

JAMES B. FULLERTON

PETROLEUM LANDMAN

NATURAL GAS CONSULTANT

1645 COURT PLACE
SUITE #406
DENVER, COLORADO 80202

PHONE: 303-534-4502

July 29, 1992

Frederick L. Lilly Jr.
2895 Brighton Road
Shaker Heights, Ohio 44120

Re: Farmout Agreements
SG Interests I, Ltd.
1) Township 29 North, Range 10 West
Section 21: NE/4SW/4
2) Township 29 North, Range 10 West
Section 24: NE/4NE/4
San Juan County, New Mexico

Dear Mr. Lilly:

In regard to our recent telephone conversation and my correspondence dated June 25, 1992, enclosed please find the following documents related to your partial Leasehold Interest under the above referenced lands:

- 1) 2 copies of the Farmout Agreement, with additional signature page, covering your Leasehold Interest in the NE/4SW/4 of Section 21.
- 2) 2 copies of the Farmout Agreement, with additional signature page, covering your Leasehold Interest in the NE/4NE/4 of Section 24.

You indicated during our recent telephone conversation that you would await a decision from Ray Haley before determining your desire to participate for your proportionate Working Interest. Mr. Haley recently advised me that he desires to Farmout his interest to SG Interests I, Ltd. under the terms I outlined in my previous letter. Thus, I have forwarded Mr. Haley the Farmout Agreements for his execution. The attached Agreements are identical to the Agreements sent to Mr. Haley for his execution. The Farmout Agreements, in part, provide for you to receive an Overriding Royalty interest equal to the difference between existing lease burdens and 80%. Since the existing lease burdens appear to total 17%, the reserved Overriding Royalty interest to you under these Agreements would be 3%.

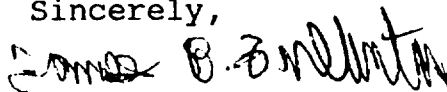
Application of SG Interests I, Ltd. for
Compulsory Pooling
Case No. 10609410610
Examiner Hearing Docket Dated 11/19/92
Exhibit No. 8

Please review the attached Farmout Agreements and advise me if you should have any questions. Please note that I have also attached a copy of that certain Assignment of Oil and Gas Leases dated February 19, 1983 executed by Frederick L. Lilly and Gladys Lilly. This Agreement provides for an Assignment to Frederick L. Lilly Jr. with a reservation of a Remainder Interest during the lifetime of the Assignors (Frederick L. Lilly and Gladys Lilly). We are not certain of the status of this Agreement as it relates to Frederick L. Lilly and Gladys Lilly. If either or both parties are still alive, then it will be necessary for them to also execute the Farmout Agreement. Please review the Assignment and advise me of the status of Frederick L. Lilly and Gladys Lilly. If necessary, I will prepare a revised Farmout Agreement listing them, in addition to you, as the Farmors.

In as much as we are proposing to begin drilling operations within the next 30 days, your early attention to this matter would be greatly appreciated. If the Agreements meet with approval, please execute one copy of each Agreement, along with the additional signature pages, and return same to me at the address listed above. Upon execution by SG Interests I, Ltd. a fully a executed signature page will be returned to you for your files.

Thank you very much. Again, if you should have any questions please feel free to call me at 303-534-4502.

Sincerely,



James B. Fullerton
Consulting Landman on behalf of
SG Interests I, Ltd.

Lilly-F/0
29-10-21

FARMOUT AGREEMENT

THIS AGREEMENT, made and entered into this 27th day of July, 1992 by and between Frederick L. Lilly, Jr., whose mailing address is 2895 Brighton Road, Shaker Heights, Ohio, 44120, "FARMOR" (hereinafter referred to as "FARMOR") and SG Interests I, Ltd., a Texas Limited partnership, as "FARMEE" (hereinafter referred to as "FARMEE").

WITNESS THAT:

WHEREAS, the parties have arrived at an agreement as more fully set forth herein whereby FARMOR will assign to FARMEE certain interests in the following described lands (hereinafter referred to as "Contract Lands") subject to the exceptions, reservations, terms, and conditions set forth in this agreement;

Township 29 North, Range 10 West, N.M.P.M.
Section 21: NE/4SW/4

containing 40.00 gross acres, more or less

See Exhibit "A" for Leases, Lands
and Interests subject to this Agreement

NOW THEREFORE, for and in consideration of the mutual promises and covenants herein contained, it is agreed by and between the parties hereto as follows:

I. Initial Test Well

On or before December 1st, 1992, FARMEE agrees to commence, or cause to be commenced, the operations for the drilling of an Initial Test Well at a legal location in the S/2 of Section 21, Township 29 North, Range 10 West, N.M.P.M., San Juan County, New Mexico and to drill to a depth sufficient to test the Fruitland (Coal Gas) Formation, or a depth of 1950 feet, whichever is the lesser, and will complete, or plug and abandon such well not later than one hundred eighty days (180) after commencement in a prudent and workmanlike manner at FARMEE's sole cost, risk and expense. If because of encountering any conditions which make further drilling impracticable, FARMEE discontinues drilling the Initial Test Well, FARMEE shall have the right to drill a Substitute Test Well as provided for in Section II hereof. FARMEE, in exchange for drilling the Initial Test Well, shall earn the assignment of such interest, as set forth in Section VII., subject to the other terms of this agreement.

II. Substitute Test Well

If because of encountering impenetrable substances, mechanical difficulties, or other conditions beyond which a prudent operator would not continue operations or further drilling of the Initial Test Well hereunder becomes impracticable, FARMEE shall have the right to drill a Substitute Test Well at a location of its choice on the applicable lands; provided, however, the actual drilling of said Substitute Well shall be commenced not later than sixty days (60) after the abandonment of the Test Well wherein impenetrable substances were encountered. Such substitute Well shall be drilled in the manner and to the depth specified and must be completed within a similar period of time as specified for the Initial Test Well for which such Substitute Well is being drilled. If such Substitute Test Well is commenced, drilled, completed, or plugged and abandoned, as herein provided, FARMEE shall have complied with the Agreement

as to the Initial Test Well to the same extent as if such Initial Test Well had been commenced, drilled, and completed in accordance herewith.

III. Geological Requirements

This agreement is subject to the geological requirements set out in Exhibit "B" attached hereto and made a part hereof.

IV. Take-over Election

After the drilling of the Initial Test Well, or any other well drilled pursuant hereto on the Contract Lands to the Contract Depth and after appropriate tests have been made, FARMEE shall promptly notify FARMOR by telephone, to be confirmed in writing, if FARMEE intends to plug and abandon said well as a dry hole. If FARMEE intends to plug and abandon said well as a dry hole, FARMOR shall have forty eight (48) hours following the receipt of such notice and all required geological data within which to notify FARMEE by telephone, to be confirmed in writing, if FARMOR concurs in FARMEE's recommendation. If FARMOR concurs in FARMEE's recommendation, FARMEE shall continue such operations at its sole cost, risk and expense. If FARMOR does not concur in the plugging and abandonment of the Initial Test Well hereunder, FARMEE will, at FARMOR's expense, run a production string and set pipe, at which time FARMOR will continue operations and diligently attempt to complete said well as a producer. If successful, FARMOR, at its expense, shall equip said well for production through and including the lease tank or separator. If, following an attempt at completion by FARMOR, FARMOR shall determine that said well is incapable of producing oil or gas in commercial quantities, FARMEE shall plug and abandon said well at its sole cost, risk and expense, except FARMOR shall bear any extra costs which would not ordinarily have been incurred if FARMOR had not continued drilling operations.

If FARMOR elects to take over operations on the well pursuant to this Section IV., FARMEE shall be deemed to have relinquished and transferred to FARMOR all of its right, title and interest in and to (i) the said Initial Test Well, (ii) the material and equipment therein and used or acquired in connection therewith which FARMOR retains for conducting operations hereunder, and (iii) the right to receive an assignment of the Contract Lands.

If FARMOR elects to continue operations on said well, as provided for herein, it shall reimburse FARMEE for the salvage value of all material and equipment used or acquired in connection with said well which will be retained by FARMOR.

V. Drilling and Completion

Unless the Initial Test Well is taken over by FARMOR pursuant to Section IV. hereof, the entire cost, expense, and risk of attempting to complete said Initial Test Well as a producer and equipping for production shall be borne by FARMEE.

VI. Definitions

For the purpose of this Agreement, the following terms shall have the meaning stated therefore:

1. "Drill Site" shall mean the portion of the contract lands which comprise the drilling unit designated by spacing regulations, or a regulatory agency having jurisdiction.

VII. Assignment

Upon completion of the Initial Test Well provided for hereunder in the manner and within the time herein provided, FARMEE shall submit to FARMOR evidence thereof and further represent that FARMEE has performed and otherwise complied with all applicable terms, covenants, and conditions herein. Thereafter and within Thirty (30) days, FARMOR shall execute and deliver an assignment to FARMEE of the Contract Lands, subject to the following:

A. If said Initial Test Well is completed as a well capable of production, FARMOR shall assign to FARMEE all of FARMOR's working interest and operating rights subject to this agreement, in and to the Contract Lands, insofar and only insofar as said rights cover from the surface of the earth down to the base of the Fruitland (Coal-Gas) Formation, but reserving to FARMOR an inclusive proportionate overriding royalty interest equal to the difference between the Lessor's royalty, overriding royalty or any other burdens in existence as of the effective date hereof and Twenty Percent (20%), in and to the oil, gas minerals and other hydrocarbons which may be produced and saved from the herein described lands under the terms of the oil and gas leases described herein. It being the intent of Farmor to deliver to Farmee a Eighty Percent (80%) net revenue interest. Said overriding royalty interest shall be subject to proportionate reduction to the extent that the interest covered by said Leases bear to the full and undivided mineral fee estate under the lands covered by said Leases and shall be further subject to proportionate reduction to the extent that the interest of the Assignor in said Leases bear to the full working interest in said Leases.

B. The Assignments hereunder shall reserve unto FARMOR, its successors, and assigns, all of its right, title, interest and estate below the depth assigned above, including the right of ingress and egress and all rights essential to the full exploration, drilling, development, and production of the products covered thereby below the depth assigned. It is understood that each party will conduct its operations on said lands so as to interfere as little as possible with the operations of the other.

VIII. Delay Rentals

In the event that any delay rental, minimum royalty or shut-in royalty payments should become due and payable on the Contract Lands covered hereby after the date of this Agreement, whether before or after FARMOR has executed assignments in favor of FARMEE, FARMOR shall make a bona fide effort to pay such rental, minimum royalty or shut-in royalty payments, and FARMEE shall reimburse FARMOR for One Hundred Percent (100%) of the total amount paid by FARMOR within Thirty (30) days after receiving FARMOR's billing therefore. FARMOR shall never be liable to FARMEE for any failure to make any delay rental or minimum royalty payments provided it has acted in a prudent manner.

IX. Titles

FARMOR shall upon request, furnish to FARMEE such abstracts and other title papers that they may have, together with photostats of the basic lease and any assignments thereof. FARMEE, upon FARMOR's written request, shall furnish FARMOR with one (1) copy of any title opinion on the Contract Lands and curative work FARMEE does or causes to be done.

X. Force Majeure

1. If a party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this Agreement,

other than the obligation to make monetary payments, said party shall give to all other parties prompt written notice of the force majeure with reasonable full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure.

2. The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

3. The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension of obligations.

XI. Rights and Relationships

Nothing contained herein as between the parties shall create or constitute an agency, trust, partnership, association or entity of any kind except that the parties hereto elect to not be excluded from the application of all of the provisions of Subchapter K of the Chapter 1 of the Subtitle A of the Internal Revenue Code of 1954 and all amendments thereto.

The rights, privileges and obligations contained herein are binding upon the parties hereto, its successors and assigns and shall be considered as covenants running with the lands. FARMEE further agrees to comply with the terms of the Oil and Gas Lease(s) subject to this Agreement.

XII. Insurance

FARMEE, or FARMEE's contractor or subcontractors, shall comply with the Workmen's Compensation Law of the State of New Mexico and shall carry at FARMEE's sole cost, insurance as set forth in Exhibit "C" attached hereto and made a part hereof.

XIII. Failure of Performance

There is no obligation upon FARMEE to commence a well under the terms of this agreement, and the only penalty for failure to commence such well, or to drill to the objective depth, will be the forfeiture of all rights hereunder, including, but not limited to FARMEE's right to receive an assignment of leasehold interest as provided for hereinabove.

XIV. Time of Essence and Modification

With respect to the commencement and completion of any Test Well provided for herein, time is of the essence of this Agreement and no provisions hereof shall be modified and waived unless the same be made in writing and signed by the parties hereto.

XV. Entire Agreement

This Agreement constitutes the entire agreement between the parties hereto and supersedes any and all other agreements, written and oral, if any. No promise, representation, agreement or covenant not included in this Agreement has been or is relied upon by either party. No modification or amendment of this Agreement shall be of any force or effect unless in writing executed by both parties.

XVI. Execution

If this Agreement shall not be duly executed by FARMOR and returned to FARMEE, within Ten (10) days of receipt by FARMOR, then and thereupon, at FARMEE's option this Agreement shall be null and void and of no force or effect.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first written.

FARMOR:

FREDERICK L. LILLY, JR.

By: _____
Frederick L. Lilly, Jr.

FARMEE:

SG Interests I, Ltd., a Texas Limited partnership, by Gordy Gas Corporation, as General Partner

ATTEST:

By: _____
Melodie I. Thompson
Secretary

By: _____
Russell D. Gordy
President-Gordy Gas Corporation

STATE OF OHIO)
) ss.
COUNTY OF _____)

Before me, the undersigned authority, on this _____ day of _____, 1992, personally appeared Frederick L. Lilly, Jr., known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that _____ (he/they) executed the same for the purposes and consideration therein expressed, and in the capacities therein stated.

WITNESS my hand and official seal the day and year last above written.

My Commission Expires: _____

Notary Public for the State
of Colorado
Address: _____

STATE OF TEXAS)
) ss.
COUNTY OF HARRIS)

Before me, the undersigned authority, on this _____ day of _____, 1992, personally appeared Russell D. Gordy, to me personally known, who, being by me duly sworn, did say that he is the President of Gordy Gas Corporation, and that said Gordy Gas Corporation in the General Partner of SG Interests I, Ltd., a Texas Limited partnership and that said instrument was signed on behalf of said partnership for the uses and purposes as therein set forth, and said Russell D. Gordy acknowledged said instrument to be the free act and deed of said partnership.

WITNESS my hand and official seal the day and year last above written.

My Commission Expires:

Notary Public for the State of Texas
Address: _____

E X H I B I T " A "

(Description of Leasehold)

Lands, Leases and Interests

Attached to and made a part of that certain Farmout Agreement dated July 27th, 1992, by and between Frederick L. Lilly, Jr., as FARMOR AND SG Interests I, Ltd., a Texas Limited partnership, as FARMEE

LEASE A:

ORIGINAL LESSOR: Raymond D. Farmer and Olive M. Farmer, husband and wife, Shirley M. Linder, a single woman, Louis C. Farmer and Frances Farmer, husband and wife, Walter C. Farmer, a single man, Carl V. Farmer and Marie Farmer, husband and wife, Audrey Foster and Howard N. Foster, wife and husband, Helen M. Dashen and Felix Dashen, wife and husband

ORIGINAL LESSEE: Claud E. Aikman

DATE: July 10th, 1956

ROYALTY: 15.00%

RECORDING DATA: Book 310, at page 174, records of San Juan County, New Mexico

DESCRIPTION: Township 29 North, Range 10 West, N.M.P.M. Section 21: NE/4SW/4
INSOFAR AND ONLY INSOFAR as said Lease covers from the surface of the earth down to the base of the Fruitland (Coal-Gas) Formation. containing 40.00 gross acres, more or less

EXHIBIT "B"

Geological Requirements

Attached to and made a part of that certain Farmout Agreement dated July 27th, 1992, by and between Frederick L. Lilly, Jr., as FARMOR AND SG Interests I, Ltd., a Texas Limited partnership, as FARMEE

Provisions Applicable to Test Wells

With respect to all wells drilled by FARMEE hereunder or subsequently under the agreement to which this Exhibit is attached, FARMEE shall perform the following operations, and furnish FARMOR, the following rights and privileges:

1. To conduct all operations in accordance with approved and accepted practices prevailing in the area where the well is drilled.
2. To make adequate tests to determine if the well is capable of producing oil or gas in paying quantities from the objective formation and from all productive formations encountered.
3. Upon written request of FARMOR, FARMEE shall promptly furnish FARMOR, as to any well (s) drilled on said lands (or on a spacing unit including any portion thereof), daily drilling reports and copies of all logs, cores, reports or tests obtained for such well or filed with any governmental agency and, after completion, copies of all reports to governmental agencies concerning reworking, deepening, shut-in, recompleting, plugging and abandonment or similar change of well status.
4. All notices, reports, logs, samples and other information above requested shall be furnished to:

Mr. Frederick L. Lilly, Jr.
2895 Brighton Road
Shaker Heights, Ohio 44120
1 (216) 561-7895

EXHIBIT "D"

INSURANCE AND INDEMNITY

Attached to and made a part of that certain Farmout Agreement dated July 27th, 1992, by and between Frederick L. Lilly, Jr., as FARMOR AND SG Interests I, Ltd., a Texas Limited partnership, as FARMEE

At all times while operations are conducted under this Agreement, Operator shall maintain for the benefit of all parties hereto, insurance of the types and in the maximum amounts as follows. Premiums for such insurance shall be charged to the Joint Account.

Non-operating working interest owners shall be named as Additional Insureds on the liability insurance policies, but only with respect to the performance of all work hereunder.

All such insurance shall be carried in an acceptable company or companies; shall be maintained in full force and effect during the terms of this agreement; and shall not be canceled, altered or amended without thirty (30) days prior written notice. If so required, Operator agrees to have its insurance carrier furnish certificates of insurance evidencing such insurance coverages.

Operator and non-operating working interest owners agree to mutually waive subrogation in favor of each other on all insurance carried by each party and/or to obtain such waiver from the insurance carrier if so required by the insurance contract. If such a waiver is not obtained, the party failing to do so shall indemnify the other party for any claim by an insurance carrier arising out of Subrogation.

Non-operating working interest owners agree that the limits and coverage carried by operator are adequate and shall hold Operator harmless if any claim exceeds such limit or is not covered by such policy. Such coverage and limits may change or be unavailable from time to time and Operator does not guarantee their continuance but will use best effort to provide such coverage and limits at reasonable costs.

- a. Workers' Compensation insurance in full compliance with all applicable State and Federal laws and regulations.
- b. Employer's Liability insurance in the limits of \$500,000.00 per accident covering injury or death to any employee who may be outside the scope of the Workers' Compensation statute of the State in which the work is performed.
- c. Commercial General Liability insurance with combined single limits per occurrence/general aggregate of \$1,000,000.00 for Bodily Injury and Property Damage, including Property Damage by Blowout and Cratering Completed Operations, and Broad Form Contractual Liability as respects any contract into which the Operator may enter under the terms of this agreement.
- d. Automobile Liability insurance covering owned, non-owned and hired automotive equipment with limits for Bodily Injury and Property Damage of \$1,000,000.00.
- e. Umbrella Liability insurance with a limit of \$4,000,000.00.

EXHIBIT "D"
(continued)

INSURANCE AND INDEMNITY

- f. Operator shall carry Operators Extra Expense insurance covering the costs of controlling a Blowout, the expenses involved in redrilling the well, certain other related costs and Seepage and Pollution Liability. (These are descriptive terms only and exact coverage can be found only in the policy.) The limits for this insurance vary according to depth and location of the well. Non-operating working interest owners not wishing to be covered under this policy must notify Operator prior to spud date, and by such refusal of coverage each non-operating working interest owner agrees to be responsible for his proportionate share of such loss, anything in this agreement to the contrary notwithstanding.

Lilly-F/0
29-10-24

FARMOUT AGREEMENT

THIS AGREEMENT, made and entered into this 27th day of July, 1992 by and between Frederick L. Lilly, Jr., whose mailing address is 2895 Brighton Road, Shaker Heights, Ohio, 44120, "FARMOR" (hereinafter referred to as "FARMOR") and SG Interests I, Ltd., a Texas Limited partnership, as "FARMEE" (hereinafter referred to as "FARMEE").

WITNESS THAT:

WHEREAS, the parties have arrived at an agreement as more fully set forth herein whereby FARMOR will assign to FARMEE certain interests in the following described lands (hereinafter referred to as "Contract Lands") subject to the exceptions, reservations, terms, and conditions set forth in this agreement;

Township 29 North, Range 10 West, N.M.P.M.
Section 24: NE/4NE/4

containing 40.00 gross acres, more or less

See Exhibit "A" for Leases, Lands
and Interests subject to this Agreement

NOW THEREFORE, for and in consideration of the mutual promises and covenants herein contained, it is agreed by and between the parties hereto as follows:

I. Initial Test Well

On or before December 1st, 1992, FARMEE agrees to commence, or cause to be commenced, the operations for the drilling of an Initial Test Well at a legal location in the N/2 of Section 24, Township 29 North, Range 10 West, N.M.P.M., San Juan County, New Mexico and to drill to a depth sufficient to test the Fruitland (Coal Gas) Formation, or a depth of 2100 feet, whichever is the lesser, and will complete, or plug and abandon such well not later than one hundred eighty days (180) after commencement in a prudent and workmanlike manner at FARMEE's sole cost, risk and expense. If because of encountering any conditions which make further drilling impracticable, FARMEE discontinues drilling the Initial Test Well, FARMEE shall have the right to drill a Substitute Test Well as provided for in Section II hereof. FARMEE, in exchange for drilling the Initial Test Well, shall earn the assignment of such interest, as set forth in Section VII., subject to the other terms of this agreement.

II. Substitute Test Well

If because of encountering impenetrable substances, mechanical difficulties, or other conditions beyond which a prudent operator would not continue operations or further drilling of the Initial Test Well hereunder becomes impracticable, FARMEE shall have the right to drill a Substitute Test Well at a location of its choice on the applicable lands; provided, however, the actual drilling of said Substitute Well shall be commenced not later than sixty days (60) after the abandonment of the Test Well wherein impenetrable substances were encountered. Such substitute Well shall be drilled in the manner and to the depth specified and must be completed within a similar period of time as specified for the Initial Test Well for which such Substitute Well is being drilled. If such Substitute Test Well is commenced, drilled, completed, or plugged and abandoned, as herein provided, FARMEE shall have complied with the Agreement

as to the Initial Test Well to the same extent as if such Initial Test Well had been commenced, drilled, and completed in accordance herewith.

III. Geological Requirements

This agreement is subject to the geological requirements set out in Exhibit "B" attached hereto and made a part hereof.

IV. Take-over Election

After the drilling of the Initial Test Well, or any other well drilled pursuant hereto on the Contract Lands to the Contract Depth and after appropriate tests have been made, FARMEE shall promptly notify FARMOR by telephone, to be confirmed in writing, if FARMEE intends to plug and abandon said well as a dry hole. If FARMEE intends to plug and abandon said well as a dry hole, FARMOR shall have forty eight (48) hours following the receipt of such notice and all required geological data within which to notify FARMEE by telephone, to be confirmed in writing, if FARMOR concurs in FARMEE's recommendation. If FARMOR concurs in FARMEE's recommendation, FARMEE shall continue such operations at its sole cost, risk and expense. If FARMOR does not concur in the plugging and abandonment of the Initial Test Well hereunder, FARMEE will, at FARMOR's expense, run a production string and set pipe, at which time FARMOR will continue operations and diligently attempt to complete said well as a producer. If successful, FARMOR, at its expense, shall equip said well for production through and including the lease tank or separator. If, following an attempt at completion by FARMOR, FARMOR shall determine that said well is incapable of producing oil or gas in commercial quantities, FARMEE shall plug and abandon said well at its sole cost, risk and expense, except FARMOR shall bear any extra costs which would not ordinarily have been incurred if FARMOR had not continued drilling operations.

If FARMOR elects to take over operations on the well pursuant to this Section IV., FARMEE shall be deemed to have relinquished and transferred to FARMOR all of its right, title and interest in and to (i) the said Initial Test Well, (ii) the material and equipment therein and used or acquired in connection therewith which FARMOR retains for conducting operations hereunder, and (iii) the right to receive an assignment of the Contract Lands.

If FARMOR elects to continue operations on said well, as provided for herein, it shall reimburse FARMEE for the salvage value of all material and equipment used or acquired in connection with said well which will be retained by FARMOR.

V. Drilling and Completion

Unless the Initial Test Well is taken over by FARMOR pursuant to Section IV. hereof, the entire cost, expense, and risk of attempting to complete said Initial Test Well as a producer and equipping for production shall be borne by FARMEE.

VI. Definitions

For the purpose of this Agreement, the following terms shall have the meaning stated therefore:

1. "Drill Site" shall mean the portion of the contract lands which comprise the drilling unit designated by spacing regulations, or a regulatory agency having jurisdiction.

VII. Assignment

Upon completion of the Initial Test Well provided for hereunder in the manner and within the time herein provided, FARMEE shall submit to FARMOR evidence thereof and further represent that FARMEE has performed and otherwise complied with all applicable terms, covenants, and conditions herein. Thereafter and within Thirty (30) days, FARMOR shall execute and deliver an assignment to FARMEE of the Contract Lands, subject to the following:

A. If said Initial Test Well is completed as a well capable of production, FARMOR shall assign to FARMEE all of FARMOR's working interest and operating rights subject to this agreement, in and to the Contract Lands, insofar and only insofar as said rights cover from the surface of the earth down to the base of the Fruitland (Coal-Gas) Formation, but reserving to FARMOR an inclusive proportionate overriding royalty interest equal to the difference between the Lessor's royalty, overriding royalty or any other burdens in existence as of the effective date hereof and Twenty Percent (20%), in and to the oil, gas minerals and other hydrocarbons which may be produced and saved from the herein described lands under the terms of the oil and gas leases described herein. It being the intent of Farmor to deliver to Farmee a Eighty Percent (80%) net revenue interest. Said overriding royalty interest shall be subject to proportionate reduction to the extent that the interest covered by said Leases bear to the full and undivided mineral fee estate under the lands covered by said Leases and shall be further subject to proportionate reduction to the extent that the interest of the Assignor in said Leases bear to the full working interest in said Leases.

B. The Assignments hereunder shall reserve unto FARMOR, its successors, and assigns, all of its right, title, interest and estate below the depth assigned above, including the right of ingress and egress and all rights essential to the full exploration, drilling, development, and production of the products covered thereby below the depth assigned. It is understood that each party will conduct its operations on said lands so as to interfere as little as possible with the operations of the other.

VIII. Delay Rentals

In the event that any delay rental, minimum royalty or shut-in royalty payments should become due and payable on the Contract Lands covered hereby after the date of this Agreement, whether before or after FARMOR has executed assignments in favor of FARMEE, FARMOR shall make a bona fide effort to pay such rental, minimum royalty or shut-in royalty payments, and FARMEE shall reimburse FARMOR for One Hundred Percent (100%) of the total amount paid by FARMOR within Thirty (30) days after receiving FARMOR's billing therefore. FARMOR shall never be liable to FARMEE for any failure to make any delay rental or minimum royalty payments provided it has acted in a prudent manner.

IX. Titles

FARMOR shall upon request, furnish to FARMEE such abstracts and other title papers that they may have, together with photostats of the basic lease and any assignments thereof. FARMEE, upon FARMOR's written request, shall furnish FARMOR with one (1) copy of any title opinion on the Contract Lands and curative work FARMEE does or causes to be done.

X. Force Majeure

1. If a party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this Agreement,

other than the obligation to make monetary payments, said party shall give to all other parties prompt written notice of the force majeure with reasonable full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure.

2. The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

3. The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension of obligations.

XI. Rights and Relationships

Nothing contained herein as between the parties shall create or constitute an agency, trust, partnership, association or entity of any kind except that the parties hereto elect to not be excluded from the application of all of the provisions of Subchapter K of the Chapter 1 of the Subtitle A of the Internal Revenue Code of 1954 and all amendments thereto.

The rights, privileges and obligations contained herein are binding upon the parties hereto, its successors and assigns and shall be considered as covenants running with the lands. FARMEE further agrees to comply with the terms of the Oil and Gas Lease(s) subject to this Agreement.

XII. Insurance

FARMEE, or FARMEE's contractor or subcontractors, shall comply with the Workmen's Compensation Law of the State of New Mexico and shall carry at FARMEE's sole cost, insurance as set forth in Exhibit "C" attached hereto and made a part hereof.

XIII. Failure of Performance

There is no obligation upon FARMEE to commence a well under the terms of this agreement, and the only penalty for failure to commence such well, or to drill to the objective depth, will be the forfeiture of all rights hereunder, including, but not limited to FARMEE's right to receive an assignment of leasehold interest as provided for hereinabove.

XIV. Time of Essence and Modification

With respect to the commencement and completion of any Test Well provided for herein, time is of the essence of this Agreement and no provisions hereof shall be modified and waived unless the same be made in writing and signed by the parties hereto.

XV. Entire Agreement

This Agreement constitutes the entire agreement between the parties hereto and supersedes any and all other agreements, written and oral, if any. No promise, representation, agreement or covenant not included in this Agreement has been or is relied upon by either party. No modification or amendment of this Agreement shall be of any force or effect unless in writing executed by both parties.

XVI. Execution

If this Agreement shall not be duly executed by FARMOR and returned to FARMEE, within Ten (10) days of receipt by FARMOR, then and thereupon, at FARMEE's option this Agreement shall be null and void and of no force or effect.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first written.

FARMOR:

FREDERICK L. LILLY, JR.

By: _____
Frederick L. Lilly, Jr.

FARMEE:

SG Interests I, Ltd., a Texas Limited partnership, by Gordy Gas Corporation, as General Partner

ATTEST:

By: _____
Melodie I. Thompson
Secretary

By: _____
Russell D. Gordy
President-Gordy Gas Corporation

STATE OF OHIO)
) ss.
COUNTY OF _____)

Before me, the undersigned authority, on this _____ day of _____, 1992, personally appeared Frederick L. Lilly, Jr., known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that _____ (he/they) executed the same for the purposes and consideration therein expressed, and in the capacities therein stated.

WITNESS my hand and official seal the day and year last above written.

My Commission Expires:

Notary Public for the State
of Colorado
Address: _____

STATE OF TEXAS)
) ss.
COUNTY OF HARRIS)

Before me, the undersigned authority, on this _____ day of _____, 1992, personally appeared Russell D. Gordy, to me personally known, who, being by me duly sworn, did say that he is the President of Gordy Gas Corporation, and that said Gordy Gas Corporation is the General Partner of SG Interests I, Ltd., a Texas Limited partnership and that said instrument was signed on behalf of said partnership for the uses and purposes as therein set forth, and said Russell D. Gordy acknowledged said instrument to be the free act and deed of said partnership.

WITNESS my hand and official seal the day and year last above written.

My Commission Expires:

Notary Public for the State of Texas
Address: _____

E X H I B I T " A "

(Description of Leasehold)

Lands, Leases and Interests

Attached to and made a part of that certain Farmout Agreement dated July 27th, 1992, by and between Frederick L. Lilly, Jr., as FARMOR AND SG Interests I, Ltd., a Texas Limited partnership, as FARMEE

LEASE A:

ORIGINAL LESSOR: Raymond D. Farmer and Olive M. Farmer, husband and wife, Shirley M. Linder, a single woman, Louis C. Farmer and Frances Farmer, husband and wife, Walter C. Farmer, a single man, Carl V. Farmer and Marie Farmer, husband and wife, Audrey Foster and Howard N. Foster, wife and husband, Helen M. Dashen and Felix Dashen, wife and husband

ORIGINAL LESSEE: Claud E. Aikman

DATE: July 10th, 1956

ROYALTY: 15.00%

RECORDING DATA: Book 310, at page 176, records of San Juan County, New Mexico

DESCRIPTION: Township 29 North, Range 10 West, N.M.P.M. Section 24: NE/4NE/4
INSOFAR AND ONLY INSOFAR as said Leases covers from the surface of the earth down to the base of the Fruitland (Coal-Gas) Formation. containing 40.00 gross acres, more or less

EXHIBIT "B"

Geological Requirements

Attached to and made a part of that certain Farmout Agreement dated July 27th, 1992, by and between Frederick L. Lilly, Jr., as FARMOR AND SG Interests I, Ltd., a Texas Limited partnership, as FARMEE

Provisions Applicable to Test Wells

With respect to all wells drilled by FARMEE hereunder or subsequently under the agreement to which this Exhibit is attached, FARMEE shall perform the following operations, and furnish FARMOR, the following rights and privileges:

1. To conduct all operations in accordance with approved and accepted practices prevailing in the area where the well is drilled.
2. To make adequate tests to determine if the well is capable of producing oil or gas in paying quantities from the objective formation and from all productive formations encountered.
3. Upon written request of FARMOR, FARMEE shall promptly furnish FARMOR, as to any well (s) drilled on said lands (or on a spacing unit including any portion thereof), daily drilling reports and copies of all logs, cores, reports or tests obtained for such well or filed with any governmental agency and, after completion, copies of all reports to governmental agencies concerning reworking, deepening, shut-in, recompleting, plugging and abandonment or similar change of well status.
4. All notices, reports, logs, samples and other information above requested shall be furnished to:

Mr. Frederick L. Lilly, Jr.
2895 Brighton Road
Shaker Heights, Ohio 44120
1 (216) 561-7895

EXHIBIT "D"

INSURANCE AND INDEMNITY

Attached to and made a part of that certain Farmout Agreement dated July 27th, 1992, by and between Frederick L. Lilly, Jr., as FARMOR AND SG Interests I, Ltd., a Texas Limited partnership, as FARMEE

At all times while operations are conducted under this Agreement, Operator shall maintain for the benefit of all parties hereto, insurance of the types and in the maximum amounts as follows. Premiums for such insurance shall be charged to the Joint Account.

Non-operating working interest owners shall be named as Additional Insureds on the liability insurance policies, but only with respect to the performance of all work hereunder.

All such insurance shall be carried in an acceptable company or companies; shall be maintained in full force and effect during the terms of this agreement; and shall not be canceled, altered or amended without thirty (30) days prior written notice. If so required, Operator agrees to have its insurance carrier furnish certificates of insurance evidencing such insurance coverages.

Operator and non-operating working interest owners agree to mutually waive subrogation in favor of each other on all insurance carried by each party and/or to obtain such waiver from the insurance carrier if so required by the insurance contract. If such a waiver is not obtained, the party failing to do so shall indemnify the other party for any claim by an insurance carrier arising out of Subrogation.

Non-operating working interest owners agree that the limits and coverage carried by operator are adequate and shall hold Operator harmless if any claim exceeds such limit or is not covered by such policy. Such coverage and limits may change or be unavailable from time to time and Operator does not guarantee their continuance but will use best effort to provide such coverage and limits at reasonable costs.

- a. Workers' Compensation insurance in full compliance with all applicable State and Federal laws and regulations.
- b. Employer's Liability insurance in the limits of \$500,000.00 per accident covering injury or death to any employee who may be outside the scope of the Workers' Compensation statute of the State in which the work is performed.
- c. Commercial General Liability insurance with combined single limits per occurrence/general aggregate of \$1,000,000.00 for Bodily Injury and Property Damage, including Property Damage by Blowout and Cratering Completed Operations, and Broad Form Contractual Liability as respects any contract into which the Operator may enter under the terms of this agreement.
- d. Automobile Liability insurance covering owned, non-owned and hired automotive equipment with limits for Bodily Injury and Property Damage of \$1,000,000.00.
- e. Umbrella Liability insurance with a limit of \$4,000,000.00.

EXHIBIT "D"
(continued)

INSURANCE AND INDEMNITY

- f. Operator shall carry Operators Extra Expense insurance covering the costs of controlling a Blowout, the expenses involved in redrilling the well, certain other related costs and Seepage and Pollution Liability. (These are descriptive terms only and exact coverage can be found only in the policy.) The limits for this insurance vary according to depth and location of the well. Non-operating working interest owners not wishing to be covered under this policy must notify Operator prior to spud date, and by such refusal of coverage each non-operating working interest owner agrees to be responsible for his proportionate share of such loss, anything in this agreement to the contrary notwithstanding.

Is your RETURN ADDRESS completed on the reverse side?

SENDER:

- Complete items 1 and/or 2 for additional services.
- Complete items 3, and 4a & b.
- Print your name and address on the reverse of this form so that we can return this card to you.
- Attach this form to the front of the mailpiece, or on the back if space does not permit.
- Write "Return Receipt Requested" on the mailpiece below the article number.
- The Return Receipt will show to whom the article was delivered and the date delivered.

I also wish to receive the following services (for an extra fee):

- 1. Addressee's Address
- 2. Restricted Delivery

Consult postmaster for fee.

3. Article Addressed to:

Frederick L. Lilly Jr.
2895 Brighton Road
Shaker Heights, Ohio 44120

4a. Article Number

P 028 989 571

4b. Service Type

- Registered Insured
- Certified COD
- Express Mail Return Receipt for Merchandise

7. Date of Delivery

5. Signature (Addressee)

6. Signature (Agent)

Frederick L. Lilly Jr.

8. Addressee's Address (Only if requested and fee is paid)

Thank you for using Return Receipt Service.

UNITED STATES POSTAL SERVICE

Official Business



PENALTY FOR PRIVATE
USE TO AVOID PAYMENT
OF POSTAGE, \$300



Print your name, address and ZIP Code here

James B. Fullerton
SG Methane Company
1645 Court Place, #406
Denver, Colo. 80202