



Santa Fe Energy Resources, Inc.

550 West Texas Avenue, Suite 1330, Midland, TX 79701

From: Steve Smith 915/686-6712

FAX 915/686-6714

Fax Cover Sheet

Date: September 15, 1998

To: Robert Landreth

Fax: 684-4783

RE: Proposed 13,700 Morrow Test
N/2 Section 4, T-23-S, R-34-E
Rio Blanco "4" Fed COM #1
Lea County, New Mexico

BEFORE THE
OIL CONSERVATION DIVISION
Case No. 12043 Exhibit No. 41
Submitted By:
Santa Fe Energy Resources
Hearing Date: September 17, 1998

Dear Mr. Landreth,

Attached is a revised copy of the Farmout Agreement which should address all of the changes you requested in your September 14th letter except for the additional language described in Section V. thereof. As to Section V., Santa Fe would be willing to make its best efforts to market your share of production, provided, however, in the event any product sales contract for any reason requires that Santa Fe deliver only its share of production, Santa Fe will no longer be required to market your share of production.

Again, I will be available throughout today to facilitate your execution of this Agreement. If for some reason we are unable to finalize this trade by this afternoon, I will need to proceed with the Compulsory Pooling hearing on Thursday.

Thank you for your cooperation. If you would like to discuss this matter, my direct number is 686-6712.

Sincerely,

Steve Smith

THIS MESSAGE IS INTENDED ONLY FOR THE USE OF THE INDIVIDUAL OR ENTITY TO WHICH IT IS ADDRESSED, AND MAY CONTAIN INFORMATION THAT IS PRIVILEGED, CONFIDENTIAL, AND EXEMPT FROM DISCLOSURE UNDER APPLICABLE LAW. If the reader of this message is not the intended recipient, or the employee or agent responsible for delivering the message to the intended recipient, you are hereby notified that any dissemination, distribution, or copying of this communication is strictly prohibited. If you have received this communication in error, please notify us immediately by telephone, and return the original message to us at the above address via U. S. Postal Service. Thank you.

Number of Pages Sent 10 (Not including cover sheet). **Please call me if all pages are not received.**

CONFIRMATION REPORT - MEMORY SEND

Time : SEP-15-98 09:33
Fax number: 9156866714
Name : SANTA FE ENERGY RESOURCES

Job : 857
Date : SEP-15 09:25
To : 96844783
Doc. pages : 11
Start time : SEP-15 09:25
End time : SEP-15 09:33
Pages sent : 11
Job:857

*** SEND SUCCESSFUL ***



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Number of Pages Sent 10 (Not including cover sheet). Please call me if all pages are not received.

FARMOUT AGREEMENT

THIS AGREEMENT dated as of this 15th day of September, 1998, between **ROBERT E. LANDRETH**, whose address is 505 N. Big Spring, Suite 507, Midland, TX 79701 (herein called "Farmor"), and **SANTA FE ENERGY RESOURCES, INC.**, a Delaware corporation, whose address is 550 West Texas, Suite 1330, Midland, Texas 79701 (herein called "Farmee").

WITNESSETH:

WHEREAS, Farmor is the owner of the undivided interests in the oil and gas leases more particularly described on Exhibit "A" (herein the "Subject Leases") insofar and only insofar as said Subject Leases covers and affects the lands and depths described on Exhibit "A" (which lands and depths so described are herein called the "Subject Lands"); and

WHEREAS, Farmee desires to earn an undivided three-fourths (3/4) of Farmor's interest in the Subject Leases by drilling the well or wells for oil and gas hereinafter described, and Farmor has agreed to participate in the Test Well for his remaining one-fourth (1/4) interest in the Subject Leases, or a 1/8 of 8/8 Gross Working Interest in said Test Well.

NOW, THEREFORE, IN CONSIDERATION of the premises and of the mutual covenants, agreements, conditions and obligations between the parties herein contained, the parties hereby agree as follows:

Section 1. Test Well. Farmee covenants and agrees to commence on or before ninety (90) days from the date of this Agreement the actual drilling of a well (the "Test Well") for oil and gas at a legal location of its choice on the subject land or lands pooled or communitized therewith and thereafter to continue the drilling of said Test Well with due diligence and in accordance with those practices which would be followed by a prudent operator, to a depth of 13,700 feet, or a depth sufficient to penetrate and thoroughly test the Morrow Formation, which ever is the lesser depth (the "Contract Depth"). The Test Well, if capable of commercial production, shall be promptly completed and equipped for the taking of production; otherwise, it shall be plugged and abandoned in accordance with the laws, rules and regulations of governmental authorities having jurisdiction.

Section 2. Substitute Well. If during the drilling of the Test Well, Farmee shall encounter granite or any other practically impenetrable substance or encounter mechanical difficulties or if the hole is lost for any reason not reasonably within control of Farmee, Farmee shall have and is hereby granted the right to abandon said well at its sole cost, risk and expense and Farmee may within thirty (30) days after such abandonment commence the actual drilling of a Substitute Well at a location which would, under the terms of this Agreement, have been permissible for the location of the Well abandoned. If such Substitute Well is commenced, it shall thereafter be drilled to the Contract Depth and thereupon Farmee's duties and obligations

herein and the provisions hereof respecting the Test Well shall apply to such Substitute Well, and such Substitute Well shall be deemed to be the Test Well for all purposes of this Agreement.

Section 3. Continuous Development Option. If the Test Well is completed as a well capable of producing oil and gas, or either of them, in commercial quantities and Farmee has otherwise complied with all of the terms and provisions of this Agreement, Farmee shall have the right to earn further interests in the balance of the Subject Lands not dedicated to the Test Well, if any, provided that Farmee commences the actual drilling of a well (a "Continuous Development Well") on the Subject Lands, or on lands pooled therewith, on or before 120 days following completion of the Test Well and thereafter undertakes a continuous drilling and development program on the Subject Lands, or lands pooled therewith. Such program shall be deemed continuous if Farmee commences the actual drilling of the next well within 120 days following completion of the previous well, either as a producer or as a dry hole. Completion date of a well shall be deemed the date on which the rig used to complete said well is released. Earning of working interest under the continuous drilling and development program shall be under the same terms and conditions as set out for earning working interest under the initial Test Well, with the exception of the following:

- (i) Any Continuous Development Well shall be drilled at a location of Farmee's choice on that portion of the Subject Lands not previously earned hereunder.
- (ii) Any Continuous Development Well may, at Farmee's option, be drilled to the shallower of (a) the Contract Depth, or (b) any formation or depth which Farmee has found to be productive in any well previously drilled hereunder. For the purposes of this agreement, any Option Well drilled pursuant to option (b) above shall be deemed to have been drilled to the Contract Depth.

Section 4. Costs and Indemnity. Except to the extent Farmor has a current working interest in any well drilled hereunder, Farmee shall bear the sole cost, risk and expense (i) of drilling, completing and equipping or plugging and abandoning (as the case may be) the Test Well, any Substitute Well or Continuous Development Well, (ii) of operating the Test Well, Substitute Well or Continuous Development Well in the event such well is completed as a successful well, and (iii) of any other development of or operation upon the Subject Lands. In that connection, Farmee agrees to indemnify, defend and hold Farmor harmless from any and all liens, encumbrances, suits, claims, judgments, obligations and liability of any kind caused or created by or arising out of Farmee's operations hereunder, except to the extent Farmor has a current working interest in the same.

Section 5. Drilling Practices. As to any well drilled pursuant to this agreement, Farmee shall test, as would a prudent operator, all zones or formations penetrated in the such having a reasonable possibility of production, and will test any zones having oil and/or gas shows. Upon completion of drilling operations, Farmee shall restore the surface of the land to the condition

required by any of the Subject Leases or by law, and in absence of such lease provisions or requirements of law, then as nearly as possible to its original condition.

Section 6. Interest Earned. If the Test Well, any Substitute Well or Continuous Development Well is drilled to the Contract Depth and thereafter completed as a well capable of producing oil and gas, or either of them, in commercial quantities (an "Earning Well"), and Farmee has otherwise complied with all of the terms and provisions of this Agreement, Farmor shall assign to Farmee, upon the conditions and subject to the reservations hereafter made, an undivided three-fourths (3/4) of Farmor's interest in the Subject Leases insofar as they are included in the Spacing Unit for the Earning Well. "Spacing Unit" shall mean a drilling and spacing unit established by the New Mexico Oil Conservation Division for the drilling of one well. Such assignment will be made on an appropriate recordable form, and the execution and delivery of such assignment shall constitute full compliance with and discharge of any and all obligations of Farmor hereunder. In the event the terms of the Subject Leases precludes an assignment thereof to Farmee, the parties, in lieu of such assignment, shall enter into an appropriate transfer of operating rights with respect to such Leases. Further, Farmor shall reserve from said assignment the following:

- (i) All rights in the Subject Leases beginning 100 feet below the stratigraphic equivalent of the base of the final completion interval in which the Earning Well is completed, including the right of ingress and egress at all times to such reserved depths for the purpose of drilling, exploring for, operating and developing oil, gas and other minerals or otherwise enjoying the reserved depths;
- (ii) The overriding royalty provided for in Section 7 herein.
- (iii) The deferred reversionary working interest provided for in Section 8 herein.

Section 7. Farmor Override. Farmor shall reserve from any assignment made to Farmee an overriding royalty interest (herein "ORRI") out of all oil, gas, and other minerals produced or sold from the Spacing Unit for each Earning Well, which ORRI shall be equal to (i) twenty-five percent of eight-eighths (25 % of 8/8ths) less (ii) the royalty reserved by the Lessor in the Subject Leases and all existing overriding royalties, production payments and other burdens, affecting or payable out of the oil and gas leasehold estate in the Subject Leases, or any part thereof. If Farmor's interest in the Subject Leases, insofar as they cover the Subject Lands, is less than a full interest, or if the Subject Leases, insofar as they cover the Subject Lands, cover less than a full interest, and/or if all or any part of the Subject Lands is pooled or communitized with other lands, the ORRI reserved by Farmor shall be proportionately reduced. Said ORRI shall be free and clear of all costs of development and operation; however, such ORRI shall bear the amount of the crude oil windfall profit tax or other similar tax levied upon such share of production and shall bear a proportionate part of all production and other similar taxes levied against Farmor's share of production.

Section 8. Farmor's Conversion Option. A portion of Farmor's reserved ORRI interest shall be convertible at Farmor's option upon payout of each Earning Well, on a well by well basis, to a twenty-five percent (25%) working interest in the Spacing Unit dedicated to the Earning Well as more particularly described on the Exhibit "A" attached hereto. If Farmor's interest in the Subject Leases, insofar as it covers the Subject Lands, is less than a full interest, or if the Subject Leases, insofar as it covers the Subject Lands, covers less than a full interest, and/or if all or any part of the Subject Lands is pooled or communitized with other lands, said working interest shall be proportionately reduced. Promptly after payout of each Earning Well, Farmee shall give Farmor notice of the same. Farmor shall have sixty (60) days after receipt of such written notice to elect whether or not to convert its reserved ORRI to a working interest and any failure to elect within said time period shall be deemed an election not to convert. In the event of such a conversion, the reversion of the working interest shall be automatic and shall be effective as of 7:00 a.m. on the first day of the month following the date of payout. Farmee shall, at Farmor's request, execute a declaration or other written instrument in recordable form to evidence Farmor's working interest having become effective. "Payout", with respect to the Earning Well, shall mean that point at which Farmee has recovered from the net proceeds from the sale of production from said Well Farmee's share of the cost of drilling, testing, completing and equipping said Well for the taking of production (including installation of all necessary surface equipment). "Net proceeds", for the purpose of this definition, shall mean gross proceeds from the sale of production less royalties, overriding royalties and other Leases burdens (including the ORRI retained by Farmor but excluding any burdens created by Farmee, its successors or assigns) and less severance taxes, gross production taxes and other similar taxes, windfall profit taxes and operating costs. In computing payout, any amounts realized from the sale or salvage of equipment shall be applied in reduction of equipment cost. In the event the interest of Farmee in the Earning Well attributable to the Subject Leases comprises less than 100% of the working interest in such Well, payout shall be computed on the basis of that share of costs and that share of production attributable to the Subject Leases for such Well. If and when such reversionary working interest becomes effective, it shall bear its proportionate part of all royalties, overriding royalties and other Lease(s) burdens existing on the date of this agreement.

Section 9. Cost Information. If any well drilled hereunder is commercially productive, Farmee shall, as soon as possible after completion, furnish to Farmor reasonably detailed information showing the cost of drilling, completing and equipping the same. Further, Farmee shall during the payout period furnish to Farmor a quarterly statement showing gross production from such well and showing Farmee's progress towards payout of the same. Farmor shall have access at all times during reasonable business hours to Farmee's cost, production and other records relating to such well.

Section 10. Well Information. With respect to each well drilled hereunder, upon request by Farmor, Farmee shall furnish to Farmor copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, test results and samples of any cores or cuttings taken.

Section 11. Subsequent Well. The provisions of this Section apply to any well (a "Subsequent Well") to be drilled in the spacing unit for an Earning Well at a time when Farmee has earned by performance hereunder the Subject Leases in such spacing unit and Farmor has no working interest therein because payout of the Earning Well has not yet occurred. Farmee shall give Farmor prompt notice of a proposal to drill a Subsequent Well, which notice shall include an AFE. Thereupon, Farmor shall have the right to elect within a period of thirty (30) days following receipt of said notice to participate in the drilling of such Well, and failure to respond within said thirty (30) day period shall be deemed an election not to participate. In the event Farmor timely elects to participate in the drilling of said Well, Farmor shall pay that share of the costs and expenses for the drilling, testing, completing and equipping or plugging and abandoning (as the case may be) of such Well which Farmor would have borne, and Farmor shall be entitled to receive that share of production from such Well which it would have been entitled to receive, if the reversion of Farmor's deferred reversionary working interest in the spacing unit for the Earning Well had already occurred. In the event of an election to participate, the Operating Agreement described in Section 12 below shall apply (on a well bore only basis if Farmor does not then have a current working interest) to all drilling and producing operations for such Well. Farmor's reserved ORRI interest shall not apply to production from any Subsequent Well in which Farmor participates. Farmee shall promptly make an assignment as may be necessary to reflect in the appropriate land title records Farmor's interest in such Subsequent Well. Said assignment shall be free and clear of all liens, encumbrances and other burdens or other interests created by Farmee, its successors or assigns. In the event Farmor elects not to participate in any Subsequent Well, then Farmor shall be entitled to receive the ORRI interest provided for in Section 7 hereof on all production from such Well, which override shall continue for the life of such Well.

Section 12. Operating Agreement. Upon the election by Farmor to (i) convert its reserved ORRI interest to a working interest as provided under Section 8 above, or (ii) participate in the drilling of any Subsequent Well as provided under Section 11 above, such interest shall formally be deemed subject to that certain Operating Agreement, dated September 10, 1998, executed by Farmor concurrently with this Agreement. All future operations on the Spacing Unit affected by said conversion or participation shall be governed by said Operating Agreement and the cost and expense thereafter of all operations upon said Spacing Unit shall be borne by the parties in the proportions provided for herein.

Section 13. Delay Rentals. If prior to delivery of an assignment by Farmor to Farmee hereunder any delay rental payments or other payments necessary to maintain the Subject Leases in force and effect should become due, Farmor shall make such payments and Farmee shall reimburse Farmor for one hundred percent (100%) of the total amount thereof within thirty (30) days after receiving Farmor's billing therefor.

Section 14. Shut-in Gas Well Payments. Following delivery of an assignment to Farmee hereunder, Farmee agrees to pay for its own account any shut-in gas well payments necessary to

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maintain the Subject Leases in full force and effect; provided, however, that Farmee shall not be liable for any failure to pay, or for making defective payment of, such shut-in gas well payment, regardless of the cause or reason.

Section 15. Compliance with Law. During the course of all operations conducted pursuant to this agreement, Farmee shall abide by all applicable laws and all lawful orders, rules and regulations of governmental authorities having jurisdiction.

Section 16. Relationship of the Parties. It is not the intent or purpose of the parties to this Agreement to create hereunder any partnership, mining or otherwise, joint venture or association relationship or the relationship of agency or employer and employee, and neither this Agreement nor any of the operations hereunder shall be construed as creating any such relationship. The parties expressly agree that no party hereto shall be responsible for the obligations of the other party hereto, each party being severally responsible only for its obligations arising hereunder and liable only for its proportionate share of the costs and expenses incurred hereunder.

Section 17. Taxation. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this Agreement and operations hereunder shall not constitute a partnership, if for federal income tax purposes this Agreement or the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all the provisions of Subchapter "K", Chapter 1, Subtitle "A". of the Internal Revenue Code of 1986, as permitted and authorized and by Section 761 of the Code and regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Treasury of the United States or the federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements and data required by Federal Regulation 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the federal Internal Revenue Service or as may be necessary to evidence this election. No such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Subject Lands are located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1986, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from operations hereunder can be adequately determined without the computation of partnership taxable income.

Section 18. Successors and Assigns. The terms, covenants, conditions and provisions of this Agreement shall be binding upon and inure to the benefit of the respective successors and assigns of the parties, and said terms, covenants, conditions and provisions shall be deemed to be real covenants burdening and running with the Subject Lands and the Subject Leases.

Section 19. Notices. All notices, statements and communications required or permitted to be given or made hereunder shall be deemed to be so given or made when deposited in the United States Mail, postage prepaid, directed to the parties at the following addresses or such other addresses as they may from time to time designate in writing.

FARMOR: Robert E. Landreth
505 N. Big Spring
Suite 507
Midland, TX 79701

FARMEE: Santa Fe Energy Resources, Inc.
550 West Texas, Suite 1330
Midland, TX 79701

Section 20. Further Assurance. Each of the parties shall, from time to time and at all times, do all such other and further acts and deliver and execute such other and further instruments and documents as may be reasonably required in order to fully perform and carry out the terms and provisions of this Agreement.

Section 21. Attachments. All Attachments referred to herein as being attached hereto are hereby incorporated by reference and made a part hereof as if fully set out herein. In the event any of the provisions of any Attachment conflict with this Agreement, then the provisions the Agreement itself shall control.

Section 22. Miscellaneous.

(a) Whenever the plural, masculine or neuter is used in this Agreement, the same shall include the singular or feminine or body politic or corporate and vice-versa as the context so requires.

(b) The parties agree that with respect to the subject matter hereof this Agreement, together with all Attachments, shall constitute the full and complete understanding and agreement of the parties, and there are no other understandings, obligations, relationships or agreements, written or oral.

(c) The terms and definitions used herein shall have the same meaning in the Attachments hereto unless the context otherwise requires.

(d) Farmor acknowledges owning an undivided 50% of the operating rights in BLM Lease NM-19142 dated June 1, 1973, INsofar ONLY as said lease covers the SW/4 of Section 4, Township 23 South, Range 34 East, N.M.P.M., Lea County, New Mexico, containing 160.00 acres, more or less. While said lease insofar as it covers said lands are not

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formally made part of this Farmout Agreement, if in the future Farmor elects to Farmout all or a portion of Farmor's interest in said lease and lands, Farmor shall initially offer the Farmout to the parties who participate ("Participants") in the Test Well on a pro rata basis. However, the parties who receive such offer shall in no way be obligated to accept the Farmout. If the Participants decline to accept said Farmout on the terms offered, or do not respond within ten (10) days from the date the Farmout proposal is received, Farmor shall be free to offer the Farmout to other parties and shall not be obligated to re-offer the Farmout to the Participants unless the interest to be retained by Farmor (i.e., Overriding Royalties and After-Payout Working Interests) have been reduced by more than 25% of the interests which Farmor proposed to retain in his prior proposal to the participants.

IN WITNESS WHEREOF, the parties have executed this Agreement to be effective for all purposes as of the day and year first above written.

ROBERT E. LANDRETH

By _____

Signature Date: _____

SANTA FE ENERGY RESOURCES, INC.

By _____

Signature Date: _____

EXHIBIT "A"

Attached to and made a part of that certain Farmout Agreement dated September 15, 1998, by and between **ROBERT E. LANDRETH**, as Farmor, and, **SANTA FE ENERGY RESOURCES, INC.**, as Farmee.

LEASES AND LANDS SUBJECT TO THIS AGREEMENT:

1. BLM Lease NM-19142 (out of NM-17067) dated June 1, 1973, by and between the United States of America, as Lessor, and _____, as Lessee, INsofar ONLY as said lease covers the Lots 1, 2, S/2 NE/4 of Section 4, Township 23 South, Range 34 East, N.M.P.M., Lea County, New Mexico, containing 159.88 acres, more or less. Farmor owns an undivided 50.0% of the operating rights in this lease subject proportionately to a 12.5% lease royalty and overriding royalties totaling 9.5% of 8/8.
2. BLM Lease NM-092782 dated May 1, 1994, by and between the United States of America, as Lessor, and Robert E. Landreth, as Lessee, covering Lots 3 and 4 of Section 4, Township 23 South, Range 34 East, N.M.P.M., Lea County, New Mexico, containing 80.15 acres, more or less. Farmor owns an undivided 100% record title and operating rights in this lease which is subject proportionately to a 12.5% lease royalty and overriding royalties totaling 2.0% of 8/8.

Under the terms of Sections 7 and 8 of this Agreement, Farmor shall be entitled to the following interests in each Earning Well which shall be in addition to any working interest Farmor may join for in the drilling of such well pursuant to the Operating Agreement described in Section 12 hereof and as provided for in this Agreement.

- A. If an Earning Well is completed as a producer in any formation which earns a 320.03 acre proration unit consisting of Lots 1, 2, 3, 4 and S/2 N/2 of said Section 4:
 - (1) During payout, an ORRI of $\frac{3}{4}$ of 10.5% of 80.15/320.03 plus $\frac{3}{4}$ of $\frac{1}{2}$ of 3.0% of 159.88/320.03, or 2.534282% of production;
 - (2) After payout, if Farmor elects to convert the above ORRI, a 9.379394% Gross Working Interest and a 7.667655% Net Revenue Interest (9.379394% x .8175);
- B. If an Earning Well is completed as a producer in any formation which earns a 160 acre proration unit consisting of Lots 3, 4 and S/2 NW/4 of said Section 4:
 - (1) During payout, an ORRI of $\frac{3}{4}$ of 10.5% of 80.15/160.15, or 3.941188% of production;

- (2) After payout, if Farmor elects to convert the above ORRI, a 9.379394% Gross Working Interest and a 7.667655% Net Revenue Interest ($9.379394\% \times .8175$);
- C. If an Earning Well is completed as a producer in any formation which earns a proration unit consisting solely of all or part of Lots 3 and 4 of said Section 4:
- (1) During payout, an overriding royalty percentage of $\frac{3}{4}$ of 10.5%, or 7.875% of production;
- (2) After payout, if Farmor elects to convert the above ORRI, a 9.379394% Gross Working Interest and a 7.667655% Net Revenue Interest ($9.379394\% \times .8175$);
- D. If an Earning Well is completed as a producer in any formation which earns a proration unit consisting solely of all or part of Lots 1, 2 and N/2 NE/4 of said Section 4:
- (1) During payout, an overriding royalty percentage of $\frac{3}{4}$ of $\frac{1}{2}$ of 3.0%, or 1.125% of production;
- (2) After payout, if Farmor elects to convert the above ORRI, a 9.379394% Gross Working Interest and a 7.667655% Net Revenue Interest ($9.379394\% \times .8175$).