

MEWBOURNE OIL COMPANY

500 W. TEXAS, SUITE 1020
MIDLAND, TEXAS 79701

(432) 682-3715
FAX (432) 685-4170

CERTIFIED MAIL NO. 7535

July 21, 2004

Mr. James D. Finley
1308 Lake Street, Suite 200
Fort Worth, TX 76102

Re: Proposed Morrow Test
Osudo "9" State COM #1 well
1,980' FNL & 660' FEL
Section 9, T-21-S, R-35-E
Lea County, New Mexico
Osudo Prospect

7-28-04 - Talked w/ Scott Ramsey. Said they had talked about it & would get back with me today!
8-4-04 - Left message. Still no answer
8-16-04 - Scott called and left message. They want to trade shallow rights for cheap.

OIL CONSERVATION DIVISION

CASE NUMBER

EXHIBIT NUMBER **3**

Dear Mr. Finley:

Mewbourne Oil Company ("Mewbourne") is preparing to drill a 12,500' Morrow test at a location 1,980' FNL & 660' FEL of Section 9, T-21-S, R-35-E, Lea County, New Mexico to be called the Osudo "9" State COM #1 well. Assuming a successful completion requiring 320 acre spacing, an N/2 communitized proration unit would be established. To facilitate drilling the well, Mewbourne also proposes forming a working interest unit covering the N/2 of said Section 9.

Based upon our most current title information you appear to own 96.875% of the operating rights in State of New Mexico Lease E-1732-008 insofar only as it covers the NE/4 of said Section 9 from the surface to 10,000'. Via Term Assignment and Farmout, Mewbourne owns the remaining 3.125% of the operating rights from the surface to 10,000' and 100% of rights below 10,000' in the NE/4 of said Section 9. Assuming you choose to participate, you would have a 48.49375% working interest in the N/2 of Section 9 working interest unit limited to depths from the surface to 10,000'. To accommodate the ownership variance at depth, Mewbourne proposes utilizing the attached Cost Allocation Formula. Using this formula, you would bear no cost of any well drilled to depths below 10,000' unless and until the well is completed above 10,000'. At that time you would reimburse the owners of rights below 10,000 as outlined in the formula.

Mewbourne hereby offers you the opportunity to participate in the proposed well as outlined above. To indicate your election to participate in the proposed well, please execute and return one of the enclosed AFE well cost estimates. Upon receipt of your election to participate, an AAPL 1982 Model Form JOA naming Mewbourne as Operator will be forwarded for your review and approval. Should you choose not to participate, Mewbourne hereby offers to purchase a two (2) year term assignment covering all of your interest in State of New Mexico Lease E-1732-008 insofar only as it covers the NE/4 of said Section 9 from the surface to 10,000' for \$150.00 per net acre based upon delivery of a 80% NRI to Mewbourne allowing you to reserve an ORRI equal to the difference by which 20% exceeds all existing lease burdens.

James D. Finley
Osuda "9" St COM #1 Well
July 21, 2004
Page 2 of 2

Feel free to call me if you have any questions or would like to discuss this proposal in greater detail. My phone number is (432) 682-3715.

Sincerely,

MEWBOURNE OIL COMPANY

A handwritten signature in black ink, appearing to read "Steven J. Smith", with a stylized flourish at the end.

Steven J. Smith
Senior Landman

Attachments

SENDER: COMPLETE THIS SECTION

- Complete items 1, 2, and 3. Also complete item 4, if Restricted Delivery is desired.
- Print your name and address on the reverse so that we can return the card to you.
- Attach this card to the back of the mail piece, or on the front if space permits.

1. Article Addressed to:

Mr. James D. Finley
1308 Lake Street, Suite 200
Fort Worth, Texas 76102

2. Article Number
(transfer from service label)

7003 1680 0006 6283 7535

PS Form 3871, August 2001

Postage and Return Receipt

102595-02-M-15-01

Order 9 State Com #1

COMPLETE THIS SECTION ON DELIVERY

A. Signature Agent Addressee
x Molly Arentz

B. Received by (Printed Name) Date of Delivery
Molly Arentz *7/23*

D. Is delivery address different from item 1? Yes No
If YES, enter delivery address below:

3. Service Type Certified Mail Express Mail
 Registered Return Receipt for Merchandise
 Insured Mail C.O.D.

4. Restricted Delivery (Extra Fee) Yes No

Cost Allocation Formula

Osudo "9" State COM #1 Well

Shallow Unit - Surface of the earth down to 10,000 feet.

Deep Unit - All depths below 10,000'.

- A. If a well is drilled to the Shallow Unit all costs will be borne by the working interest owners of the Shallow Unit.
- B. If a well is drilled to the Deep Unit and the initial casing point election provides for a completion attempt in the Deep Unit:

The entire cost of drilling the well will be initially borne by the working interest owners of the Deep Unit with no right to be reimbursed by the working interest owners of the Shallow Unit, unless and until the well is to be recompleted in the Shallow Unit at which time the working interest owners of the Shallow Unit shall reimburse the working interest owners of the Deep Unit in accordance with the following formula:

1. Drilling Costs:

All pre-casing point drilling costs that can be isolated to the Shallow Unit or the Deep Unit (i.e. logging, testing coring, fishing, etc.) will be paid for by the participating working interest owners of those particular units with no right of adjustment between units. All other pre-casing point drilling costs ("Remaining Costs") shall be borne by the various participating working interest owners according to their respective interests as follows:

Participants in the Shallow Unit:

$$\frac{1}{2} \times \frac{\text{Footage to the base of Shallow Unit}}{\text{Total Depth}} \times \text{Remaining Costs.}$$

Participants in the Deep Unit:

$$\frac{1}{2} \times \frac{\text{Footage to the base of Shallow Unit}}{\text{Total Depth}} \times \text{Remaining Costs,}$$

PLUS

$$100\% \times \frac{\text{Footage from base of Shallow unit to Total Depth}}{\text{Total Depth}} \times \text{Remaining Costs.}$$

2. Completion Costs Less Casing, Tubing and Surface Equipment:

In the event of a completion attempt in a single zone or interval, all associated completion costs less and except down hole equipment and surface equipment shall be borne by the participating working interest owners in the applicable unit in which the completion attempt is made with no right of adjustment between units.

In the event a dual completion attempt is made in both the Deep Unit and Shallow Unit, all completion costs that can be isolated to the Deep or Shallow Units shall be paid for by the participating working interest owners of those units with no right of adjustment between units. All other costs, with the exception of casing, tubing and surface equipment shall be paid for equally by the participants in the Shallow Unit and Deep Unit.

3. Down Hole Equipment

Average per foot cost of casing, tubing and down hole equipment from the surface to the base of the Shallow Unit shall be borne:

Participants in the Shallow Unit - 2/3

Participants in the Deep Unit - 1/3

Average per foot cost of casing, tubing and down hole equipment below the base of the Shallow Unit shall be borne:

Participants in the Deep Unit - 100%

4. Surface Equipment

The cost of all surface equipment shall be borne equally (50/50) between the Shallow Unit and the Deep Unit, provided however, any surface equipment that can be isolated to the Deep Unit or Shallow Unit (i.e., tanks, separation units, pumping units, etc) shall be paid for by the participating working interest owners of those particular units.

C. If a well is drilled to the Deep Unit and the initial casing point election provides for a completion attempt in the Shallow Unit:

The entire cost of drilling the well will be initially borne by the working interest owners of both the Shallow Unit and the Deep Unit in accordance with the following formula:

1. Drilling Costs:

All pre-casing point drilling costs that can be isolated to the Shallow Unit or the Deep Unit (i.e. logging, testing coring, fishing, etc.) will be paid for by the participating working interest owners of those particular units with no right of adjustment between units. All other pre-casing point drilling costs ("Remaining Costs") shall be borne by the various participating working interest owners according to their respective interests as follows:

Participants in the Shallow Unit:

$$100\% \times \frac{\text{Footage to the base of Shallow Unit}}{\text{Total Depth}} \times \text{Remaining Costs.}$$

Participants in the Deep Unit:

$$100\% \times \frac{\text{Footage from base of Shallow unit to Total Depth}}{\text{Total Depth}} \times \text{Remaining Costs.}$$

2. Completion Costs Including Casing, Tubing and Surface Equipment:

All completion costs including down hole equipment and surface equipment shall be borne by the participating working interest owners in the Shallow Unit with no right of adjustment between units.

D. Non-Consent Elections

Any cost adjustments resulting from the provisions hereof that are attributable to the interest of a party hereto that is then non-consent in the well shall be applied to the remaining balance of that party's non-consent penalty.

MEWBOURNE OIL COMPANY

500 W. TEXAS, SUITE 1020
MIDLAND, TEXAS 79701

(432) 682-3715
FAX (432) 685-4170

VIA FAX AND CERTIFIED MAIL NO. 5010

August 18, 2004

Mr. James D. Finley
1308 Lake Street, Suite 200
Fort Worth, TX 76102

*called Scott Ramsey 9-23-04
left message.*

Re: Proposed Morrow Test
Osudo "9" State COM #1 well
1,980' FNL & 660' FEL
N/2 Section 9, T-21-S, R-35-E
Lea County, New Mexico
Osudo Prospect

Dear Mr. Finley:

Reference is made to my letter to you dated July 21, 2004 proposing the referenced well. Reference is also made to the phone message Mr. Scott Ramsey recently left indicating that, rather than granting the Term Assignment proposed in my letter, your preference would be to trade part of your shallow rights (surface to 10,000') for part of Mewbourne's interest in the deep rights.

After discussing your preference with my management, I regret to inform you that we can't entertain a trade based upon your preference. Mewbourne simply does not wish to reduce its interest in the primary objective for a greater interest in a bailout position.

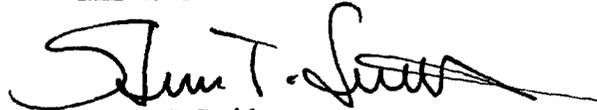
To facilitate moving forward towards drilling the well, in addition to the options detailed in the July 21st letter, Mewbourne hereby offers you the opportunity to participate in the proposed well as to rights from the surface to 10,000' on a well bore basis subject to entering into a Joint Operating Agreement limited to the well bore and utilizing the same Cost Allocation Formula attached to the July 21st letter. There would be no pooling and you would have your full 96.875% in the well bore. You would also retain your full interest in any offsets in the NE/4 of Section 9. You would bear no cost of drilling the well unless and until it was either initially completed or subsequently recompleted above 10,000'. Prior to commencement of any completion or recompletion effort above 10,000' you would be given the opportunity to elect either to participate or go non-consent. If you chose to participate, you would reimburse the owners of rights below 10,000' as outlined in the Cost Allocation Formula. As an additional alternative, Mewbourne hereby offers to purchase an assignment covering all of your right, title and interest in and to all production from the well bore of the referenced well based upon a one time bonus payment of \$5,812.50 and delivery of a 80% NRI to Mewbourne.

James D. Finley
Osudo "9" St COM #1 Well
August 18, 2004
Page 2 of 2

We thank you for your consideration and cooperation. Feel free to call me if you have any questions or would like to discuss this proposal in greater detail. My phone number is (432) 682-3715.

Sincerely,

MEWBOURNE OIL COMPANY



Steven J. Smith
Senior Landman

SENDER: COMPLETE THIS SECTION	COMPLETE THIS SECTION ON DELIVERY
<ul style="list-style-type: none">Complete items 1, 2, and 3. Also complete item 4 if Restricted Delivery is desired.Print your name and address on the reverse so that we can return the card to you.Attach this card to the back of the mailpiece, or on the front if space permits.	<p>A. Signature <i>Molly Arentz</i> <input type="checkbox"/> Agent <input checked="" type="checkbox"/> Addressee</p> <p>B. Received by (Printed Name) <i>Molly Arentz</i></p> <p>C. Date of Delivery <i>8/23</i></p> <p>D. Is delivery address different from item 1? <input type="checkbox"/> Yes if YES, enter delivery address below <input checked="" type="checkbox"/> No</p>
1. Article/Addressed to <div data-bbox="430 1617 933 1816" style="border: 1px solid black; padding: 5px;"><p>Mr. James D. Finley 1308 Lake Street, Suite 200 Fort Worth, Texas 76102</p></div>	3. Service Type <input checked="" type="checkbox"/> Certified Mail <input type="checkbox"/> Express Mail <input type="checkbox"/> Registered <input type="checkbox"/> Return Receipt for Merchandise <input type="checkbox"/> Insured Mail <input type="checkbox"/> C.O.D. <p>4. Restricted Delivery? (Extra Fee) <input type="checkbox"/> Yes</p>
2. Article Number (Transfer from service label)	7002 2410 0000 1362 5010
PS Form 3811, August 2001	Domestic Return Receipt <i>Osudo 9 St Com #1</i> 102595-02-M-1540