Partnership, whose address is PO Box 1394, Artesia, NM 88211, as Lessor (whether one or more), and Sovereign Exploration Company, LLC, whose address is P.O. Box 968, Roswell, NM 88202, as Lessee. All printed portions of this lease were prepared by the party hereinabove named as Lessee, but all other provisions (including the completion of blank spaces) were prepared jointly by Lessor and Lessee.

1. **Grant of Leased Premises.** In consideration of a cash bonus in hand paid and the covenants herein contained, Lessor hereby grants, leases and lets exclusively to Lessee the following described land, hereinafter called Leased Premises:

Township 2 South, Range 29 East, NMPM  
Section 26: N/2, SE/4

these lands being located in the County of Roosevelt, State of New Mexico, containing 23.7092 net acres, whether it actually comprises more or less (including any interests therein which Lessor may hereafter acquire by reversion, prescription, re-survey, or otherwise), for the purpose of exploring for, developing, producing and marketing oil and gas, along with all hydrocarbon products and by-products, and non-hydrocarbon substances produced in association therewith ("Oil and Gas Substances"). This lease also covers and includes all land owned or claimed by Lessor adjacent or contiguous to the land particularly described above, whether or not the same be within the boundaries of the land particularly described above. The term "gas" as used herein includes helium, carbon dioxide, gaseous sulfur compounds, methane produced from coal formations and other commercial gases, as well as normal hydrocarbon gases. In addition to the above-described land, this lease and the term "Leased Premises" also covers accretions and strips or parcels of land now or hereafter owned by Lessor which are contiguous or adjacent to the above-described land, and, in consideration of the aforementioned cash bonus, Lessor agrees to execute at Lessee's request any additional or supplemental instruments for a more complete or accurate description of the land so covered. For the purpose of determining the amount of any payments based on acreage hereunder, the number of gross acres above specified shall be deemed correct, whether actually more or less.

2. **Consideration.** In exchange for Ten Dollars (\$10.00) and other good and valuable consideration, the terms of which shall remain confidential, the receipt and sufficiency of which is hereby acknowledged, the Lessor hereby conveys and exchanges this Agreement.

3. **Ancillary Rights.** The rights granted to Lessee hereunder shall include the right of ingress and egress on the Leased Premises or lands pooled or unitized therewith, along with such rights as may be reasonably necessary to conduct operations for exploring, developing, producing and marketing Oil and Gas Substances, including but not limited to geophysical operations, the drilling of wells, and the construction and use of roads, canals, pipelines, tanks, water wells, disposal wells, injection wells (including, but not limited to wells to inject gas, waters, other fluids, and air into subsurface strata), pits, electric and telephone lines, power stations, and other facilities deemed necessary by Lessee to explore, discover, produce, store, treat and/or transport Oil and Gas Substances and water produced from the Leased Premises or other lands that share central facilities and are jointly operated with the Leased Premises for gathering, treating, compression and water disposal. In its operations, Lessee shall have free use of any Oil and Gas Substances, water and/or other substances produced on the Leased Premises, except water from Lessor's wells or ponds, and the royalty shall be computed after deducting any such substances used. In exploring, developing, producing or marketing from the Leased Premises or lands pooled or unitized therewith, the ancillary rights granted herein shall apply (a) to the entire Leased Premises, notwithstanding any partial release or other partial termination of this lease; and (b) to any other lands in which Lessor now or hereafter has authority to grant such rights in the vicinity of the Leased Premises or lands pooled or unitized therewith. When requested by Lessor in writing, Lessee shall bury its pipelines below ordinary plow depth on cultivated lands. No well shall be located less than 200 feet from any house or barn now on the Leased Premises or other lands of Lessor used by Lessee hereunder, without Lessor's consent, and Lessee shall pay for damage caused by its operations to buildings and other improvements now on the Leased Premises or such other lands, and to commercial timber and growing crops thereon. Lessee shall have the right at any time to remove its fixtures, equipment and materials, including well casing, from the Leased Premises or such other lands during the term of this lease or within a reasonable time thereafter.

Lessor, by virtue of the lease,

a) grants a mineral permit for entry, exit, egress for all exploration and drilling purposes, including but not limited to surface seismic data acquisition, cross-well seismic data acquisition, well logging and data acquisition, airborne, gravity and/or other remote sensing data acquisition for the term of the lease; and

b) to the extent Lessor owns or controls surface rights, grants a surface permit for entry, exit, egress for all exploration and drilling purposes, including but not limited to surface seismic data acquisition, cross-well seismic data acquisition, well logging and data acquisition, airborne, gravity, and /or other remote sensing data acquisition for the term of the lease; and

c) to the extent Lessor owns or controls surface rights, grants rights-of-way for entry, exit and egress for all exploration, drilling and development purposes including but not limited to surface vehicles, electrification, oil and gas pipeline, and all related producing infrastructure.

4. **Term of Lease.** This lease shall be in force for a primary term of five (5) years from the date hereof, and for as long thereafter as oil or gas or other substances covered hereby are produced from the Leased Premises or from lands pooled or unitized therewith or this lease is otherwise maintained in effect pursuant to the provisions hereof. Lessee is hereby given the option, to be exercised prior to the date on which this lease or any portion thereof would expire in accordance with its terms and provisions, of extending this lease for a period of five (5) years as to all or any portion of the acreage then held hereunder which would expire unless so extended, the only action required by Lessee to exercise this option being the payment to Lessor (delivered by certified mail to the address hereinabove identified for Lessor) of the additional consideration of the sum equal to that paid for primary term, which payment shall cover the five (5) year term extension. If this lease is extended as to only a portion of the acreage then covered hereby, Lessee shall designate such portion by a recordable instrument and the additional consideration shall be proportionately reduced.

5. **Operations.** If Lessee drills a well which Lessee determines is uneconomic (hereinafter called "dry hole") on the Leased Premises or lands pooled or unitized therewith, or if all production permanently ceases from any cause, including a revision of unit boundaries pursuant to the provisions of this lease or the action of any governmental authority, then in the event this lease is not otherwise being maintained in force it shall nevertheless remain in force if Lessee commences further operations for reworking an existing well or for drilling an additional well or for otherwise obtaining or restoring production on the Leased Premises or lands pooled or unitized therewith within 180 days after completion of operations on such dry hole or within 180 days after such cessation of all production. If after the primary term this lease is not otherwise being maintained in force, but Lessee is then engaged in Operations, as defined below, this lease shall remain in force so long as any one or more of such Operations are prosecuted with no interruption of more than 180 consecutive days, and if any such Operations result in the production of Oil and Gas Substances, as long thereafter as there is production from the Leased Premises or lands pooled or unitized therewith. After completion of a well hereunder, Lessee shall drill such additional wells on the Leased Premises or lands pooled or unitized therewith as a reasonably prudent operator would drill under the same or similar circumstances to (a) develop the Leased Premises, or (b) protect the Leased Premises from uncompensated drainage by any well or wells located on other lands not pooled or unitized therewith. There shall be no covenant to drill exploratory wells or any additional wells except as expressly provided herein. Notwithstanding anything herein to the contrary, Lessee shall not be required to drill additional wells or produce Oil and Gas Substances from existing wells that in Lessee's sole opinion are uneconomic or inadequately priced in the market. As used herein, the term Operations shall mean any activity conducted on or off the Leased Premises that is reasonably calculated to obtain or restore production, including without limitation, (i) drilling or any act preparatory to drilling (such as obtaining permits, surveying a drill site, staking a drill site, building roads, clearing a drill site, or hauling equipment or supplies); (ii) reworking, hydraulic fracturing, plugging back, deepening, treating, testing, stimulating, refitting, installing any artificial lift or production-enhancement equipment or technique; (iii) constructing facilities related to the production, treatment, transportation and marketing of substances produced from the lease premises; (iv) contracting for marketing services and sale of Oil and Gas Substances; and (v) construction of water disposal facilities and the physical movement of water produced from the Leased Premises.

6. **Shut-in Royalty.** If at any time when this lease is not validated by other provisions hereof and there is a gas and/or oil well on said land, or land pooled therewith, but gas or oil is not being so sold or used and such well is shut in, either before or after production therefrom, then on or before 180 days after said well is shut in, and thereafter at annual intervals, lessee may pay or tender an advance shut-in royalty equal to \$1.00 per net acre of lessor's gas acreage then held under this lease by the party making such payment or tender, and so long as said shut-in royalty is paid or tendered, this lease shall not terminate and it shall be considered under all clauses hereof that gas is being produced from the leased premises in paying quantities. Each such payment shall be paid or tendered to the party or parties who at the time of such payment would be entitled to receive the royalties which would be paid under this lease if the well were in fact producing. The payment or tender of royalties and shut-in royalties may be made by check or draft. Any timely payment or tender of shut-in royalty which is made in a bona fide attempt to make proper payment, but which is erroneous in whole or in part as to parties or amounts, shall nevertheless be sufficient to prevent termination of this lease in the same manner as though a proper payment had been made if lessee shall correct such error within 90 days after lessee has received written notice thereof by certified mail from the party or parties entitled to receive payment together with such written instruments (or certified copies thereof) as are necessary to enable lessee to make proper payment. The amount realized from the sale of oil or gas on or off the premises shall be the price established by the sales contract entered into in good faith by lessee and purchaser for such term and under such conditions as are customary in the industry. "Price" shall mean the net amount received by lessee after giving effect to applicable regulatory orders and after application of any applicable price adjustments specified in such contract or regulatory orders. Lessee's failure to properly pay shut-in royalty shall render Lessee liable for the amount due, but shall not operate to terminate this lease.

7. **Royalty Payment.** For all Oil and Gas Substances that are physically produced from the Leased Premises, or lands pooled, unitized or communitized therewith, and sold, lessor shall receive as its royalty one-sixth (1/6th) of the sales proceeds actually received by Lessee or, if applicable, its affiliate, as a result of the first sale of the affected production to an unaffiliated party, less this same percentage share of all Post Production Costs and this same percentage share of all production, severance and ad valorem taxes. As used in this provision, Post Production Costs shall mean all costs actually incurred by Lessee or its affiliate and all losses of produced volumes whether by use as fuel, line loss, flaring, venting or otherwise from and after the wellhead to the point of sale. These costs include without limitation, all costs of gathering, marketing, compression, dehydration, transportation, removal of liquid or gaseous substances or impurities from the affected production, and any other treatment or processing required by the first unaffiliated party who purchases the affected production. For royalty calculation purposes, Lessee shall never be required to adjust the sales proceeds to account for the purchaser's costs or charges downstream of the point of sale.

Lessee or its affiliate shall have the right to construct, maintain and operate any facilities providing some or all of the services identified as Post Production Costs. If this occurs, the actual costs of such facilities shall be included in the Post Production Costs as a per barrel or per mcf charge, as appropriate, calculated by spreading the construction, maintenance and operating costs for such facilities over the reasonably estimated total production volumes attributable to the well or wells using such facilities.

Lessee shall have free use of Oil and Gas Substances to assist in producing or enhancing production of Oil and Gas Substances and Lessor's royalty shall be computed after deducting any Oil and Gas Substances so used. If Lessee uses the Oil and Gas Substances (other than to assist in producing or enhancing production of Oil and Gas Substances or as fuel in connection with the production and sale thereof) in lieu of receiving sale proceeds, the price to be used under this provision shall be based upon arm's-length sale(s) to unaffiliated parties for the applicable month that are obtainable, comparable in terms of quality and quantity, and in closest proximity to the Leased Premises. Such comparable arm's-length sales price shall be less any Post Production Costs applicable to the specific arms-length transaction that is utilized.

8. **Pooling and Unitization.** Lessee, at its option, is hereby given the right and power at any time and from time to time as a recurring right, either before or after production, as to all or any part of the Leased Premises described herein and as to any one or more of the formations, subsurface depths, or horizons hereunder, to pool or unitize the leasehold estate and the mineral estate covered by this lease with other land, lease or leases in the immediate vicinity for the production of oil and gas, or separately for the production of either, when in Lessee's judgment it is necessary or advisable to do so, and irrespective of whether authority similar to this exists with respect to such other land, lease or leases. Likewise, units previously formed to include formations not producing oil or gas, may be reformed to exclude such non-producing formations. The forming or reforming of any unit shall be accomplished by Lessee executing and filing of record in the county in which the lease premises are located either before or after completion of well(s) a declaration of such pooling, unitization or reformation, which declaration shall describe the unit. Any unit may include land upon

which a well has theretofore been completed or upon which operations for drilling have theretofore been commenced. Production, drilling or reworking operations, or a well shut in for want of a market anywhere on a unit which includes all or a part of this lease, shall be treated as if it were production, drilling or reworking operations or a well shut in for want of market under this lease. In lieu of the royalties elsewhere herein specified, including shut-in gas royalties, Lessor shall receive on production from the unit so pooled royalties only on the portion of such production that the total number of surface acres covered by this lease and included in the unit bears to the total number of surface acres in such unit. In addition to the foregoing, Lessee shall have the right but not the obligation to unitize, pool, or combine all or any part of the above described lands or interest therein as to one or more of the formations thereunder with other lands in the same general area by entering in one or more cooperative or unit plan of development(s) or operation (approved by any governmental authority, if required by law) and, from time to time, with like approval if required by law, to modify, change or terminate any such plan or agreement. In such event, the terms, conditions, and provisions of this lease shall be deemed modified to conform to the terms, conditions, and provisions of such approved cooperative or unit plan of development or operation and, particularly, all drilling and development requirements of this lease, express or implied, shall be satisfied by compliance with the drilling and development requirements of such plan or agreement, and this lease shall not terminate or expire during the life of such plan or agreement. In the event that said above described lands, or any part thereof, shall hereafter be operated under any such cooperative or unit plan of development or operation whereby the production therefrom is allocated to different portions of the land covered by said plan, then the production allocated to any particular tract of land shall, for the purpose of computing the royalties to be paid hereunder to Lessor, be regarded as having been produced from the particular tract of land to which it is allocated and not to any other tract of land; and the royalty payments to be made hereunder to Lessor shall be based upon production only as so allocated. Lessor shall formally express Lessor's consent to any cooperative or unit plan of development or operation adopted by Lessee and, if required by law then approved by any governmental agency, by executing the same upon request of Lessee. Upon permanent cessation thereof, Lessee may terminate the unit by filing of record a written declaration describing the unit and stating the date of termination. Pooling hereunder shall not constitute a cross-conveyance of interests.

**9. Payment Reductions.** If Lessor owns less than the full mineral estate in all or any part of the Leased Premises, payment of royalties and shut-in royalties hereunder shall be reduced as follows: royalties and shut-in royalties for any well on any part of the Leased Premises or lands pooled therewith shall be reduced to the proportion that Lessor's interest in such part of the Leased Premises bears to the full mineral estate in such part of the Leased Premises. To the extent any royalty or other payment attributable to the mineral estate covered by this lease is payable to someone other than Lessor, such royalty or other payment shall be deducted from the corresponding amount otherwise payable to Lessor hereunder.

**10. Ownership Changes.** The interest of either Lessor or Lessee hereunder may be assigned, devised or otherwise transferred in whole or in part, by area and/or by depth or zone, and the rights and obligations of the parties hereunder shall extend to their respective heirs, devisees, executors, administrators, successors and assigns. No change in Lessor's ownership shall have the effect of reducing the rights or enlarging the obligations of Lessee hereunder, and no change in ownership shall be binding on Lessee until 60 days after Lessee has been furnished the original or duly authenticated copies of the documents establishing such change of ownership to the satisfaction of Lessee or until Lessor has satisfied the notification requirements contained in Lessee's usual form of division order. In the event of the death of any person entitled to shut-in royalties hereunder, Lessee may pay or tender such shut-in royalties to the credit of decedent or decedent's estate. If at any time two or more persons are entitled to shut-in royalties hereunder, Lessee may pay or tender such shut-in royalties to such persons either jointly or separately in proportion to the interest which each owns. If Lessee transfers its interest hereunder in whole or in part Lessee shall be relieved of all obligations thereafter arising with respect to the transferred interest, and failure of the transferee to satisfy such obligations with respect to the transferred interest shall not affect the rights of Lessee with respect to any interest not so transferred. If Lessee transfers a full or undivided interest in all or any portion of the area covered by this lease, the obligation to pay or tender shut-in royalties hereunder shall be divided between Lessee and the transferee in proportion to the net acreage interest in this lease then held by each.

**11. Release of Lease.** Lessee may, at any time and from time to time, deliver to Lessor or file of record a written release of this lease as to a full or undivided interest in all or any portion of the area covered by this lease or any depths or zones thereunder, and shall thereupon be relieved of all obligations thereafter arising with respect to the interest so released. If Lessee releases less than all of the interest or area covered hereby, Lessee's obligation to pay or tender shut-in royalties shall be proportionately reduced in accordance with the net acreage interest retained hereunder.

**12. Regulation and Delay.** Lessee's obligations under this lease, whether express or implied, shall be subject to all applicable laws, rules, regulations and orders of any governmental authority having jurisdiction, including restrictions on the drilling and production of wells, and regulation of the price or transportation of oil, gas and other substances covered hereby. When drilling, reworking, production or other operations are prevented or delayed by such laws, rules, regulations or orders, or by inability to obtain necessary permits, equipment, services, material, water, electricity, fuel, access or easements, or by fire, flood, adverse weather conditions, war, sabotage, rebellion, insurrection, riot, strike or labor disputes, or by inability to obtain a satisfactory market for production or failure of purchasers or carriers to take or transport such production, or by any other cause not reasonably within Lessee's control, this lease shall not terminate because of such prevention or delay, and, at Lessee's option, the period of such prevention or delay shall be added to the term hereof. Lessee shall not be liable for breach of any provisions or implied covenants of this lease when drilling, production or other operations are so prevented or delayed.

**13. Breach or Default.** No litigation shall be initiated by Lessor for damages, forfeiture or cancellation with respect to any breach or default by Lessee hereunder, for a period of at least 90 days after Lessor has given Lessee written notice fully describing the breach or default, and then only if Lessee fails to remedy the breach or default within such period. In the event the matter is litigated and there is a final judicial determination that a breach or default has occurred, this lease shall not be forfeited or cancelled in whole or in part unless Lessee is given a reasonable time after said judicial determination to remedy the breach or default and Lessee fails to do so.

**14. Title.** Lessor hereby warrants and agrees to defend title conveyed to Lessee hereunder, and agrees that Lessee at Lessee's option may pay and discharge any taxes, mortgages or liens existing, levied or assessed on or against the Leased Premises. If Lessee exercises such option, Lessee shall be subrogated to the rights of the party to whom payment is made, and, in addition to its other rights, may reimburse itself out of any royalties or shut-in royalties otherwise payable to Lessor hereunder. In the event Lessee is made aware of any claim inconsistent with Lessor's title, Lessee may suspend the payment of royalties and shut-in royalties hereunder, without interest, until Lessee has been furnished satisfactory evidence that such claim has been resolved.

IN WITNESS WHEREOF, this lease is executed to be effective as of the date first written above, but upon execution shall be binding on the signatory and the signatory's heirs, devisees, executors, administrators, successors and assigns, whether or not this lease has been executed by all parties hereinabove named as Lessor.

**LESSORS:**

Yates Brothers, a Partnership

By: Yates Private Equity II LLP, Partner

By: \_\_\_\_\_  
John A. Yates, Jr.

Title: Manager \_\_\_\_\_

**ACKNOWLEDGMENTS**

**NOTE:**

The following forms of acknowledgment are the short forms approved by the Uniform Law on Notarial Acts. The validity and effect of these forms in any state will depend upon the statutes of the state.

**Individual Acknowledgment**

STATE OF \_\_\_\_\_ )  
 ) § ss.  
COUNTY OF \_\_\_\_\_ )

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 2014, by John A. Yates, Jr., as Manager of Yates Brothers, a Partnership, a New Mexico Partnership.

\_\_\_\_\_  
**Notary Public**

My Commission Expires:

\_\_\_\_\_