

# Kaneb Operating Company, Ltd.

A Limited Partnership

November 3, 1987

Mitchell Energy Corporation  
1000 Bicercroft Savings Building  
200 North Loraine  
Midland, Texas 79701

Attention: Mr. Steven J. Smith

Re: Proposed Devonian Test  
Erwin No. 1 Well  
Lea County, New Mexico  
Kaneb's Austin Reef Prospect

Debra Thornton Stagner  
OIL CONSERVATION DIVISION  
File No. 39  
Case No. \_\_\_\_\_

Gentlemen:

Mitchell Energy Corporation ("Mitchell") has proposed the drilling of a 14,700' Devonian Test ("Test Well") in the NE/4 NW Section 35, Township 15 South, Range 35 East with the revised footage location being 660' from the north line and 1,830' from the west line of Section 3. We have discussed this with Steven Smith and reduce to writing the terms under which Kaneb Operating Company, Ltd. ("Kaneb") is agreeable to farming out to Mitchell:

1. Upon Mitchell drilling the above Test Well to a total depth of 14,700' or to a depth sufficient to test the Devonian formation, and upon completion of said well as a well capable of producing oil and/or gas, Kaneb agrees to assign all its right, title and interest in and to the leasehold estate included in the proration unit of said Test Well; i.e. 80 acres for the Penn Reef, 40 acres for the Devonian, however, should the New Mexico Oil and Gas Commission permit commingling of production from the Devonian and Penn Reef, then 80 acres of each formation will be assigned; 320 acres for the Morrow formation and in addition, the assignment will cover the acreage included in the proration unit of any other formation found to be productive in the Test Well.
2. As to the proration unit capable of producing in the Test Well, said assignment shall retain unto Kaneb an overriding royalty interest equal to the difference between the leasehold royalty and other burdens, if any, and twenty-five percent (25.0%), which overriding royalty interest will be convertible at Kaneb's election to a backin of twenty-five percent (25.0%) working interest upon payout of the Test Well.
3. In addition to 1 and 2 above, Kaneb agrees to assign unto Mitchell an undivided fifty percent (50.0%) of its leasehold interest in the balance of the NW/4 of Section 3, Township 5 South, Range 35 East, Lea County, New Mexico, not included in a proration unit(s) for the Test Well.
4. All rights earned shall be limited to 100' below total depth drilled.

Mitchell Energy Corporation  
Farmout proposal  
November 3, 1987

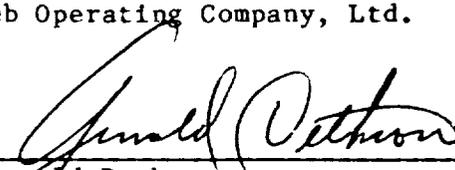
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If Mitchell is in agreement with the above terms, please sign and return one (1) copy of this letter and we will prepare a formal Farmout Agreement.

Very truly yours,

Kaneb Operating Company, Ltd.

By:

  
\_\_\_\_\_  
Arnold Dethrow  
Vice President - Land

AD/jo

AGREED TO AND ACCEPTED THIS \_\_\_\_\_

day of November, 1987.

MITCHELL ENERGY CORPORATION

By: \_\_\_\_\_