



May 13, 2013

Dean Kinsolving
P.O. Box 325
Tatum NM 88257-0325

3300 N. A Street, Bldg. 7-200
Midland, Texas 79705
432.688.1700
432.688.1701 fax
SM-Energy.com

RE: Well Proposal
Osage 34 Federal 1H
N/2 N/2 Section 34, T-19-S, R-29-E, N.M.P.M.
Eddy County, New Mexico

Mr. Kinsolving:

SM Energy Company, as Operator, hereby proposes the drilling of a horizontal well to test the Second Bone Spring Sand interval in the Bone Spring formation in the N/2 N/2 of said Section 34. The well will have a surface location in the NE/4 NE/4 and a planned bottom hole location in the NW/4 NW/4 of said Section 34. The planned TVD is 8,020' and TMD is 12,491'. The estimated dry hole and completed well costs for this Bone Spring horizontal well are \$4,017,165.00 and \$6,515,585.00 respectively and are detailed on the AFE enclosed herewith.

A drilling title opinion indicates you are entitled to participate in this well with a 0.80% working interest. In the event you do not elect to participate in the well, SM Energy Company would be interested in acquiring your interest through a farmout agreement or term assignment.

Enclosed herein please find the following:

- Two copies of the AFE
- One copy of the Operating Agreement
- Two copies of signatory pages of Operating Agreement
- Two copies of the Memorandum of Operating Agreement

In the event you elect to participate in the drilling of the Osage 34 Federal 1H well, please return the following to my attention:

- One (1) signed copy of this letter indicating your election
- One (1) signed copy of the AFE
- One (1) set of signed signature pages to the Operating Agreement
- One (1) executed copy of the Memorandum of Operating Agreement

NMOCD CASE NO. 15018
JULY 11, 2013
SM ENERGY EX. NO. 3

For your convenience the return copies of each of these items are labeled and self-addressed, postage paid return envelope is enclosed. The additional copies are for your records. You will be provided with fully executed copies, including a complete Exhibit "A", when available.

We appreciate your prompt response to this proposal. If you have any questions or need any additional information, please feel free to contact the undersigned. Technical questions regarding the proposed well should be directed to Malcolm Kintzing at (432)688-3125 or mkintzing@sm-energy.com.

Sincerely,

Wilson Cash, RPL
Landman, Permian Region
432-688-3399
wcash@sm-energy.com

WELL ELECTION

_____ I/WE ELECT TO PARTICIPATE IN THE DRILLING OF THE OSAGE 34 FEDERAL 1H WELL

_____ I/WE DO NOT ELECT TO PARTICIPATE IN THE DRILLING OF THE OSAGE 34 FEDERAL 1H WELL

Dean Kinsolving

By: _____

Title: _____



May 13, 2013

3300 N. A Street, Bldg. 7-200
Midland, Texas 79705
432.688.1700
432.688.1701 fax
SM-Energy.com

Devargas Street LLC
4613 Los Poblanos Cir., NW
Albuquerque, NM 87107

RE: Well Proposal
Osage 34 Federal 1H
N/2 N/2 Section 34, T-19-S, R-29-E, N.M.P.M.
Eddy County, New Mexico

Gentlemen:

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Sincerely,

Wilson Cash, RPL
Landman, Permian Region
432-688-3399
wcash@sm-energy.com

WELL ELECTION

_____ I/WE ELECT TO PARTICIPATE IN THE DRILLING OF THE OSAGE 34 FEDERAL 1H WELL

_____ I/WE DO NOT ELECT TO PARTICIPATE IN THE DRILLING OF THE OSAGE 34 FEDERAL 1H WELL

Devargas Street LLC

By: _____

Title: _____

AUTHORITY FOR EXPENDITURE - Drlg Est.

SM Energy

Date: 4/30/2013

Lease / Well Number: Osage 34 Federal 1H

Prepared By: Michael Mataaifi & Malcolm Kintzing

Location: Sec 34 - T19S - 28E

Prospect Name: Bone Spring Horizontal

SHL 450 FNL 330 FEL

County, State: Eddy, NM

BHL 330 FNL 330 FWL

Projected Total Depth: 12491' VS 4,831'

Primary Objectives: Bone Spring

NOTES

Daywork Contract - Horiz Oil Well - Closed Loop System - No Pilot Hole
3 Csg Strings, Packer Plus
Assumes regulatory agent approves casing program
Note all pcp prices may be subject to increase due to market fluctuations

It is recognized that the amounts provided here are estimates only and approval of this authorization shall extend to actual costs incurred in conducting the operations specified, whether more or less than estimated.

Intan. Drilling Costs BCP	COSTS
750 238 Abandonment & Cleanup	\$ 30,000
750 205 Environmental/Safety	\$ 17,145
750 020 Insurance	\$ 10,000
750 010 Legal, Permits & Fees	\$ 10,000
750 010 Staking Location & Surveys	\$ 1,600
750 025 Location, Road & ROW	\$ 125,000
750 035 IDC Daywork Days 33 0 \$/Day 19900	\$ 656,700
750 060 Mobilization / Demobilization	\$ 220,325
750 075 Rig Fuel Days 33 0 \$/Day 4180	\$ 137,940
750 040 IDC Footage \$/ft	\$ -
750 175 Supervision/Consultants Days 37.5 \$/Day 3750	\$ 140,625
750 230 Operating Overhead	\$ 32,800
750 065 Bits & Reamers	\$ 77,500
750 130 Rentals Surface	\$ 284,515
750 135 Rentals Sub-Surface	\$ 123,340
750 135 Drill Pipe / Motors Days 5 \$/Day 4500	\$ 22,500
750 115 Casohole Log/Perf/Wire	\$ 6,000
750 062 Directional Services	\$ 280,000
750 095 Inspection - Drill String	\$ 15,000
750 095 Well Control & Testing	\$ 24,000
750 195 Miscellaneous IDC	\$ 10,250
750 125 Mud Logging Days 20 \$/Day 2155	\$ 58,090
750 170 Contract Labor	\$ 100,000
750 180 Transportation	\$ 50,000
750 080 Surface Casing Crews	\$ 10,000
750 085 Surface Cement and Cement Services	\$ 60,000
751 055 Surface Float Equipment & Centralizers	\$ 2,200
750 080 1st Intermediate Surface Casing Crews	\$ 12,000
750 085 1st Intermediate Cement and Cement Services	\$ 45,000
750 055 1st Intermediate Float Equipment and Centralizers	\$ 5,000
750 080 2nd Intermediate Surface Casing Crews	\$ 15,000
750 085 2nd Intermediate Cement and Cement Services	\$ 55,000
751 055 2nd Intermediate Float Equipment & Centralizers	\$ 5,000
750 080 3rd Intermediate Surface Casing Crews	\$ 20,000
750 085 3rd Intermediate Cement and Cement Services	\$ 45,000
751 055 3rd Intermediate Float Equipment & Centralizers	\$ 5,000
750 070 Mud & Additives	\$ 75,000
750 070 Corrosion Control & Chem	\$ 10,000
750 070 Water	\$ 100,000
750 210 Water / Mud Disposal	\$ 150,000
750 140 Pump Truck	\$ 12,000
Contingency (10%)	\$ 302,753
TOTAL	\$ 3,342,283

Intan. Formation Testing BCP	COSTS
750 110 Logging & Wireline	\$ 7,500
750 120 Drill Stem - Formation Tests	\$ -
750 120 Coring & Analysis (Sidewall Cores)	\$ -
Contingency (10%)	\$ 750
TOTAL	\$ 8,250

Tangible Lease & Well Equipment BCP	COSTS
751 015 Conductor Pipe	\$0
751 025 Surface Casing 20" 13-3/8" \$/ft 109 Feet 340	\$ 40,706
751 030 Intermediate Csg 13-3/8" \$/ft 43 Feet 1500	\$ 70,950
751 030 Intermediate Csg 9-5/8" \$/ft 29 Feet 3550	\$ 113,245
751 030 Intermediate Csg 7" \$/ft 30 Feet 8451	\$ 278,843
751 020 Casing Head	\$ 12,000
751 075 Wellhead Equipment	\$ 17,000
750 025 Cattle Guards	\$ -
Contingency (5%)	\$ 26,642
TOTAL EQUIPMENT	\$ 659,486

TOTAL DRILLING	\$ 3,910,019
TOTAL INTANGIBLE	\$ 4,874,478

Joint Interest Approval

Company

Company SME

By

Date

By Michael Mataaifi

Intan. Comp. Costs ACP	COSTS
750 238 Abandonment & Cleanup	\$ (30,000)
755 040 IDC Daywork Days 3 5 \$/Day 19900	\$ 69,650
755 075 Rig Fuel Days 3 5 \$/Day 4180	\$ 14,630
755 175 Drilling Rig Supervision Days 3 5 \$/Day 3750	\$ 13,125
755 080 Production Casing Crews	\$ 20,000
755 085 Production Casing Cement & Services	\$ -
760 055 Prod Float Equipment & Centralizers	\$ 6,000
755 045 Completion / Swab Unit Days 0 \$/Day 0	\$ 28,000
755 165 Compl Rig Supervision Days 0 \$/Day 650	\$ 9,000
755 230 Operating Overhead	\$ -
755 152 Water Transfer	\$ 40,000
755 140 Water Hauling	\$ 80,000
755 115 Logging, Perforations & Wireline	\$ 10,000
755 135 Rentals Subsurface	\$ 25,000
755 130 Rentals Surface	\$ 125,000
755 057 Nitrogen Service & Coiled Tubing	\$ -
755 100 Fishing	\$ -
755 145 Stimulation	\$ 750,000
755 180 Transportation	\$ 25,000
755 170 Contract Labor & Roundabout	\$ 25,000
755 065 Bits & Reamers	\$ -
760 070 Couplings & Fittings	\$ -
755 075 Location & Road Expense	\$ 25,000
755 195 Miscellaneous IDC/Special Services	\$ -
755 095 Pipe Inspection & Recondition	\$ -
755 127 Flowback Rental	\$ 75,000
755 210 Disposal	\$ 75,000
755 150 Swabbing Unit	\$ -
Contingency (10%)	\$ 138,541
TOTAL	\$ 1,823,848

Tangible Well Equipment ACP	COSTS
760 040 Prod Csg / Liner 4-1/2" \$/ft 12 Feet 4500	\$ 59,400
760 040 Packers System	\$ 285,000
760 040 Tubing \$/ft 0 Feet	\$ 50,000
760 075 Wellhead	\$ 10,000
760 065 Rods & Pump	\$ 30,000
760 069 Subsurface Equipment	\$ 6,000
Contingency (5%)	\$ 21,020
TOTAL EQUIPMENT	\$ 441,420

Tangible Lease & Battery Equipment ACP	COSTS
760 090 Pumping Unit / Prime Mover	\$ 200,000
760 120 Separator / Heater Treater	\$ 70,000
760 095 Tanks / Walkways / Stairway	\$ 100,000
760 100 Motor / Meter Run	\$ 8,000
760 110 Flowline / Connections	\$ 24,000
760 070 Valves / Fittings	\$ 83,000
760 105 Wireline Degradation/Equip	\$ 22,000
760 135 Installation Costs	\$ 75,000
Contingency (10%)	\$ 58,200
TOTAL EQUIPMENT	\$ 640,200

TOTAL COMPLETION	\$ 2,695,568
TOTAL TANGIBLE	\$ 1,641,108

TOTAL DRY HOLE COST	\$ 4,017,185
TOTAL WELL COST	\$ 6,516,588

Date: 4/30/2013

A.A.P.L. FORM 610 - 1989
MODEL FORM OPERATING AGREEMENT

Osage 34 Federal 1H

OPERATING AGREEMENT

DATED

May 13 , 2013 ,
year

OPERATOR SM Energy Company

CONTRACT AREA See Exhibit "A"

COUNTY OR PARISH OF Eddy County , STATE OF New Mexico

COPYRIGHT 1989 - ALL RIGHTS RESERVED
AMERICAN ASSOCIATION OF PETROLEUM
LANDMEN, 4100 FOSSIL CREEK BLVD.
FORT WORTH, TEXAS, 76137. APPROVED FORM.

A.A.P.L. NO. 610 - 1989

Exhibit "A"

**Attached to and made a part of that certain Operating Agreement dated
May 13, 2013, between SM Energy Company, as Operator, and
Byron A. Bachschmid et al, as Non-Operators.**

I. Description of Lands and Depths Subject to This Agreement:

The N/2N/2 of Section 34, T-19-S, R-29-E. N.M.P.M., Eddy County, New Mexico, containing 160 acres, more or less.

II. Depth Restrictions:

This agreement shall be limited to depths from the top of the Bone Spring formation to the top of the Morrow formation, defined as the stratigraphic equivalent of that interval seen between the depths of 5,569' and 11,195' subsurface on the dual lateral log from the Siete Oil & Gas, Osage Fed. No. 8 well located 1980' FNL & 1980' FEL of Section 34, T-19-S, R-29-E, Eddy County, New Mexico, API # 30-015-26089.

III. Parties to this Agreement and Their Interests:

Working Interest in the Contract Area to be determined

III. Addresses of Parties:

Parties to be determined

V. OIL AND GAS LEASES SUBJECT TO THIS AGREEMENT:

Lease No. 1:

Lease Serial No.: NMNM90807
Date of Lease: February 1, 1975
Lessor: United State of America
Lessee: Hugh R. McAteer
Recorded: Unrecorded in Eddy County, New Mexico
Land Description: Captioned and other lands, containing 1,320 acres, more or less.

Note: This Agreement specifically excludes currently existing wellbores, associated equipment, associated production including the operation of same whether or not such wellbores are currently producing, shut-in or temporarily abandoned as of the date of this Agreement.

End of Exhibit "A"

Wilson Cash

From: Wilson Cash
Sent: Monday, July 08, 2013 10:17 AM
To: Dean Kinsolving (dkinsolving@lcecnecnet.com)
Subject: FW: Osage 34-1H
Attachments: Osage 34-1H Well Proposal.pdf; Osage 34-1H AFE.pdf; Osage 34-1H JOA.pdf; MEMO OF OPERATING AGREEMENT 34-1H.PDF; Dean Kinsolving WI N2N2 Sec 34.pdf

Mr. Kinsolving:

Following up your conversation with Rita, please find attached the Osage 34-1H well proposal letter, AFE, JOA, and Memorandum of Operating Agreement. I've also attached a spreadsheet detailing your interest in the four forty acre tracts included in the 160 acre spacing unit for this well. This well is scheduled to be spud on 7/21/2013. Please be aware that a compulsory pooling hearing has been scheduled for July 11. As I mentioned yesterday, SM prefers reaching voluntary agreements with partners if possible prior to this date. Please let me know if you have any questions or need any additional information. I appreciate your assistance with SM throughout this situation.

Also, I'll be sending another email this afternoon detailing your interest in the acreage you farmed out to SM Energy and the production results of the wells drilled on this acreage.

Best Regards,

SM ENERGY

*Wilson Cash, RPL
Landman- Permian Region
SM Energy Company
3300 N. A St., Bldg #7, Suite 200
Midland, TX 79705
Office: 432-688-3399; Fax: 432-688-1702*

Wilson Cash

From: Wilson Cash
Sent: Wednesday, July 03, 2013 11:36 AM
To: 'dkinsolving@lcecnecnet.com'
Cc: Rita Buress
Subject: Osage 34-1H
Attachments: Osage 34-1H Well Proposal.pdf; Osage 34-1H AFE.pdf; Osage 34-1H JOA.pdf; MEMO OF OPERATING AGREEMENT 34-1H.PDF; Dean Kinsolving WI N2N2 Sec 34.pdf

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Best Regards,

SM ENERGY

*Wilson Cash, RPL
Landman- Permian Region
SM Energy Company
3300 N. A St., Bldg #7, Suite 200
Midland, TX 79705
Office: 432-688-3399; Fax: 432-688-1702*

Wilson Cash

From: Wilson Cash
Sent: Tuesday, June 25, 2013 3:06 PM
To: 'Caroll Follingstad'
Subject: RE: Osage 34-1H Term Assignment

Caroll,

Please let me know if you, your sisters, or John Catron have any questions or need any additional information regarding this well proposal/term assignment. I appreciate you working with us to reach a voluntary agreement by July 10th. As I mentioned below, once you advise me to your election I'll proceed with forwarding the corresponding agreement.

Regards,

SM ENERGY

*Wilson Cash, RPL
Landman- Permian Region
SM Energy Company
3300 N. A St., Bldg #7, Suite 200
Midland, TX 79705
Office: 432-688-3399; Fax: 432-688-1702*

From: Caroll Follingstad [<mailto:carolls-email@comcast.net>]
Sent: Tuesday, June 25, 2013 2:40 PM
To: Wilson Cash
Subject: Re: Osage 34-1H Term Assignment

Wilson, I have forwarded your message to my sisters and John Catron. of the Catron Law firm, in Santa Fe, for their comments and advise. I also explained that we have a July 10th absolute deadline on this. I will, in the mean time, look up on the internet all the terms so that I can better understand what you are suggesting that we do about this. Thank you for your time in this matter. Caroll
On Jun 20, 2013, at 4:31 PM, Wilson Cash wrote:

Caroll:

Following up our phone conversation, please find attached a letter agreement dated July 11, 1988 between William W. Hunker and Siete Oil and Gas Corporation. Per recent title opinions DeVargas Street LLC's interest in these wells in Eddy County, New Mexico is subject to 25% burdens. As a result, you reserved a 0% Overriding Royalty Interest (ORRI) in your three Farmouts covering the N/2S/2 of Section 34 and S/2 of Section 35, T19S, R29E, Eddy County, NM. Consequently, you cannot convert your ORRI to a reduced WI upon payout and therefore cannot participate in subsequent wells (Parkway 35-5H). As consideration for these Farmouts SM will pay DeVargas \$1000/net acre farmed out. We hope to have this check in the mail soon.

SM is willing to complete a Term Assignment with DeVargas covering the acreage in the Osage 34-1H spacing unit. This Term Assignment will have many of the same provisions as the previous Farmouts. Our title opinion indicates that DeVargas has a 0.40% interest in the Osage 34-1H well. DeVargas has the option to participate with their 0.40% interest, assign all of their 0.40% interest in this well to SM, or assign a portion of their interest and participate in the well with the retained interest. As consideration for the Term Assignment SM will pay DeVargas \$1000/net acre

assigned. DeVargas' estimated proportionate (if participate with 0.40% interest) dry hole and completed well costs are \$16,068.66 and \$26,062.34 respectively. A compulsory pooling hearing is scheduled on July 11 for this well.

Please let me know if you have any questions or need any additional information. Please advise to if you wish to participate with your 0.40% interest, assign SM your interest, or assign SM a portion of your interest in the Osage 34-1H and I'll proceed with emailing you a Term Assignment/well proposal.

Best Regards,

<image001.jpg>

Wilson Cash, RPL

Landman- Permian Region

SM Energy Company

3300 N. A St., Bldg #7, Suite 200

Midland, TX 79705

Office: 432-688-3399; Fax: 432-688-1702

<0721_001.pdf>