



T. Kent Woolley, CPL  
Senior Landman

OXY USA INC.  
Box 50250, Midland, TX 79710

Phone (915) 685-5946  
FAX: (915) 685-5742

March 27, 1997

Threshold Development Company  
Broad Street Financial Company  
Leland Hodges and  
Herbert F. Boles  
c/o Threshold Development Company  
Fort Worth Club Tower  
Penthouse II, Suite D  
777 Taylor Street  
Fort Worth, Texas 76102

Re: Sections 8 as to all rights below three thousand (3000) feet subsurface and Section 9 as to all rights below five thousand (5000) feet subsurface, Township 19 South, Range 29 East, N.M.P.M., Eddy County, New Mexico (hereinafter the "Subject Lands")

Gentlemen:

This letter shall serve to confirm the terms and provisions of the Agreement between OXY USA Inc., hereinafter "OXY" and Threshold Development Company, Broad Street Financial Company, Leland A. Hodges, and Herbert F. Boles (hereinafter referred to collectively as "Farmors") regarding the acquisition by OXY of a portion of Farmors' interest in those certain Oil, Gas and Mineral Leases more particularly described in Exhibit "A" attached hereto and incorporated herein for all purposes (hereinafter the "Subject Leases") as to the depths specified herein and in Exhibit "A" (hereinafter the "Subject Depths").

For, and in consideration of the mutual covenants and Agreements of the parties hereto, OXY and Farmors do hereby covenant and agree as follows:

1. OXY shall commence, or cause to be commenced actual drilling operations for the first test well at a location of OXY's choice on the Subject Lands on or before the later of July 1, 1997, or sixty (60) days after execution of this Agreement by all of the Farmors, and thereafter drill such well in a continuous, good and workmanlike manner, with no cessation of operations for more than thirty (30) consecutive days, to a depth sufficient in OXY's opinion to test the Morrow formation, but in no event less than 11,000 feet below the surface of the Subject Lands (hereinafter the "Objective Depth"), and thereafter either plug and abandon such well if it is a dry hole, or complete and equip such well through the tanks if completed as an oil well, or through the christmas tree if completed as a gas well, all at OXY's sole risk, cost and expense.
2. OXY shall commence or cause to be commenced actual drilling operations for the second well at a location of OXY's choice on the other section of the Subject Lands within sixty (60) days of the release of the drilling rig from the location for the first test well, said second test well shall be drilled and completed on the same terms and to the same depth as required for the first test well as provided herein.

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An Occidental Oil and Gas company

EXHIBIT A

3. Should OXY fail to timely commence actual drilling operations for the first test well as provided herein for any reason, OXY shall pay Farmers the sum of fifty thousand dollars (\$50,000.00) as liquidated damages, and not as a penalty, in full settlement for OXY's failure to perform hereunder whereupon OXY's rights hereunder shall immediately terminate. After drilling the first test well as required hereunder, should OXY fail, for any reason, to commence actual drilling operations for the drilling of the second test well in a timely manner OXY shall pay to Farmers the sum of twenty five thousand dollars (\$25,000.00) as liquidated damages, and not as a penalty, in full settlement for OXY's failure to perform hereunder whereupon OXY's rights hereunder with respect to any portion of the Subject Lands other than that portion of the same earned by the drilling and completion of the first test well, shall terminate.

4. Should either first test well or second test well be lost or should conditions therein be encountered which make the continuation of drilling operations therein impractical for any reason, said well shall be deemed to be a lost well and OXY may continue its rights under this Agreement by commencing actual drilling operations for a substitute well therefor within sixty (60) days of the date the drilling rig was released from the location for the lost well. Any substitute well timely drilled to the Objective Depth and completed as specified herein for either the first test well or the second test well shall be deemed for all purposes to be such test well.

5. Separately as to first test well and the second test well, upon reaching the Objective Depth therein and the same being completed and equipped as a well capable of producing oil and/or gas in commercial quantities, OXY shall earn all of Farmers' right, title and interest in and to the Subject Leases, insofar and only insofar as they cover the lands lying within the minimum spacing unit for production established by the New Mexico Oil Conservation Division (hereinafter "NMOCD") for the said well or 320 acres, whichever is smaller (hereinafter the "Earned Unit") but only as to the Subject Depths 100 feet below the total depth drilled in said well (hereinafter the "Earned Depths"), subject to a right of Farmers to receive a forty-six and one-half percent (46.5%) working interest in said well and Earned Unit upon the occurrence of "payout" as hereinafter defined; provided, however, that, with respect to all zones, horizons, depths and formations within the Subject Depths and above the base of the Bone Springs Formation in the Earned Unit, OXY shall only earn fifty percent (50%) of Farmers' interest in such zones, horizons, depths and formations within the Subject Depths and above the base of the Bone Springs formation. Within ten (10) business days after receipt of a notice from OXY advising that the subject well has been completed and equipped as required herein, Farmers shall deliver to OXY an assignment in the form attached hereto as Exhibit "B" covering the Earned Unit for such well as to the Earned Depths.

6. With regard to those portions of the Subject Lands not within an Earned Unit for either the first test well or the second test well, OXY shall have the option to continue drilling wells on the Subject Leases until the said lands shall be fully developed with one well on each minimum spacing unit for production as such units shall be prescribed by the NMOCD, provided, that no more than one hundred eighty (180) days shall elapse between the drilling rig release date for one well and the commencement of actual drilling operations for the drilling of the next succeeding well. The failure to commence operations for the drilling of a well on or before the one hundred eightieth (180th) day from the drilling rig release date for the preceding well shall terminate OXY's right to drill more wells on the then unearned portions of the Subject Lands. With regard to any such well drilled to or completed in the Bone Springs formation or any shallower formation covered by this Agreement, the

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Farmors shall have the right and option to participate in the drilling of such well to the extent of their respective pro-rata portion of an undivided fifty percent (50%) working interest under the terms and conditions of an Operating Agreement in the form of that attached hereto as Exhibit "C". Any well proposed and completed in a horizon lying below the base of the Bone Springs formation shall be drilled under the same provisions as provided herein for the first test well. Any well drilled pursuant to this paragraph shall be hereinafter referred to as an "Option Well".

7. Upon reaching total depth in any Option Well OXY shall earn either 1) fifty percent (50%) of all of Farmors' right, title, and interest, in and to the Subject Leases, insofar and only insofar as the same cover the lands contained within the minimum spacing unit for production attributed to such Option Well as may be prescribed by the NMOCD for those wells completed in any zone, horizon or formation within the Subject Depths but above the base of the Bone Springs formation, the Farmors having elected to participate in the drilling of such Option Well or elected non-consent status under Article IV.B. of the Operating Agreement; or 2) one hundred percent (100%) of Farmors' right, title and interest, in and to the Subject Leases insofar and only insofar as the same cover lands contained within said minimum spacing unit for production attributed to such Option Well as may be prescribed by the NMOCD subject to Farmor's right to receive a forty-six and one half percent (46.5%) working interest at "payout" (as hereinafter defined) for those wells completed below the base of the Bone Springs formation. In either case, OXY shall only earn an assignment of the Subject Leases as to the minimum spacing unit and only as to the Subject Depths 100 feet below the total depth drilled in any such well and the assignment from Farmors to OXY shall be in substantially the form as attached hereto revised only to reflect the delivery and retention of the correct interests for the well which earned such assignment.

8. Should any Option Well drilled hereunder be lost for any reason or should conditions be encountered in such well which make continued drilling operations impractical prior to reaching total depth therein said well shall be deemed to be a lost well and the date the drilling rig shall have been released from the location for such lost well shall be fixed as the completion date for said well for the purposes of commencing the next one hundred eighty (180) day continuous development period and OXY's rights under this Agreement shall continue as though said well had been duly completed, save and except no assignment shall have been earned due to the drilling of said lost well. Unless OXY's rights under this Agreement shall be preserved by some other provision hereof, failure to commence operations for the drilling of a well on or before the one hundred eightieth (180th) day from the drilling rig release date for the preceding well shall terminate OXY's right to drill more wells on the Subject Lands and earn additional portions of the same pursuant hereto.

9. With regard to any well to be drilled on the Subject Lands below the base of the Bone Springs formation whether such well is an Option Well or a well proposed to be drilled on an Earned Unit, all such wells shall be drilled at the sole risk, cost and expense of OXY and Farmors shall be entitled to receive an undivided forty-six and one half percent (46.5%) working interest in such well upon the occurrence of payout (as hereinafter defined), it being the expressed intention hereof that, any and all wells drilled on the Subject Lands below the base of the Bone Springs formation shall be subject to the Farmor's right to back-in for a full forty-six and one half percent (46.5%) working interest upon the occurrence of payout (as hereinafter defined.).

10. If the Subject Leases cover less than the full oil and gas leasehold estate in and to the Subject

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Lands or if Farmers' interest in such lease(s) and lands is less than the full oil and gas leasehold estate (excluding and disregarding any royalty, overriding royalty, production payment or other burden to which such leasehold estate is subject), then with respect to any well in which Farmers may have a right to back-in for a working interest, that working interest shall be in the proportion that the oil and gas leasehold estate in such lease(s) covering the lands described herein bears to the full oil and gas leasehold estate in said lands.

11. Any interest reserved to or to be received by, or any monies to be paid to Farmers herein, shall be shared between the Farmers as follows: fifty percent (50%) to Threshold Development Company; thirty seven and one half percent (37.5%) to Broad Street Financial Company, eleven and seven eighths percent (11.875%) to Leland A. Hodges; and five eighths of one percent (0.625%) to Herbert F. Boles.

12. Operations on the Subject Lands shall be governed by and the parties hereto shall execute the Operating Agreement which is attached hereto as Exhibit "C", including those exhibits to that Agreement as are included therewith.

13. The term "Payout" as used herein shall mean that point in time when the value of proceeds from the sale of OXY's gross working interest share in the production obtained by and through the wellbore of the initial test well, second test well or any other well to which the occurrence of "payout" may be relevant, after the payment of OXY's share of production and severance or similar taxes, royalties and overriding royalties, if any, (but specifically excluding any overriding royalties or other burdens created after the date of this Agreement) equals the lesser of (i) Nine Hundred Thousand Dollars (\$900,000.00) [hereinafter the "Maximum Amount"] or (ii) the actual, reasonable and necessary expenses paid by OXY (and which are permitted by the Accounting Procedures attached to the Operating Agreement) in connection with the drilling, testing, completing, equipping, and operating of the initial test well, second test well, or any other well to which the occurrence of payout may be relevant. Separate payout accounts shall be established and maintained for the first test well, the second test well and any other well to which the occurrence of payout is relevant.

Within thirty (30) days after completion of the initial test well, the second test well, and any other well to which the occurrence of payout may be relevant, OXY shall furnish Farmers with a detailed statement of the cost incurred in the drilling, completing and equipping of each such well. Thereafter, until the occurrence of payout, OXY shall provide Farmers with monthly statements indicating the status of payout for each such well.

Separately, upon the occurrence of payout of the initial test well, the second test well, or any other well to which the occurrence of payout may be relevant, an undivided forty-six and one half percent (46.5%) interest in the Subject Leases as to the Earned Unit and Earned Depth for the well on which payout has occurred shall automatically revert to Farmers, together with a like interest in all of the materials, pipelines, plants and all equipment used in connection with producing such well or pertaining thereto, and the production therefrom, free of any liens, claims, encumbrances or other burdens placed thereon by OXY. Such reversion shall be effective as of 7:00 a.m. on the day following the date payout occurs. OXY shall execute, acknowledge and deliver to Farmers such assignments, division orders, transfer orders, documents of conveyance or other documents necessary to evidence the occurrence of payout and the reversion of the interests in the Subject Leases resulting

therefrom; provided that the Assignment by OXY to Farmers shall be in substantially the form of the Assignment attached hereto as Exhibit "B". Should any well drilled pursuant to this Agreement in which Farmers retain and are entitled to a reversionary interest be lost for any reason prior to the occurrence of payout for that well, OXY may drill a replacement well therefor. The then outstanding balance of the payout account for such lost well shall be added to the costs of drilling, testing, completing, equipping and operating said replacement well for the purpose of determining the occurrence of payout for such well.

14. Upon the cessation of production from the Subject Depths from an Earned Unit all of OXY's rights, titles and interests in and to the Subject Leases, insofar as they cover such Earned Unit shall terminate and OXY shall reassign its interest in the Subject Leases to Farmers free and clear of any liens, encumbrances or burdens which arise after the date of this Agreement; provided, however, OXY's rights shall nevertheless remain in full force and effect if OXY commences further operations for reworking an existing well or for drilling an additional well or for otherwise obtaining or restoring production on the subject Earned Unit or within 90 days after completion of operations on such dry hole or within 90 days after such cessation of all production and OXY's rights hereunder shall continue and no reassignment shall be due to Farmers so long as any one or more of such operations are prosecuted with no cessation of more than 90 consecutive days and, if any such operations result in the production of oil or gas or other substances covered hereby, so long thereafter as there is production in paying quantities from the Earned Unit.

No termination of OXY's rights in and to the Subject Leases as to such Earned Unit pursuant to this provision shall relieve OXY of its obligation to properly plug and abandon all such wells from which production has ceased in accordance with NMOCD regulations.

15. OXY shall indemnify and save and hold Farmers, and each of them (and their respective agents, officers, directors and shareholders), harmless, from and against any and all claims, demands, liabilities, debts, actions or causes of action (including attorney's fees and related expenses incurred in connection with the defense or investigation of any of such claims, demands, liabilities, debts, actions or causes of action) relating to or arising in connection with operations by OXY on the Subject Lands.

16. OXY agrees to give Farmers and their designated representatives access at all times to the well site, including the derrick floor, for the purpose of observation. In addition to the common mudlogging and open hole logging programs typically run by a prudent operator in an exploratory well in this area, OXY agrees that in regard to the interval to be covered by surface casing (hereinafter the "Surface Hole") and in order to assist Farmers in evaluating same, OXY shall, at its sole expense, conduct prudent drilling operations with ample drilling fluids so that representative formation samples and open hole logs are obtained, and OXY shall, maintain an on-site mudlogger to circulate and collect samples and report to Farmers all mudlog shows across all prospective pay zones including depths and horizons not within the Subject Depths and specifically including, but not limited to, the Yates, Seven Rivers, Queen, Grayburg and San Andres formations and to run a normal suite of Schlumberger open hole logs across these zones of interest. The minimum requirements for the open hole logs shall be a Dual Induction, Compensated Neutron-Formation Density, GammaRay and Caliper. Any information requested by Farmers concerning any relevant operations to all wells while the same are being drilled, completed or operated shall be promptly

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furnished by OXY. OXY shall provide Farmers copies of all daily drilling and completion reports, open-hole and cased-hole logs, test results, plugging records, all NMOCD filings and other similar data and information.

17. Any interest which OXY may earn pursuant to this Agreement shall be subject to all of the terms and provisions of the Subject Leases and any assignments thereof, and to any farmout agreements, or other agreements or contract rights to which the Subject Leases or the interests of Farmers' therein may be subject and with regard to which such agreements are either contained in the County Records for the Eddy County, New Mexico, or with regard to which Farmers' have give actual notice in writing to OXY.

18. The parties hereto have entered into an Operating Agreement of the same date covering and effecting the Contract Area. The terms, conditions and provisions contained within this Letter Agreement are subject to the terms, conditions and provisions contained within the Operating Agreement. Reference to the Operating Agreement is hereby made for all purposes and the terms, conditions and provisions of the Operating Agreement are incorporated herein for all purposes. In the event of a conflict between the terms and provisions contained within this Letter Agreement, and the terms and provisions contained within the Operating Agreement, the terms and provisions of this Letter Agreement shall control.

19. It is the intention of the parties that the laws of the State of New Mexico shall govern the validity of this Agreement and the construction of its terms and the interpretation of the rights and duties of the parties.

20. This Agreement may not be altered or amended except by an instrument in writing executed by all parties to this Agreement.

21. This Agreement shall be binding upon, and shall inure to the benefit of, the parties hereto and their respective heirs, successors and assigns. OXY shall not assign its rights herein prior to the drilling and completion of the second test well without the prior written consent of all other parties; however, such consent will not be unreasonably withheld and no assignment by Farmers or any of them shall be effective to bind OXY until thirty (30) days after OXY shall have received written notice with respect thereto from Farmor(s).

In the event any party fails to assign or reassign to any other party as required by the terms of this Agreement, the party entitled to receive such assignment or reassignment shall be entitled to the remedy of specific performance, in addition to and not in lieu of any other remedy, at law or at equity.

22. The parties do not intend to create, nor shall this Agreement be construed as creating, any mining or other partnership or association, nor does this Agreement render the parties hereto liable as partners. The liability of the parties hereto shall be several and not joint or collective.

23. In the performing, closing and consummation of this Agreement, time is of the essence.

24. This Agreement together with the Exhibits annexed hereto contain the entire agreement of

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Threshold Development Company  
Sections 8 & 9, T19S-R29E,  
Eddy County, New Mexico

March 27, 1997  
Page 7

the parties hereto with respect to the subject matter hereof and supersede all negotiations, prior discussions, prior agreements and understandings relating to such subject matter.

If the above and foregoing correctly sets forth your understanding of our agreement regarding the subject matter hereof, please execute two (2) copies of this Agreement in the space provided below and return the same to the attention of Mr. T. Kent Woolley. This Agreement may be executed in any number of counterparts, no one of which need bear the signatures of all of the parties, but any one of which will constitute an original hereof for all purposes. Timely execution and return of this letter by all the Farmers is a condition precedent to any obligation on the part of OXY under this Agreement. Should any of the Farmers fail to execute and return a copy of this letter to OXY within thirty (30) days of the receipt hereof this proposal shall terminate and this Agreement shall be deemed to have been rejected and to be null and void for all purposes.

Upon receipt of fully executed copies of this Agreement OXY will complete its examination of Farmers' title in and to the Subject Leases and advise as to any objections it may have as well as commence preparations to undertake performance, assuming OXY can clear and approve title.

Very truly yours,

OXY USA Inc.

T. Kent Woolley  
Senior Landman

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

THRESHOLD DEVELOPMENT COMPANY

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

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

BROAD STREET FINANCIAL COMPANY

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

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Threshold Development Company  
Sections 8 & 9, T19S-R29E,  
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March 27, 1997  
Page 8

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\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Leland A. Hodges

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\_\_\_\_\_  
Margery Ann Hodges

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\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Herbert F. Boles

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\_\_\_\_\_  
Norma J. Boles

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Page 7

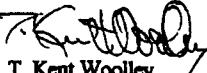
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Very truly yours,

OXY USA Inc.

  
T. Kent Woolley  
Senior Landman

AGREED to and ACCEPTED this  
3rd day of April, 1997.

THRESHOLD DEVELOPMENT COMPANY

By:   
Its: President

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

BROAD STREET FINANCIAL COMPANY

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

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Threshold Development Company  
Sections 8 & 9, T19S-R29E,  
Eddy County, New Mexico

March 27, 1997  
Page 7

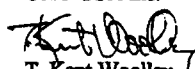
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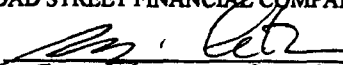
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THRESHOLD DEVELOPMENT COMPANY

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Its: \_\_\_\_\_

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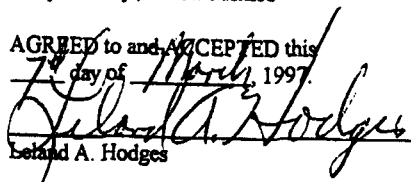
BROAD STREET FINANCIAL COMPANY

By:   
Its: Executive Vice President

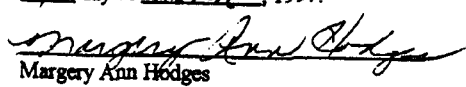
Threshold Development Company  
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Page 8

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Leland A. Hodges

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7 day of March, 1997.

  
Margery Ann Hodges

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Norma J. Boles

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Norma J. Boles  
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