

UNIT AGREEMENT  
FOR THE DEVELOPMENT AND OPERATION  
OF THE  
Calfrope State Exploratory Unit  
LEA COUNTY, NEW MEXICO  
NO. \_\_\_\_\_

THIS AGREEMENT, entered into as of the 29<sup>th</sup> day of August, 2002, by and between the parties subscribing, ratifying or consenting hereto, and herein referred to as the "parties hereto";

WITNESSETH:

WHEREAS, the parties hereto are the owners of working, royalty, or other oil or gas interests in the unit area subject to this agreement; and

WHEREAS, the Commissioner of Public Lands of the State of New Mexico is authorized by an Act of the Legislature (Sec 3, Chap. 88, Laws 1943) as amended by Sec. 1 of Chapter 162, Laws of 1951, (Chap. 19, Art. 10, Sec. 45, N. M. Statutes 1978 Annot.), to consent to and approve the development or operation of State Lands under agreements made by lessees of State Land jointly or severally with other lessees where such agreements provide for the unit operation or development of part of or all of any oil or gas pool, field, or area; and

WHEREAS, the Commissioner of Public Lands of the State of New Mexico is authorized by an Act of the Legislature (Sec. 1, Chap. 162), (Laws of 1951, Chap. 19, Art. 10, Sec. 47, N. M. Statutes 1978 Annotated) to amend with the approval of lessee, evidenced by the lessee's execution of such agreement or otherwise, any oil and gas lease embracing State Lands so that the length of the term of said lease may coincide with the term of such agreements for the unit operation and development of part or all of any oil or gas pool, field, or area; and

WHEREAS, the Oil Conservation Division of the Energy and Minerals Department of the State of New Mexico (hereinafter referred to as the "Division"), is authorized by an Act of the Legislature (Chap. 72, Laws 1935, as amended, being Section 70-2-1 et seq. New Mexico Statutes Annotated, 1978 Compilation) to approve this agreement and the conservation provisions hereof; and

BEFORE THE OIL CONSERVATION DIVISION  
Santa Fe, New Mexico  
Case No. 12923 Exhibit No. 1  
Submitted by:  
YATES PETROLEUM CORPORATION  
Hearing Date: September 19, 2002

WHEREAS, the parties hereto hold sufficient interests in the CALFROPE EXPLORATORY UNIT AREA covering the land hereinafter described to give reasonably effective control of operations therein; and

WHEREAS, it is the purpose of the parties hereto to conserve natural resources, prevent waste and secure other benefits obtainable through development and operation of the area subject to this agreement under the terms, conditions and limitations herein set forth;

NOW, THEREFORE, in consideration of the premises and the promises herein contained, the parties hereto commit to this agreement their respective interests in the below defined unit area, and agree severally among themselves as follows:

1. UNIT AREA: The following described land is hereby designated and recognized as constituting the unit area:

Township 15 South, Range 34 East  
Section 28: SW4, W2NW4, SE4NW4  
Section 29: All  
Section 32: All  
containing 1560.00 acres, more or less  
Lea County, New Mexico

Exhibit "A" attached hereto is a map showing the unit area and the boundaries and identity of tracts and leases in said area to the extent known to the unit operator. Exhibit "B" attached hereto is a schedule showing to the extent known to the unit operator the acreage, percentage and kind of ownership of oil and gas interests in all lands in the unit area. However, nothing herein or in said schedule or map shall be construed as a representation by any party hereto as to the ownership of any interest other than such interest or interests as are shown on said map or schedule as owned by such party. Exhibit "A" and "B" shall be revised by the unit operator whenever changes in ownership in the unit area render such revisions necessary or when requested by the Commissioner of Public Lands, hereinafter referred to as "Commissioner" or the Oil Conservation Division, hereinafter referred to as the "Division".

All land committed to this agreement shall constitute land referred to herein as "unitized land" or "land subject to this agreement".

2. UNITIZED SUBSTANCES: All oil, gas, natural gasoline, and associated fluid hydrocarbons in any and all formations of the unitized land are unitized under the terms of this agreement and herein are called "unitized substances".

3. UNIT OPERATOR: Yates Petroleum Corporation, whose address is 105 South Fourth Street, Artesia, New Mexico 88210 is hereby designated as unit operator and by signature hereto commits to this agreement all interest in unitized substances vested in it as set forth in Exhibit "B", and agrees and consents to accept the duties and obligations of unit operator for the discovery, development and production of unitized substances as herein provided. Whenever reference is made herein to the unit operator, such reference means the unit operator acting in that capacity and not as an owner of interests in unitized substances, and the term "working interest owner" when used herein shall include or refer to unit operator as the owner of a working interest when such an interest is owned by it.

4. RESIGNATION OR REMOVAL OF UNIT OPERATOR: Unit operator shall have the right to resign at any time but such resignation shall not become effective until a successor unit operator has been selected and approved in the manner provided for in Section 5 of this agreement. The resignation of the unit operator shall not release the unit operator from any liability or any default by it hereunder occurring prior to the effective date of its resignation.

Unit operator may, upon default or failure in the performance of its duties or obligations hereunder, be subject to removal by the same percentage vote of the owners of working interests determined in like manner as herein provided for the selection of a new unit operator. Such removal shall be effective upon notice thereof to the Commissioner and the Division.

The resignation or removal of the unit operator under this agreement shall not terminate his right, title or interest as the owner of a working interest or other interest in unitized substances, but upon the resignation or removal of unit operator becoming effective, such unit operator shall deliver possession of all equipment, materials, and appurtenances used in conducting the unit operations and owned by the working interest owners to the newly qualified successor unit operator, or to the owners thereof if no such new unit operation is elected, to be used for the purpose of conducting unit operations hereunder. Nothing herein shall be construed as authorizing removal of any material, equipment and appurtenances needed for the preservation of wells.

5. SUCCESSOR UNIT OPERATOR: Whenever the unit operator shall resign as unit operator or shall be removed as hereinabove provided, the owners of the working interests according to their respective acreage interests in all unitized land shall by a majority vote select a successor unit operator; provided that, if a majority but less than seventy five percent (75%) of the working interests qualified to vote is owned by one party to

this agreement, a concurring vote of sufficient additional parties, so as to constitute in the aggregate not less than seventy-five percent (75%) of the total working interests, shall be required to select a new operator. Such selection shall not become effective until (a) a unit operator so selected shall accept in writing the duties and responsibilities of unit operator, and (b) the selection shall have been approved by the Commissioner. If no successor unit operator is selected and qualified as herein provided, the Commissioner at his election, with notice to the Division, may declare this unit agreement terminated.

6. ACCOUNTING PROVISIONS: The unit operator shall pay in the first instance all costs and expenses incurred in conducting unit operations hereunder, and such costs and expenses and the working interest benefits accruing hereunder shall be apportioned among the owners of the unitized working interests in accordance with an operating agreement entered into by and between the unit operator and the owners of such interests, whether one or more, separately or collectively. Any agreement or agreements entered into between the working interest owners and the unit operator as provided in this section, whether one or more, are herein referred to as the "Operating Agreement". No such agreement shall be deemed either to modify any of the terms and conditions of this unit agreement or to relieve the unit operator of any right or obligation established under this unit agreement and in case of any inconsistencies or conflict between this unit agreement and the operating agreement, this unit agreement shall prevail.

7. RIGHTS AND OBLIGATIONS OF UNIT OPERATOR: Except as otherwise specifically provided herein, the exclusive right, privilege and duty of exercising any and all rights of the parties hereto which are necessary or convenient for prospecting for, producing, storing, allocating and distributing the unitized substances are hereby delegated to and shall be exercised by the unit operator as herein provided. Acceptable evidence of title to said rights shall be deposited with said unit operator and, together with this agreement, shall constitute and define the rights, privileges and obligations of unit operator. Nothing herein, however, shall be construed to transfer title to any land or to any lease or operating agreement, it being understood that under this agreement the unit operator, in its capacity as unit operator, shall exercise the rights of possession and use vested in the parties hereto only for the purposes herein specified.

8. DRILLING TO DISCOVERY: The unit operator shall, within sixty (60) days after the effective date of this agreement, commence operations upon an adequate test well for oil and gas upon some part of the lands embraced within the unit area and shall drill said well with due diligence to a depth sufficient to attain the top of the

Mississippian formation or to such a depth as unitized substances shall be discovered in paying quantities at a lesser depth or until it shall, in the opinion of unit operator, be determined that the further drilling of said well shall be unwarranted or impracticable; provided, however, that unit operator shall not, in any event, be required to drill said well to a depth in excess of 14,000 feet. Until a discovery of a deposit of unitized substances capable of being produced in paying quantities (to wit: quantities sufficient to repay the cost of drilling and producing operations with a reasonable profit) unit operator shall continue drilling diligently, one well at a time, allowing not more than six months between the completion of one well and the beginning of the next well, until a well capable of producing unitized substances in paying quantities is completed to the satisfaction of the Commissioner or until it is reasonably proven to the satisfaction of the unit operator that the unitized land is incapable of producing unitized substances in paying quantities in the formation drilled hereunder.

Any well commenced prior to the effective date of this agreement upon the unit area and drilled to the depth provided herein for the drilling of an initial test well shall be considered as complying with the drilling requirements hereof with respect to the initial well. The Commissioner may modify the drilling requirements of this section by granting reasonable extensions of time when in his opinion such action is warranted. Upon failure to comply with the drilling provisions of this article the Commissioner may, after reasonable notice to the unit operator and each working interest owner, lessee and lessor at their last known addresses, declare this unit agreement terminated, and all rights, privileges and obligations granted and assumed by this unit agreement shall cease and terminate as of such date.

9. OBLIGATIONS OF UNIT OPERATOR AFTER DISCOVERY OF UNITIZED SUBSTANCES:

Should unitized substances in paying quantities be discovered upon the unit area, the unit operator shall on or before six months from the time of the completion of the initial discovery well and within thirty days after the expiration of each twelve months period thereafter, file a report with the Commissioner and Division of the status of the development of the unit area and the development contemplated for the following twelve months period.

It is understood that one of the main considerations for the approval of this agreement by the Commissioner of Public Lands is to secure the orderly development of the unitized lands in accordance with good conservation practices so as to obtain the greatest ultimate recovery of unitized substances.

After discovery of unitized substances in paying quantities, unit operator shall proceed with diligence to reasonably develop the unitized area as a reasonably prudent operator would develop such area under the same or similar circumstances.

If the unit operator should fail to comply with the above covenant for reasonable development this agreement may be terminated by the Commissioner as to all lands of the State of New Mexico embracing undeveloped regular well spacing or proration units, but in such event, the basis of participation by the working interest owners shall remain the same as if this agreement had not been terminated as to such lands; provided, however, the Commissioner shall give notice to the unit operator and the lessees of record in the manner prescribed by (Sec. 19-10-20 N.M. Statutes 1978 Annotated,) of intention to cancel on account of any alleged breach of said covenant for reasonable development and decision entered thereunder shall be subject to appeal in the manner prescribed by (Sec. 19-10-23 N.M. Statutes 1978 Annotated), and, provided further, in any event the unit operator shall be given a reasonable opportunity after a final determination within which to remedy any default, failing in which this agreement shall be terminated as to all lands of the State of New Mexico embracing undeveloped regular well spacing or proration units.

Notwithstanding any of the provisions of this Agreement to the contrary, all undeveloped regular well spacing or proration unit tracts within the unit boundaries embracing lands of the State of New Mexico shall be automatically eliminated from this Agreement and shall no longer be a part of the unit or be further subject to the terms of this Agreement unless at the expiration of five years (5) after the first day of the month following the effective date of this Agreement diligent drilling operations are in progress on said tracts.

10. PARTICIPATION AFTER DISCOVERY: Upon completion of a well capable of producing unitized substances in paying quantities, the owners of working interests shall participate in the production therefrom and in all other producing wells which may be drilled pursuant hereto in the proportions that their respective leasehold interests covered hereby on an acreage basis bears to the total number of acres committed to this unit agreement, and such unitized substances shall be deemed to have been produced from the respective leasehold interests participating therein. For the purpose of determining any benefits accruing under this agreement and the distribution of the royalties payable to the State of New Mexico and other lessors, each separate lease shall have allocated to it such percentage of said production as the number of acres in each lease respectively committed to this agreement bears to the total number of acres committed hereto.

Notwithstanding any provisions contained herein to the contrary, each working interest owner shall have the right to take such owner's proportionate share of the unitized substances in kind or to personally sell or dispose of the same, and nothing herein contained shall be construed as giving or granting to the unit operator the right to sell or otherwise dispose of the proportionate share of any working interest owner without specific authorization from time to time so to do.

11. ALLOCATION OF PRODUCTION: All unitized substances produced from each tract in the unitized area established under this agreement, except any part thereof used for production or development purposes hereunder, or unavoidably lost, shall be deemed to be produced equally on an acreage basis from the several tracts of the unitized land, and for the hereunder, or unavoidably lost, shall be deemed to be produced equally on an acreage basis from the several tracts of the unitized land, and for the purpose of determining any benefits that accrue on an acreage basis, each such tract shall have allocated to it such percentage of said production as its area bears to the entire unitized area. It is hereby agreed that production of unitized substances from the unitized area shall be allocated as provided herein, regardless of whether any wells are drilled on any particular tracts of said unitized area.

12. PAYMENT OF RENTALS, ROYALTIES AND OVERRIDING ROYALTIES: All rentals due the State of New Mexico shall be paid by the respective lease owners in accordance with the terms of their leases.

All royalties due to the State of New Mexico under the terms of the leases committed to this agreement shall be computed and paid on the basis of all unitized substances allocated to the respective leases committed hereto; provided, however, the State shall be entitled to take in kind its share of the unitized substances allocated to the respective leases, and in such case the unit operator shall make deliveries of such royalty share in accordance with the terms of the respective leases.

All rentals, if any, due under any leases embracing lands other than the State of New Mexico, shall be paid by the respective lease owners in accordance with the terms of their leases and all royalties due under the terms of any such leases shall be paid on the basis of all unitized substances allocated to the respective leases committed hereto.

If the unit operator introduces gas obtained from sources other than the unitized substances into any producing formation for the purpose of repressuring, stimulating or increasing the ultimate recovery of unitized substances therefrom, a like amount of gas, if available, with due allowance for loss or depletion from any cause

may be withdrawn from the formation into which the gas was introduced royalty free as to dry gas but not as to the products extracted therefrom; provided, that such withdrawal shall be at such time as may be provided in a plan of operation consented to by the Commissioner and approved by the Division as conforming to good petroleum engineering practices; and provided further, that such right of withdrawal shall terminate on the termination of this unit agreement.

If any lease committed hereto is burdened with an overriding royalty, payment out of production or other charge in addition to the usual royalty, the owner of such lease shall bear and assume the same out of the unitized substances allocated to the lands embraced in each such lease as provided herein.

13. LEASES AND CONTRACTS CONFORMED AND EXTENDED INSOFAR AS THEY APPLY TO LANDS WITHIN THE UNITIZED AREA: The terms, conditions and provision of all leases, subleases, operating agreements and other contracts relating to the exploration, drilling development or operation for oil or gas of the lands committed to this agreement, shall as of the effective date hereof, be and the same are hereby expressly modified and amended insofar as they apply to lands within the unitized area to the extent necessary to make the same conform to the provisions hereof and so that the respective terms of said leases and agreements will be extended insofar as necessary to coincide with the terms of this agreement and the approval of this agreement by the Commissioner and the respective lessors and lessees shall be effective to conform the provisions and extend the terms of each such lease as to lands within the unitized area to the provisions and terms of this agreement; but otherwise to remain in full force and effect. Each lease committed to this agreement, insofar as it applies to lands within the unitized area, shall continue in force beyond the term provided therein as long as this agreement remains in effect, provided, drilling operations upon the initial test well provided for herein shall have been commenced or said well is in the process of being drilled by the unit operator prior to the expiration of the shortest term lease committed to this agreement. Termination of this agreement shall not affect any lease which pursuant to the terms thereof or any applicable laws would continue in full force and effect thereafter. The commencement, completion, continued operation or production on each of the leasehold interests committed to this agreement and operations or production pursuant to this agreement shall be deemed to be operations upon and production from each leasehold interest committed hereto and there shall be no obligation on the part of the unit operator or any of the owners of the respective leasehold interests committed hereto to drill offset to wells as between the leasehold interests committed to this agreement, except as provided in Section 9 hereof.

Any lease embracing lands of the State of New Mexico of which only a portion is committed hereto shall be segregated as to the portion committed and as to the portion not committed and the terms of such leases shall apply separately as two separate leases as to such segregated portions, commencing as of the effective date hereof. Notwithstanding any of the provisions of this agreement to the contrary, any lease embracing lands of the State of New Mexico having only a portion of its lands committed hereto shall continue in full force and effect beyond the term provided therein as to all lands embraced within the unitized area and committed to this agreement, in accordance with the terms of this agreement. If oil and gas, or either of them, are discovered and are being produced in paying quantities from some part of the lands embraced in such lease which part is committed to this agreement at the expiration of the secondary term of such lease, such production shall not be considered as production from lands embraced in such lease which are not within the unitized area, and which are not committed thereto, and drilling or reworking operations upon some part of the lands embraced within the unitized area and committed to this agreement shall be considered as drilling and reworking operations only as to lands embraced within the unit agreement and not as to lands embraced within the lease and not committed to this unit agreement; provided, however, as to any lease embracing lands of the State of New Mexico having only a portion of its lands committed hereto upon which oil and gas, or either of them, has been discovered is discovered upon that portion of such lands not committed to this agreement, and are being produced in paying quantities prior to the expiration of the primary term of such lease, such production in paying quantities shall serve to continue such lease in full force and effect in accordance with its terms as to all of the lands embraced in said lease.

14. CONSERVATION: Operations hereunder and production of unitized substances shall be conducted to provide for the most economical and efficient recovery of said substances without waste, as defined by or pursuant to State laws or regulations.

15. DRAINAGE: In the event a well or wells producing oil or gas in paying quantities should be brought in on land adjacent to the unit area draining unitized substances from the lands embraced therein, unit operator shall drill such offset well or wells as a reasonably prudent operator would drill under the same or similar circumstances.

16. COVENANTS RUN WITH LAND: The covenants herein shall be construed to be covenants running with the land with respect to the interests of the parties hereto and their successors in interest until this agreement terminates, and any grant, transfer or conveyance of interest in land or leases subject hereto shall be

and hereby is conditioned upon the assumption of all privileges and obligations hereunder to the grantee, transferee or other successor in interest. No assignment or transfer or any working, royalty, or other interest subject hereto shall be binding upon unit operator until the first day of the calendar month after the unit operator is furnished with the original, photostatic, or certified copy of the instrument of transfer.

17. EFFECTIVE DATE AND TERM: This agreement shall become effective upon approval by the Commissioner and the Division and shall terminate in five years after such date unless (a) such date of expiration is extended by the Commissioner, or (b) a valuable discovery of unitized substances has been made on unitized land during said initial term or any extension thereof in which case this agreement shall remain in effect so long as unitized substances are being produced in paying quantities from the unitized land and, should production cease, so long thereafter as diligent operations are in progress for the restoration of production or discovery of new production and so long thereafter as the unitized substances so discovered are being produced as aforesaid. This agreement may be terminated at any time by not less than seventy-five percent (75%) on an acreage basis of the owners of the working interests, signatory hereto, with the approval of the Commissioner and with notice to Division. Likewise, the failure to comply with the drilling requirements of Section 8 hereof, may subject this agreement to termination as provided in said section.

18. RATE OF PRODUCTION: All production and the disposal thereof shall be in conformity with allocations, allotments, and quotas made or fixed by the Division, and in conformity with applicable laws and lawful regulations.

19. APPEARANCES: Unit operator shall, after notice to other parties affected, have the right to appear for and on behalf of any and all interests affected hereby, before the Commissioner of Public Lands and the Division, and to appeal from orders issued under the regulations of the Commissioner or Division, or to apply for relief from any of said regulations or in any proceedings on its own behalf relative to operations pending before the Commissioner or Division; provided, however, that any other interest party shall also have the rights at his own expense to appear and to participate in any such proceeding.

20. NOTICES: All notices, demands or statements required hereunder to be given or rendered to the parties hereto, shall be deemed fully given, if given in writing and sent by postpaid registered mail, addressed to such party or parties at their respective addresses, set forth in connection with the signatures hereto or to the

ratification or consent hereof, or to such other address as any such party may have furnished in writing to party sending the notice, demand, or statement.

21. LOSS OF TITLE: In the event title to any tract of unitized land or substantial interest therein shall fail, and the true owner cannot be induced to join the unit agreement so that such tract is not committed to this agreement, or the operation thereof hereunder becomes impracticable as a result thereof, such tract may be eliminated from the unitized area, and the interest of the parties readjusted as a result of such tract being eliminated from the unitized area. In the event of a dispute as to the title to any royalty, working, or other interest subject hereto, the unit operator may withhold payment or delivery of the allocated portion of the unitized substances involved on account thereof, without liability for interest until the dispute is finally settled, provided that no payments of funds due the State of New Mexico shall be withheld. Unit operator, as such, is relieved from any responsibility for any defect or failure of any title hereunder.

22. SUBSEQUENT JOINDER: Any oil or gas interest in lands within the unit area not committed hereto, prior to the submission of the agreement for final approval by the Commissioner and the Division, may be committed hereto by the owner or owners of such rights, subscribing or consenting to this agreement, or executing a ratification thereof, and if such owner is also a working interest owner, by subscribing to the operating agreement providing for the allocation of costs of exploration, development and operation. A subsequent joinder shall be effective as of the first day of the month following the approval by the Commissioner and the filing with the Division of duly executed counterparts of the instrument or instruments committing the interest of such owner to this agreement, but such joining party or parties, before participating in any benefits hereunder, shall be required to assume and pay to unit operator, their proportionate share of the unit expenses incurred prior to such party's or parties joinder in the unit agreement, and the unit operator shall make appropriate adjustments caused by such joinder, without any retroactive adjustment of revenue.

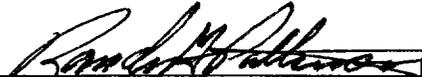
23. COUNTERPARTS: This agreement may be executed in any number of counterparts, no one of which needs to be executed by all parties, or may be ratified or consented to by separate instrument in writing specifically referring hereto, and shall be binding upon all those parties who have executed such a counterpart, ratification, or consent hereto with the same force and effect as if all such parties had signed the same document, and regardless of whether or not it is executed by all other parties owning or claiming an interest in the lands within the above described unit area.

IN WITNESS WHEREOF, the undersigned parties hereto have caused this agreement to be executed as of the respective dates set forth opposite their signatures.

UNIT OPERATOR AND WORKING INTEREST OWNERS

YATES PETROLEUM CORPORATION  
YATES DRILLING COMPANY  
ABO PETROLEUM CORPORATION  
MYCO INDUSTRIES, INC.

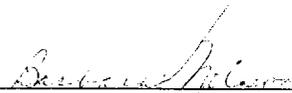
Date 8-30-02

  
\_\_\_\_\_  
Attorney-in-Fact

STATE OF NEW MEXICO     §  
  §  
COUNTY OF EDDY         §

The foregoing instrument was acknowledged before me this 30<sup>th</sup> day of August, 2002 by Randy G. Patterson, Attorney-in-Fact for YATES PETROLEUM CORPORATION, YATES DRILLING COMPANY, ABO PETROLEUM CORPORATION and MYCO INDUSTRIES, INC., all New Mexico corporations, on behalf of said corporations.

My commission expires:  
1-8-04

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

IN WITNESS WHEREOF, the undersigned parties hereto have caused this agreement to be executed as of the respective dates set forth opposite their signatures.

WORKING INTEREST OWNER

David Petroleum Corp.

Date 9/12/02

Edward N. David  
Edward N. David, Vice President

McMillan Production <sup>Company</sup> ~~Corporation~~, Inc.

Date 9/12/02

Colin McMillan  
Colin McMillan, President & CEO

McMillan Ventures, LLC

Date 9/12/02

Colin McMillan  
Colin McMillan, Managing Member

Permian Exploration ~~Company~~ Corporation

Date 9/12/02

Colin McMillan  
Colin McMillan, Chairman & CEO

Michael A. McMillan

Date 9-12-02

Michael A. McMillan

Edward N. David

Date 9-12-02

Edward N. David

Keith E. McKamey

Date 9-12-02

Keith E. McKamey

William B. Owen

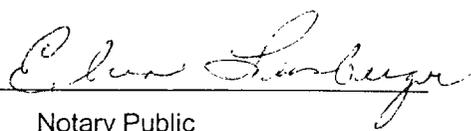
Date 9-12-02

William B. Owen

STATE OF NEW MEXICO §  
COUNTY OF CHAVES §  
§

The foregoing instrument was acknowledged before me this 12th day of September, 2002 by Edward N. David, as Vice-President of David Petroleum Corporation, a Texas corporation, on behalf of said corporation.

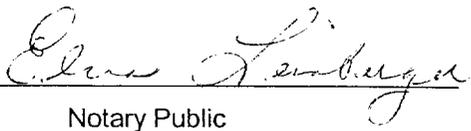
My commission expires:  
7/31/05

  
Notary Public

STATE OF NEW MEXICO §  
COUNTY OF CHAVES §  
§

The foregoing instrument was acknowledged before me this 12th day of September, 2002 by Colin McMillan, as President and CEO for McMillan Production Company, a New Mexico corporation, on behalf of said corporation.

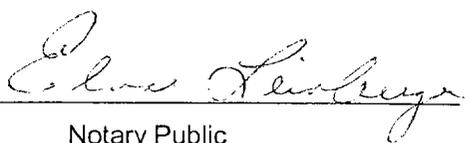
My commission expires:  
7/31/05

  
Notary Public

STATE OF NEW MEXICO §  
COUNTY OF CHAVES §  
§

The foregoing instrument was acknowledged before me this 12th day of September 2002, by Colin McMillan, as Managing Member of McMillan Ventures, LLC, a New Mexico limited liability company, on behalf of said company.

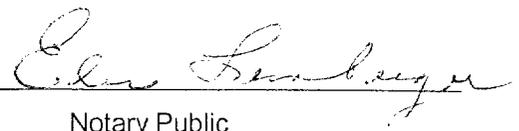
My commission expires:  
7/31/05

  
Notary Public

STATE OF NEW MEXICO §  
COUNTY OF CHAVES §  
§

The foregoing instrument was acknowledged before me this 12th day of September, 2002 by Colin McMillan, as Chairman and CEO for Permian Exploration Corporation, a New Mexico corporation, on behalf of said corporation.

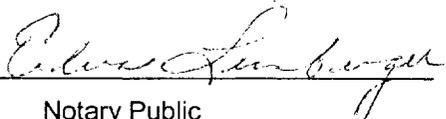
My commission expires:  
7/31/05

  
Notary Public

STATE OF NEW MEXICO §  
COUNTY OF CHAVES §

The foregoing instrument was acknowledged before me this 12th day of September, 2002 by Keith E. McKamey.

My commission expires:  
7/31/05

  
Notary Public

STATE OF NEW MEXICO §  
COUNTY OF CHAVES §

The foregoing instrument was acknowledged before me this 12th day of September, 2002 by William B. Owen.

My commission expires:  
7/31/05

  
Notary Public

STATE OF NEW MEXICO §  
COUNTY OF CHAVES §

The foregoing instrument was acknowledged before me this 12th day of September, 2002 by Edward N. David.

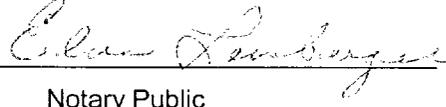
My commission expires:  
7/31/05

  
Notary Public

STATE OF NEW MEXICO §  
COUNTY OF CHAVES §

The foregoing instrument was acknowledged before me this 12th day of September, 2002 by Michael A. McMillan.

My commission expires:  
7/31/05

  
Notary Public



**EXHIBIT B**  
**CALFROPE STATE EXPLORATORY UNIT**  
**LEA COUNTY, NM**

TRACT NUMBER	DESCRIPTION OF LANDS	NET ACRES	SERIAL NUMBER AND EXPIRATION DATE	LESSOR	LESSEE OF RECORD	OVERRIDING ROYALTY	WORKING INTEREST
1.	<u>T155, R34E</u> Sec: 29: All	640.00	VA-1688 10/1/02	State of New Mexico	Yates Petroleum Corporation	None	Yates Petroleum Corporation 49.0000% Yates Drilling Company 7.0000% Abo Petroleum Corporation 7.0000% Mycro Industries, Inc. 7.0000% David Petroleum Corp. 12.7200% McMillian Production Corporation, Inc. 4.7699% McMillian Ventures 6.0000% Permian Exploration Company 5.3853% Michael A. McMillian 0.5633% Edward N. David 0.2811% Keith E. McKamey 0.1411% William B. Owen 0.1411%
2.	<u>T155, R34E</u> Sec: 32: All	640.00	VA-1699 11/1/02	State of New Mexico	Yates Petroleum Corporation	None	Yates Petroleum Corporation 49.0000% Yates Drilling Company 7.0000% Abo Petroleum Corporation 7.0000% Mycro Industries, Inc. 7.0000% David Petroleum Corp. 12.7200% McMillian Production Corporation, Inc. 4.7699% McMillian Ventures 6.0000% Permian Exploration Company 5.3853% Michael A. McMillian 0.5633% Edward N. David 0.2811% Keith E. McKamey 0.1411% William B. Owen 0.1411%
3.	<u>T155, R34E</u> Sec 28: SW4, W2NW4, SE4NW4	280.00	VO-6100 1/1/06	State of New Mexico	Yates Petroleum Corporation	None	Yates Petroleum Corporation 49.0000% Yates Drilling Company 7.0000% Abo Petroleum Corporation 7.0000% Mycro Industries, Inc. 7.0000% David Petroleum Corp. 12.7200% McMillian Production Corporation, Inc. 4.7699% McMillian Ventures 6.0000% Permian Exploration Company 5.3853% Michael A. McMillian 0.5633% Edward N. David 0.2811% Keith E. McKamey 0.1411% William B. Owen 0.1411%
<b>TOTAL STATE LANDS</b>		<b>1560 ACRES</b>					
<b>TOTAL ACRES</b>		<b>1560 ACRES</b>					

**COMMISSIONER'S OFFICE**

Phone (505) 827-5760  
Fax (505) 827-5766

**ADMINISTRATION**  
Phone (505) 827-5700  
Fax (505) 827-5853

**GENERAL COUNSEL**  
Phone (505) 827-5713  
Fax (505) 827-4262

**PUBLIC AFFAIRS**  
Phone (505) 827-1245  
Fax (505) 827-5766



**New Mexico State Land Office  
Commissioner of Public Lands  
Ray Powell, M.S., D.V.M.**

**COMMERCIAL RESOURCES**  
Phone (505) 827-5724  
Fax (505) 827-6157

**MINERAL RESOURCES**  
Phone (505) 827-5744  
Fax (505) 827-4739

**ROYALTY MANAGEMENT**  
Phone (505) 827-5772  
Fax (505) 827-4739

**SURFACE RESOURCES**  
Phone (505) 827-5793  
Fax (505) 827-5711

September 17, 2002

Yates Petroleum Corporation  
105 South Fourth Street  
Artesia, New Mexico 88210

Attention: Mr. Robert Bullock

Re: Preliminary Approval  
Proposed Calftrope State Exploratory Unit  
Lea County, New Mexico

Dear Mr. Bullock:

This office has received the unexecuted copy of the unit agreement, which you have submitted for the proposed Calftrope State Exploratory Unit area, Lea County, New Mexico. This agreement meets the general requirements of the Commissioner of Public Lands, who has this date granted you preliminary approval as to form and content.

Preliminary approval shall not be construed to mean final approval of this agreement in any way and will not extend any short term leases, until final approval and an effective date have been given.

When submitting your agreement for final approval, please submit the following:

1. Application for final approval by the Commissioner setting forth the tracts that have been committed and the tracts that have not been committed.
2. Pursuant to Rule 1.045, applications for approval shall contain a statement of facts showing:
  - a. That such agreement will tend to promote the conservation of oil and gas and the better utilization of reservoir energy.
  - b. That under the proposed unit operation, the State of New Mexico will receive its fair share of the recoverable oil and gas in place under its lands in the proposed unit area.
  - c. That each beneficiary institution of the State of New Mexico will receive its fair and equitable share of the recoverable oil and gas under its lands within the unit area.
  - d. That such unit agreement is in other respects for the best interest of the trust.
3. All ratifications from the Lessees of Record and Working Interest Owners. All signatures should be acknowledged by a notary and one set must contain original signatures.
4. Order of the New Mexico Oil Conservation Division. Our approval will be conditioned upon subsequent favorable approval by the New Mexico Oil Conservation Division.
5. Please submit two copies of the Unit Agreement.

BEFORE THE OIL CONSERVATION DIVISION  
Santa Fe, New Mexico  
Case No. 12923 Exhibit No. 2  
Submitted by:  
YATES PETROLEUM CORPORATION  
Hearing Date: September 19, 2002

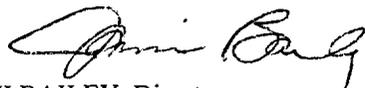
Yates Petroleum Corporation  
September 17, 2002  
Page 2

6. A copy of the Unit Operating Agreement (if applicable).
7. Copies of all the well records for the initial unit well.
8. Your filing fee in the amount of \$90.00 has been received.

If you have any questions or if we may be of further help, please contact Pete Martinez at (505) 827-5791.

Very truly yours,

RAY POWELL, M.S., D.V.M.  
COMMISSIONER OF PUBLIC LANDS

BY: 

JAMI BAILEY, Director  
Oil, Gas and Minerals Division  
(505) 827-5744

RP/JB/pm

cc: OCD-Santa Fe, Attention: Mr. Roy Johnson  
William F. Carr



105 SOUTH FOURTH STREET  
 ARTESIA, NEW MEXICO 88210  
 TELEPHONE (505) 748-1471

**AUTHORITY FOR EXPENDITURE**  
 NEW DRILLING, RECOMPLETION & RE-ENTRY

AFE NO. 02-316-0  
 AFE DATE 8/20/02

AFEND (rev 6/98)  
 8-20-02

AFE Type:	Well Objective:	Well Type:
<input type="checkbox"/> New Drilling	<input type="checkbox"/> Oil	<input type="checkbox"/> Development
<input type="checkbox"/> Recompletion	<input checked="" type="checkbox"/> Gas	<input type="checkbox"/> Exploratory
<input checked="" type="checkbox"/> Re-entry	<input type="checkbox"/> Injector	

AFE STATUS:

<input checked="" type="checkbox"/>	Original
<input type="checkbox"/>	Revised
<input type="checkbox"/>	Final
<input type="checkbox"/>	Supplemental

LEASE NAME	Calprope State Unit #1	PROJ'D DEPTH	14,000'
COUNTY	Lea	STATE	New Mexico
FIELD		HORIZON	Mississippian
LOCATION	Section 28, T15S-R34E, 2068' S & 610' W		

DIVISION CODE	100	DIVISION NAME	Oil & Gas Division
DISTRICT CODE		DISTRICT NAME	
BRANCH CODE		BRANCH NAME	

PROGNOSIS: Re-enter and deepen existing well drilled to 11,650' by Chevron in 1990.

INTANGIBLE DRILLING COSTS:		DRY HOLE	COMP'D WELL
920-100	Staking, Permit & Legal Fees	3,000	3,000
920-110	Location, Right-of-Way	20,000	20,000
920-120	Drilling, Footage	0	0
920-130	Drilling, Daywork 25 days @ \$7,500/day + \$25,000 for mob	225,000	225,000
920-140	Drilling Water, Fasline Rental	15,000	15,000
920-150	Drilling Mud & Additives	30,000	30,000
920-160	Mud Logging Unit, Sample Bags	12,000	12,000
920-170	Cementing - Surface Casing		
920-180	Drill Stem Testing, OHT		
920-190	Electric Logs & Tape Copies	35,000	35,000
920-200	Tools & Equip. Rntl., Trkg. & Welding	50,000	50,000
920-205	Control of Well-Insurance	4,700	4,700
920-210	Supervision & Overhead	14,000	14,000
920-230	Coring, Tools & Service		
920-240	Bits, Tool & Supplies Purchase	25,000	25,000
920-350	Cementing - Production Casing		35,000
920-410	Completion Unit - Swabbing		25,000
920-420	Water for Completion		5,000
920-430	Mud & Additives for Completion		1,000
920-440	Cementing - Completion		0
920-450	Elec. Logs, Testing, Etc. - Completion		20,000
920-460	Tools & Equip. Rental, Etc. - Completion		35,000
920-470	Stimulation for Completion		100,000
920-480	Supervision & O/H - Completion		6,000
920-490	Additional LOC Charges - Completion		3,000
920-510	Bits, Tools & Supplies - Completion		1,800
920-500	Contingency for Completion		
<b>TOTAL INTANGIBLE DRILLING COSTS</b>		<b>433,700</b>	<b>665,500</b>

TANGIBLE EQUIPMENT COSTS:		DRY HOLE	COMP'D WELL
930-010	Christmas Tree & Wellhead	5,000	25,000
930-020	Casing 5 1/2" @ 14,000'		122,000
930-030	Tubing 2 7/8" @ 13,800'		55,000
930-040	Packer & Special Equipment		
940-010	Pumping Equipment		
940-020	Storage Facilities		15,000
940-030	Separation Equip., Flowlines, Misc.		30,000
940-040	Trucking & Construction Costs		15,000
<b>TOTAL TANGIBLE EQUIPMENT COSTS</b>		<b>5,000</b>	<b>262,000</b>

**TOTAL COSTS** 438,700 927,500

IT IS RECOGNIZED THAT THE AMOUNTS PROVIDED FOR HEREIN ARE ESTIMATED ONLY AND APPROVAL OF THIS AFE SHALL EXTEND TO THE ACTUAL COSTS INCURRED IN CONDUCTING THE OPERATIONS SPECIFIED WHETHER MORE OR LESS THAN HEREIN SET OUT.

Prepared By RB Cory Frederick	Operations Approval
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BY	DATE
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BY	DATE
----	------

BY	DATE
----	------

BY	DATE
----	------

BEFORE THE OIL CONSERVATION DIVISION  
 Santa Fe, New Mexico  
 Case No. 12923 Exhibit No. 3  
 Submitted by:  
 YATES PETROLEUM CORPORATION  
 Hearing Date: September 19, 2002

## BRIEF SUMMARY

### ATTEMPTS TO LEASE ETCHEVERRY FAMILY LIMITED PARTNERSHIP MINERALS

- 10/15/00 1. Contacted Nancy Etcheverry re: acreage in Sections 21 and 28  
Offered \$100/acre for three year paid up lease - 3/16 royalty (\$24,480.00)  
Lease contained 180 day continuous development clause and 2 year shut-in  
royalty clause.
- 10/18/00 **Mailed lease and draft to Nancy Etcheverry.**
2. Etcheverry indicated she was using a local attorney, Gene Samberson, to  
negotiate the lease. After numerous calls to Samberson were not returned,  
Etcheverry indicated she would use Joel Carson (Artesia attorney) as her  
consultant. Our conversation with Joel Carson ended when he learned Yates  
Petroleum was involved. He declined, citing a possible conflict of interest.
- 2/22/01 Etcheverry then chose Mike Boling as her consultant. After a conversation with  
Boling, an apparent agreement was reached (which he opposed) for a three year  
term, which reserved a 1/6 royalty with a bonus of \$261.00 per acre  
(\$62,640.50). This trade would be in line with a recent state tract acquired in the  
area (with the exception being the State Lease was a five year term.)
- Mailed lease and draft to Nancy Etcheverry.**
- 3/01 1. This office was contact by Dell Morgan (Mrs. Etcheverry's son), who indicated  
they were not accepting any lease, which only reserved a 1/6 royalty. After  
further negotiations, we felt we had reached an agreement for a three year lease,  
3/16<sup>th</sup> royalty and \$150 per acre bonus (\$36,480.00).
- 3/27/01 **New lease and draft for the aforementioned terms mailed to Nancy  
Etcheverry.**
- 10/6/01 Received Surface User Agreement – Yates, et al elected not to agree to same.
- 5/14/02 Morgan contacted this office indicating the Etcheverrys were now regarding a  
bonus of \$175/acre, three year term, 3/16 royalty (\$42,480.00) (Still no surface  
damage agreement).
- 5/15/02 1. **This office mailed above offer oil and gas lease, draft, etc.**
2. Morgan contacted us indicating Etcheverrys now wanted \$200/acre, three year  
term, reserving a 3/16 royalty, BPO, ¼ royalty APO. We negotiated an apparent  
trade providing for the above royalty with a bonus of \$200/acre for acreage in  
Section 28 and \$175/acre for acreage in Section 21 (\$43,813.35). Again  
requested surface damage agreement.
- 6/1/02 Contacted Morgan to recommence negotiations for a lease. Morgan indicated  
Etcheverry's new policy for oil and gas leases was \$200.00, a 1/5 royalty BPO  
and ¼ royalty APO. He indicated the surface agreement was being modified  
and much more onerous. We requested a copy.

8/21/02 YPC mailed Etcheverry AFE and offered him the opportunity to participate in well.

8/23/02 YPC mailed Etcheverry a letter giving them an opportunity to participate in unit.

8/26/02 Received Surface Damage Agreement.

8/28/02 Advised Etcheverry we could not agree to Surface Damage Agreement. They said it was non-negotiable.

9/5/02 Offered to only lease part of land and change Surface Agreement. They said "No."

9/12/02 Offered to lease only 40 acres in NE/4NW/4.

9/13/02 Offered to lease 40 acres and said we would not touch their surface.



105 South Fourth Street  
Artesia, NM 88210

August 21, 2002

Etcheverry Family Limited Partnership  
PO Box 1656  
Lovington, NM 88260

**Certified Mail**  
Return Receipt Requested

**Re: Callrope State Unit #1**  
**Township 15 South, Range 34 East**  
**Section 28: W/2**  
**Lea County, New Mexico**

Gentlemen:

Please find enclosed our AFE to drill the captioned well. Your interest in this well is 8.33333% by virtue of owning 26.66667 unleased mineral acres in the NENW of Section 28. If you wish to participate please execute the enclosed AFE and remit your check in the amount of \$36,558.19 which is your share of the AFE dry hole costs.

Should you not wish to participate Yates would lease your mineral interest for a two year term, 1/5 royalty and a total consideration of \$2,666.67.

Please call me at 505-748-4351 if you would like to discuss.

Thank you.

Very truly yours,

**YATES PETROLEUM CORPORATION**

A handwritten signature in cursive script that reads 'Robert Bullock'.

Robert Bullock  
Landman

RB:bn  
enclosure(s)



106 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

**AUTHORITY FOR EXPENDITURE**  
NEW DRILLING, RECOMPLETION & RE-ENTRY

AFE NO. 02-316-0  
AFE DATE 8/20/02

APEND (Rev 8/98)  
8-20-02

AFE Type:	Well Objective:	Well Type:
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<input type="checkbox"/> Recompletion	<input checked="" type="checkbox"/> Gas	<input type="checkbox"/> Exploratory
<input checked="" type="checkbox"/> Re-entry	<input type="checkbox"/> Injector	

AFE STATUS:

<input checked="" type="checkbox"/>	Original
<input type="checkbox"/>	Revised
<input type="checkbox"/>	Final
<input type="checkbox"/>	Supplemental

LEASE NAME	Calhoun State Unit #1	PROJ'D DEPTH	14,000'
COUNTY	Lea	STATE	New Mexico
FIELD		HORIZON	Mississippian
LOCATION	Section 28, T15S-R34E, 2068' S & 810' W		

DIVISION CODE	100	DIVISION NAME	Oil & Gas Division
DISTRICT CODE		DISTRICT NAME	
BRANCH CODE		BRANCH NAME	

PROGNOSIS: Re-enter and deepen existing well drilled to 11,650' by Chevron in 1990.

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920-110	Location, Right-of-Way	20,000	20,000
920-120	Drilling, Footage	0	0
920-130	Drilling, Daywork 25 days @ \$7,500/day + \$25,000 for mob	225,000	225,000
920-140	Drilling Water, Fastline Rental	15,000	15,000
920-150	Drilling Mud & Additives	30,000	30,000
920-160	Mud Logging Unit, Sample Bags	12,000	12,000
920-170	Cementing - Surface Casing		
920-180	Drill Stem Testing, OHT		
920-190	Electric Logs & Tape Copies	35,000	35,000
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920-240	Bits, Tool & Supplies Purchase	25,000	25,000
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920-420	Water for Completion		5,000
920-430	Mud & Additives for Completion		1,000
920-440	Cementing - Completion		0
920-450	Elec. Logs, Testing, Etc. - Completion		20,000
920-460	Tools & Equip. Rental, Etc. - Completion		35,000
920-470	Stimulation for Completion		100,000
920-480	Supervision & O/H - Completion		6,000
920-490	Additional LOC Charges - Completion		3,000
920-510	Bits, Tools & Supplies - Completion		1,800
920-500	Contingency for Completion		
<b>TOTAL INTANGIBLE DRILLING COSTS</b>		<b>433,700</b>	<b>665,500</b>

TANGIBLE EQUIPMENT COSTS:		DRY HOLE	COMP'D WELL
930-010	Christmas Tree & Wellhead	5,000	25,000
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930-040	Packer & Special Equipment		
940-010	Pumping Equipment		
940-020	Storage Facilities		15,000
940-030	Separation Equip., Flowlines, Misc.		30,000
940-040	Trucking & Construction Costs		15,000
<b>TOTAL TANGIBLE EQUIPMENT COSTS</b>		<b>5,000</b>	<b>282,000</b>

**TOTAL COSTS** 438,700 927,500

IT IS RECOGNIZED THAT THE AMOUNTS REVIEWED FOR THE ABOVE DESCRIBED OPERATIONS ARE SUBJECT TO THE ACTUAL COSTS INCURRED IN CONDUCTING THE OPERATIONS SPECIFIED WHETHER MORE OR LESS THAN HEREIN SET OUT.

Prepared By RB	Cory Frederick	Operations Approval	
BY		DATE	

AUG-23-2002 09:31

5057484572

P. 02



105 South Fourth Street  
Artesia, NM 88210

August 23, 2002

Etcheverry Family Limited Partnership  
PO Box 1656  
Lovington, NM 88260

**Certified Mail**  
Return Receipt Requested

**Re: Calftrope State Unit #1**  
**Township 15 South, Range 34 East**  
**Section 28: W/2**  
**Lea County, New Mexico**

Gentlemen:

This letter is being written as a follow-up to our letter of August 21, 2000 concerning our plans to drill the captioned well.

As a part of our plans to drill this well we are forming a State Exploratory Unit which includes all of Sections 29 and 32 and the W/2 of Section 28, containing 1600 total acres. You have the right and we hereby solicit you to join this unit as a drilling party or a leasing party and your interest in this scenario would be 26.66667 acres/1600 acres. You would benefit in a well drilled anywhere within the unit boundary.

If you choose not to join the State Exploratory Unit you have the right and we hereby solicit you to join the well as a drilling party or a leasing party and your interest would be 26.66667 acres/320 acres. Under this scenario you would only benefit in a well drilled in the W/2 of Section 28.

Please call me at 505-748-4351 if I can answer any additional questions regarding the above. Thank you.

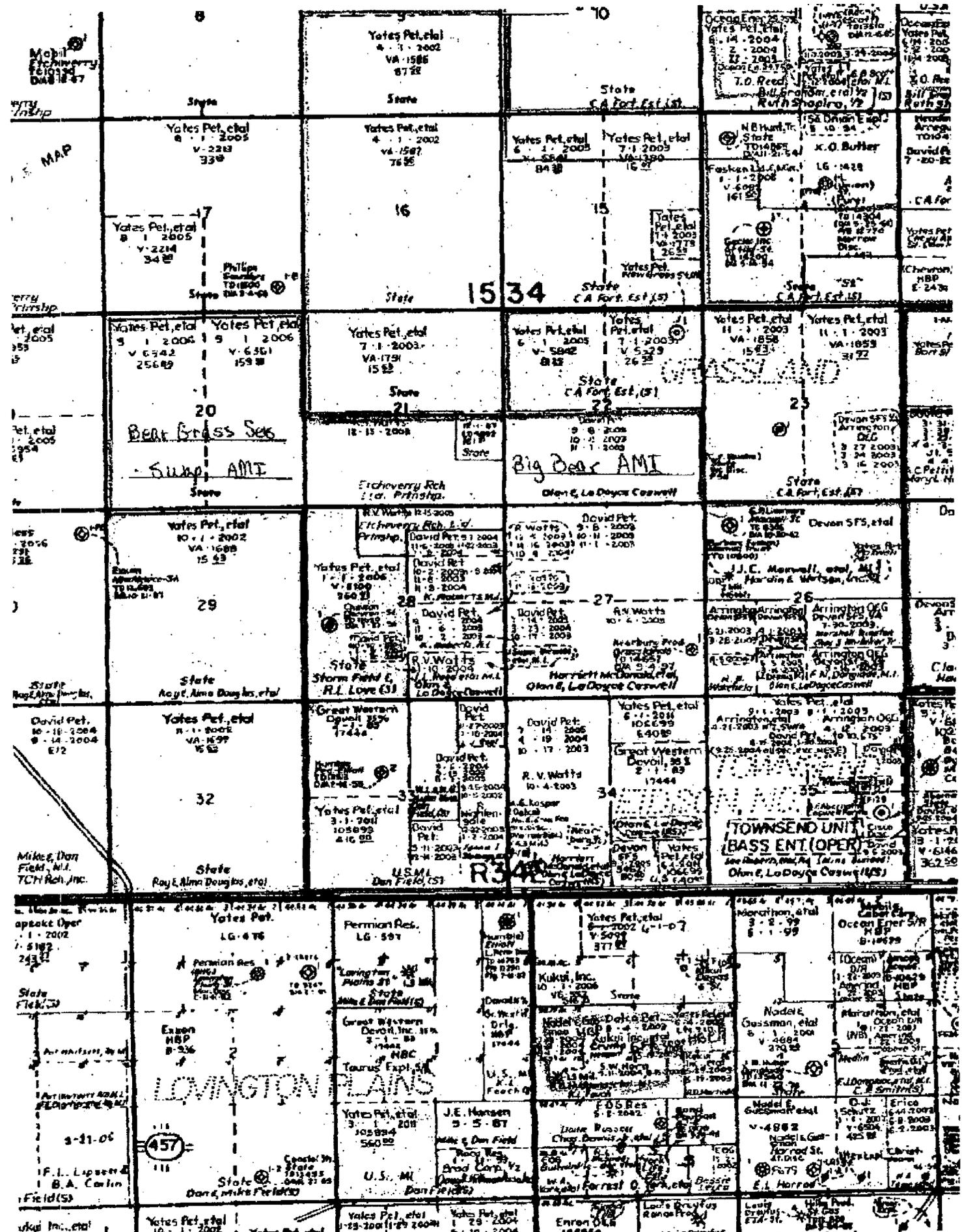
Very truly yours,

**YATES PETROLEUM CORPORATION**

A handwritten signature in cursive script that reads 'Robert Bullock'.

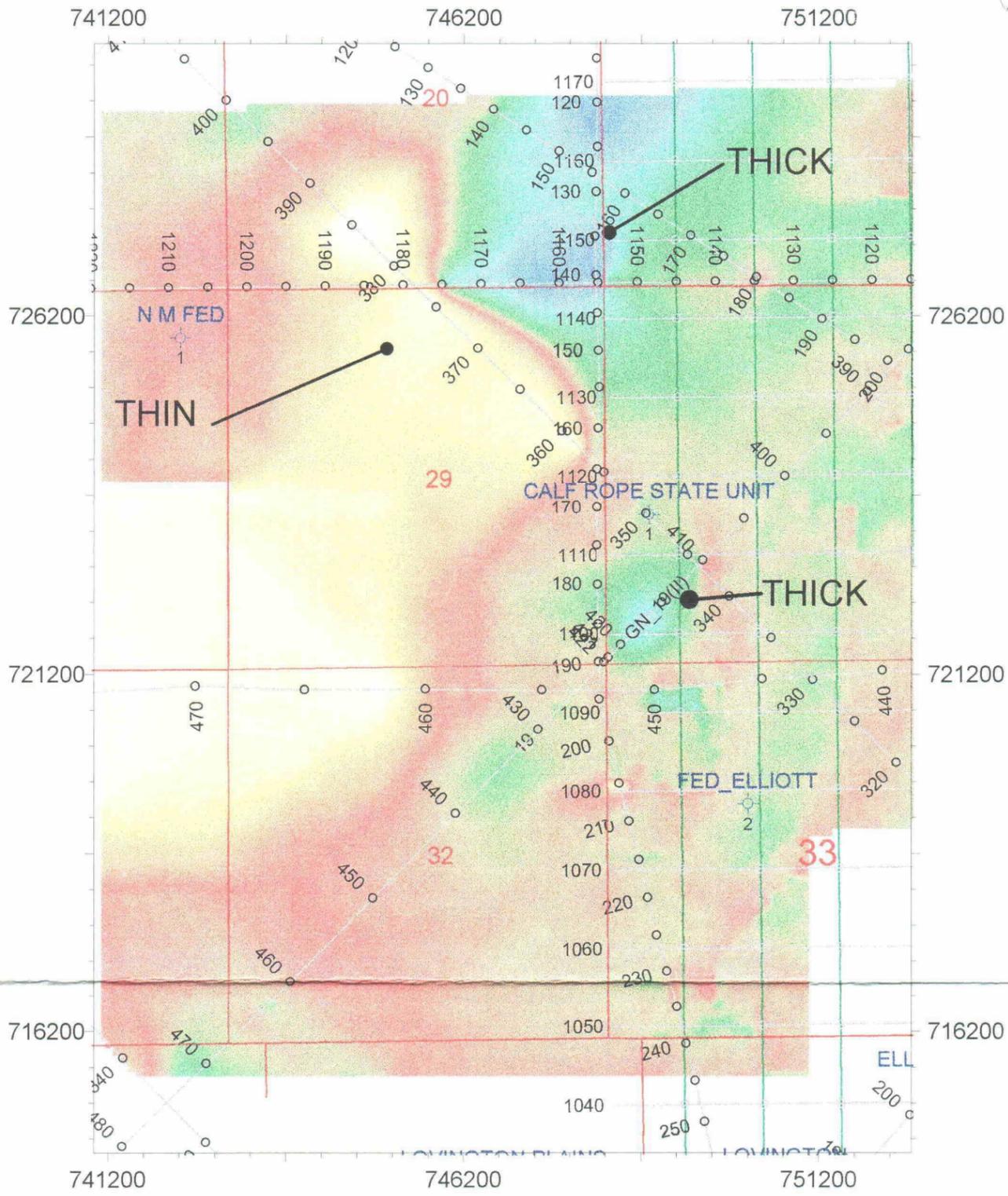
Robert Bullock  
Landman

RB:bn



AUG-23-2002 14:21

5057484572



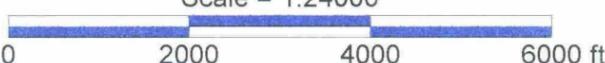
 **DAVID PETROLEUM CORP.**

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Project: CALF ROPE UNIT  
LEA COUNTY, NEW MEXICO

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Scale = 1:24000




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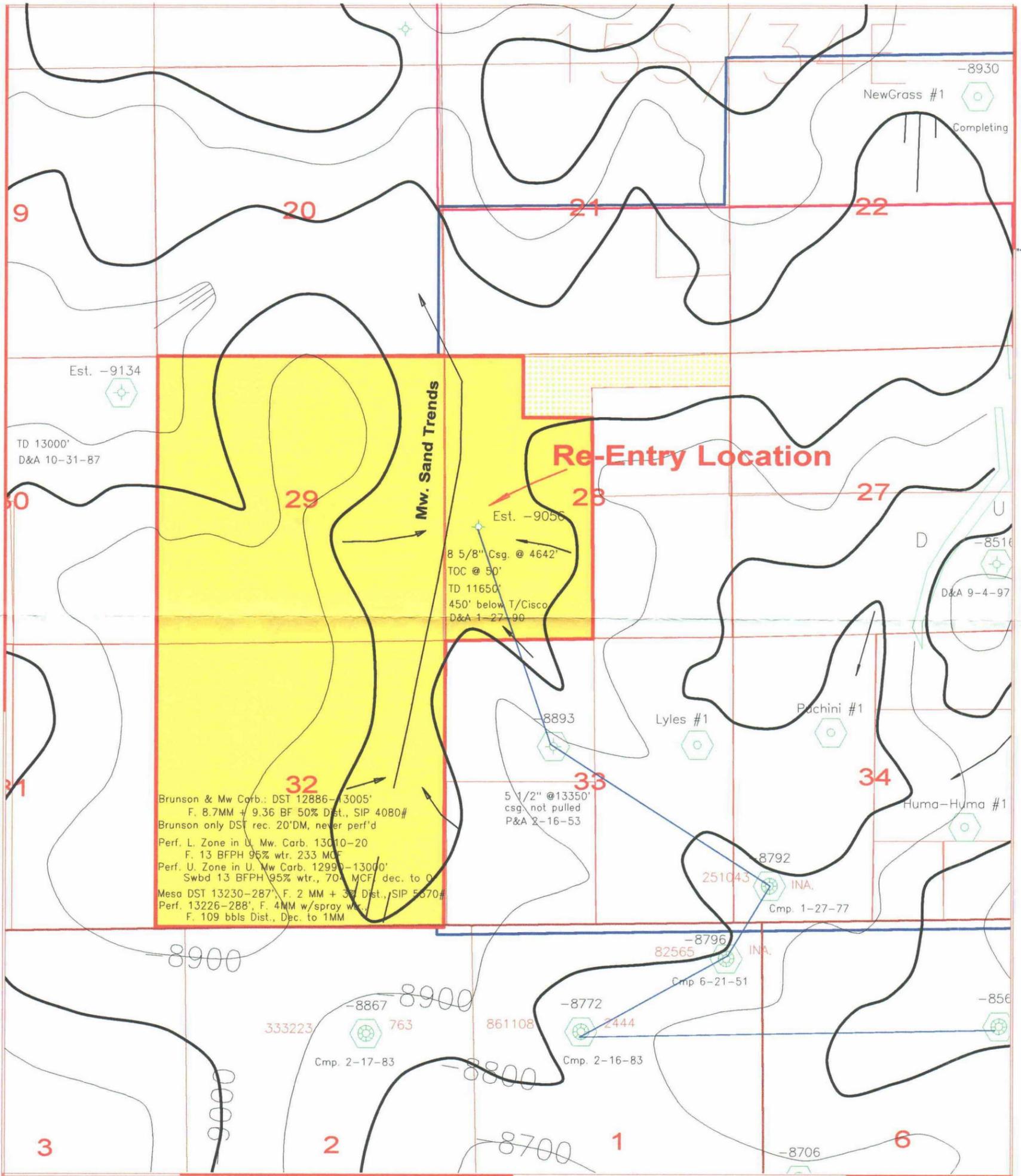
Grid: B/ATOKA\_ISO\_GRD (PXC) (Red), Data Type: Time  
MICHAEL MCMILLAN

# CALFROPE UNIT MORROW STRUCTURE

(Seismic Corrected):

Geol.: Keith E. McKamey

Updated 8-23-02



DAVID PETROLEUM CORPORATION		
CALFROPE UNIT (Red) Morrow Structure Northwest-Southeast X Section (Blue)		
Keith E. McKamey	Atoka Digitized	9/18/2002
C.I. 100'	Scale 1:24000.	MwS1117

BEFORE THE OIL CONSERVATION DIVISION  
Santa Fe, New Mexico  
Case No. 12923 Exhibit No. 5  
Submitted by:  
YATES PETROLEUM CORPORATION  
Hearing Date: September 19, 2002