

November 26, 2002

BP America Production Company  
P.O. Box 3092  
Houston, Texas 77253-3092

Attn: Mr. Lee Scarborough

Re: Little Box State Lease  
Section 36, T-20-S, R-21-E,  
Eddy County, New Mexico

Dear Lee:

I am in receipt of your November 18, 2002 letter regarding the suspension of the overriding royalty interest owned by Trilogy Operating, Inc. As you are already aware by documentation, negotiations and prior conversations, Trilogy Operating, Inc., formerly Stevens & Tull, Inc., did indeed retain an override in said property.

This override has been paid since the initial Little Box production was established. As you know, assignment # 12 was executed simply to convey Record Title with the BLM into Atlantic Richfield Company. Said assignment was never intended to convey the overrides reserved in the county records to Atlantic Richfield Company. Stevens & Tull, Inc. conveyed all of its working interest at a 75% net revenue to Atlantic Richfield Company. However, in order to once again assist you in curing title concerns, please find enclosed the following materials:

1. Copy of Certificate of Amendment from the State of Texas acknowledging that Trilogy Operating, Inc. is the successor of Stevens & Tull, Inc.
2. Copy of recorded Assignment of Overriding Royalty Interest from JPAK, LP, Wesley K. Noe and wife, Renae Noe, and Tonjua Metcalf and husband, Jeff Metcalf. This instrument was filed to re-convey the interest previously transferred under assignment no. 24 of the April 26, 2002 Original Division Order Title Opinion.
3. Copy of Transfer Order from Atlantic Richfield Company acknowledging the transfer of a portion of Trilogy Operating, Inc.'s original override to Roy S. Peugh, Jr.

I trust this documentation will assist you in placing Trilogy and Roy Peugh, Jr.'s overrides back into a pay status. I am forwarding a copy of this letter and attachments to David A. Sutter at Stubbeman, McRae, Sealy, Laughlin & Browder, Inc. Should you have any further questions, please do not hesitate to contact me.

Yours very truly,

Jerry A. Weant  
President

cc: David A. Sutter  
Stubbeman, McRae, Sealy, Laughlin & Browder, Inc.  
P.O. Box 1540  
Midland, Texas 79702

Correspondence: Sweet Thing: Little Box 112602

**BEFORE THE OIL CONSERVATION  
DIVISION**  
Santa Fe, New Mexico  
Case Nos. 12967 and 12968 Exhibit No. 16  
Submitted by: Trilogy Operating Inc.  
Hearing Date: January 9, 2003

**Report on Review of  
Gas Revenue Distributions For:**

B & C Federal #1	Little Box State #2
Bullseye Federal #1	Little Box State #4
Crooked Canyon 35 Fed. #1	Nasser Federal
Hilltop Federal #1	Sweet Thing Fed. Unit #1
Jaguar Federal #1	Sweet Thing Fed. Unit #2
Leggett Federal #1	Sweet Thing Fed. 36 #1
Little Box State #2	Sweet Thing State 36 #2

**For Production From February 1999  
through September 2001**

**Operated by BP America, Inc.  
(Formerly Arco Permian)**

**Accounting by PricewaterhouseCoopers, LLP**

**BEFORE THE OIL CONSERVATION  
DIVISION**

**Santa Fe, New Mexico**

**Case Nos. 12967 and 12968 Exhibit No. 17**

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Leggett Federal #1	Sweet Thing Fed. 36 #1
Little Box State #2	Sweet Thing State 36 #2

**For Production From February 1999  
through September 2001**

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**BEFORE THE OIL CONSERVATION  
DIVISION**

Santa Fe, New Mexico

Case Nos. 12967 and 12968 Exhibit No. 17

Submitted by: Trilogy Operating Inc.

Hearing Date: January 9, 2003

**REPORT ON REVIEW OF  
GAS REVENUE DISTRIBUTIONS**

**FOR**

**B & C FEDERAL #1  
BULLSEYE FEDERAL #1  
CROOKED CANYON 35 FEDERAL #1  
HILLTOP FEDERAL #1  
JAGUAR FEDERAL #1  
LEGGETT FEDERAL #1  
LITTLE BOX STATE #2  
LITTLE BOX STATE #3  
LITTLE BOX STATE #4  
NASSER FEDERAL  
SWEET THING FED.UNIT #1  
SWEET THING FED.UNIT #2  
SWEET THING STATE 36 #1  
SWEET THING STATE 36 #2**

**FOR PRODUCTION FROM FEBRUARY 1999 THROUGH SEPTEMBER 2001**

**OPERATED BY**

**BP AMERICA INC. (formerly ARCO Permian)  
Accounting by PricewaterhouseCoopers LLP**

**Report on Review of  
Gas Revenue Distributions  
For:**

<b>B &amp; C Federal #1</b>	<b>Little Box State #3</b>
<b>Bullseye Federal #1</b>	<b>Little Box State #4</b>
<b>Crooked Canyon 35 Federal #1</b>	<b>Nasser Federal</b>
<b>Hilltop Federal #1</b>	<b>Sweet Thing Federal Unit #1</b>
<b>Jaguar Federal #1</b>	<b>Sweet Thing Federal Unit #2</b>
<b>Leggett Federal #1</b>	<b>Sweet Thing State 36 #1</b>
<b>Little Box State #2</b>	<b>Sweet Thing State 36 #2</b>

**Operated by BP America Inc. (formerly ARCO Permian)  
Accounting by PricewaterhouseCoopers LLP**

We have completed our review of gas revenue distributions applicable to properties listed above for the production months from February 1999 through September 2001 made on checks dated April 1999 through November 2001. Our review procedures were performed to determine that the gross sales from production were allocated appropriately between the producing properties and distributed to the non-operators in full.

**GENERAL INFORMATION**

The leases are located in Eddy County, New Mexico with varied completion dates. Initially, gas production from 5 wells was purchased by Agave Energy Company: Little Box State #2, Little Box State #3, Little Box State #4, Sweet Thing State 36 #1, and Sweet Thing Fed Unit #2. Presently, only the gas production from the Little Box #2 and the Sweet Thing State 36 #1 is still purchased by Agave. The remainder has been gathered through the El Paso Field Services (EPFS) and marketed by ARCO Permian until its acquisition by BP, which commenced the marketing and distribution functions with the November 2000 production. The EPFS gas is purchased by a related BP marketing entity, BPETC, then sold to third parties. Owners are paid per a "netback" price that is the negotiated price of sales to third parties less transportation and gathering charges. According to industry sources, it is not unusual for large companies to use a separate company for marketing purposes. There are 4 different central point of delivery meters (CPD's) used for sales in the EPFS: Nasser (the largest), Little Box #2, Sweet Thing and Bullseye. All CPD's except the Bullseye, had production from various wells flowing through them during the audit period which required allocations between the wells. Only 5 wells (or producing zones) flowed through CPD's other than the Nasser.

Gross revenue distributions for the period reviewed were approximately as follows:

B & C Federal #1	\$1,730,000
Bullseye Federal #1	251,000
Crooked Canyon 35 Federal #1	50,000
Hilltop Federal #1	37,000
Jaguar Federal #1	20,000
Leggett Federal #1	10,000
Little Box State #2	50,569,000
Little Box State #3	410,000
Little Box State #4	5,838,000
Nasser Federal	2,749,000
Sweet Thing Federal Unit #1	171,000
Sweet Thing Federal Unit #2	26,683,000
Sweet Thing State 36 #1 & #2	<u>50,219,000</u>
Total	<u>\$138,737,000</u>

## SCOPE OF COMPLIANCE REVIEW

The purpose of our engagement is twofold: 1) to determine that production and sales have been correctly accounted for and allocated, and that fees related to the sales and handling have been properly assessed; and 2) to report on compliance with the provisions of the Joint Operating Agreements, related amendments and other applicable agreements.

Our review procedures were performed to meet these primary objectives. We reviewed the supporting documentation provided by the Operator for items we judgmentally selected to test for compliance. If the requested documentation was not provided to us or did not support the check distributions, an exception to compliance is reported.

We examined, in detail, selected documentation for gross gas sales allocations and distributions as we deemed necessary. Not all allocations or distributions were reviewed. Final adjustments may merit additional review. The examination included, but was not limited to, specific reviews in the following areas:

- Calculation of allocations and distribution of CPD sales by the operator
- Verification of proper distribution of third party direct purchases

Certain assumptions were made with regard to internal system prices used by BP for distributions. Validation of BP's system prices used would require a separate and lengthy audit. Therefore, these prices were compared to published prices referred to in sales agreements for reasonableness.

## SUMMARY OF REVIEW FINDINGS

Based on the examination completed, exceptions in the amount of \$1,155,330.78 were identified as detailed in the following attachments. These may be summarized as below.

Undocumented adjustments	\$844,529.08
Undocumented volume differences	198,514.08
Incorrect calculations or distributions	58,325.90
Non-payment of purchaser's revisions	47,570.41
Pricing differences	3,296.72
Loss of cash flow	3,094.59
Suspense documentation not provided	<u>Undetermined</u>
Total	<u>\$1,155,330.78</u>

It is requested that the Operator respond to each exception in writing within 180 days, detailing the specific checks on which adjustments will or have been received.

Midland, Texas  
June 30, 2002



**TRILOGY OPERATING, INC., ET AL PROPERTIES**  
**SUMMARY OF REVIEW EXCEPTIONS**

<b><u>Review Exception</u></b>	<b><u>Description</u></b>	<b><u>Reference</u></b>	<b><u>Requested Credit Amount</u></b>
1	Wrong BTU factors used on Nasser allocation & Bullseye	Attachment A	\$3,930.18
2	Wrong BTU factors used on Nasser allocation & Bullseye	Attachment B	2,631.61
3	Wrong BTU factors used on Nasser allocation & Bullseye; Nasser CPD allocation incorrectly calculated	Attachment C	3,664.95
4	Nasser CPD allocation incorrectly calculated	Attachment D	To be Determined
5	Nasser CPD allocation incorrectly calculated and underpayment	Attachment E	To be Determined
6	Non-payment of purchaser's revised calculation for Sweet Thing State 36 #1 & Little Box #2	Attachment F	25,106.13
7	Non-payment of purchaser's revised calculation for Sweet Thing State 36 #1 & Little Box #2	Attachment G	22,464.28
8	Pricing difference on B&C Federal #1	Attachment H	522.91
9	Pricing difference on Little Box #3	Attachment I	2,773.81
10	Undocumented adjustment on Little Box State #4	Attachment J	28,831.61
11	Loss of cash flow from negative adjustment on Sweet Thing Fed Unit #2	Attachment K	3,094.59
12	Incorrect distribution for Little Box #4	Attachment L	47,234.56
13	Undocumented adjustment for Sweet Thing Fed. #2	Attachment M	628.20
14	Undocumented adjustment for Bullseye	Attachment N	413.10
15	Undocumented adjustments for Nasser CPD allocations	Attachment O	391.62

**TRILOGY OPERATING, INC., ET AL PROPERTIES  
SUMMARY OF REVIEW EXCEPTIONS**

16	Undocumented adjustment for Sweet Thing Fed. #1	Attachment P	311.15
17	Incorrect distribution for Nasser Federal & B&C Federal 25 #1	Attachment Q	412.73
18	Incorrect distribution for Little Box State #2	Attachment R	451.87
19	Incorrect reversal of distribution for Sweet Thing Fed. Unit #2	Attachment S	813,953.40
20	Suspense report not received		Undetermined
21	Undocumented volume differences	Attachment T	<u>198,514.08</u>
<b>Total</b>			<b><u>\$ 1,155,330.78</u></b>

**TRILOGY OPERATING, INC., ET AL PROPERTIES**  
**EXCEPTION COMMENTS**

EXCEPTION NO. 1

**Wrong BTU factor used**

05/99 production. The MMBTU calculations for the Nasser CPD used the Bullseye CPD BTU factor in error, resulting in underpayment on all properties in the allocation (7/27/99 check). Also, according to the gas volume statement, the incorrect BTU factor was used for the Bullseye CPD, resulting in underpayment for that CPD as well. Additional payment to the producers is requested for the difference in calculations. (See Attachment A)

Credit due \$3,930.18

EXCEPTION NO. 2

**Wrong BTU factor used**

04/99 production. The MMBTU calculations for the Nasser CPD used the incorrect BTU factor in error (not the Bullseye factor), resulting in underpayment on all properties in the allocation (6/25/99 check). Also, according to the gas volume statement, the incorrect BTU factor was used for the Bullseye CPD, resulting in underpayment for that CPD as well. Additional payment to the producers is requested for the difference in calculations. (See Attachment B)

Credit due \$2,631.61

EXCEPTION NO. 3

**Wrong BTU factor used and incorrect allocation**

07/99 Production. There are 2 problems with this production month that caused incorrect allocations and payments:

1) 3 well volumes were included in the total at actual instead of being allocated, see note C on attachment.

2) The MMBTU calculations for the Nasser CPD used an incorrect BTU factor in error, resulting in underpayment on all properties in the allocation (9/28/99 check). Also the MMBTU for the Bullseye was incorrectly calculated, resulting in underpayment. Additional payment to the producers is requested for the difference in calculations. (See Attachment C)

Credit due \$3,664.95

#### EXCEPTION NO. 4

##### **Incorrect allocation**

12/99 Production. 3 well volumes were included in the allocated volumes at actual volume instead of being allocated pro rata. This causes improper calculation of gross value distributions between the wells. The higher the price and volume, the greater the miscalculation. Over a period of months, differences of \$500 to \$1,200 could result in misallocations of between \$6,000 to over \$14,000 for which the Nasser would be underpaid and the Little Box #2 & 3, Sweet Thing 36 #1 and Sweet Thing Fed #2 would be overpaid. The same problem occurred in several other months, however, the differences in allocation were relatively immaterial. Reallocation between properties is requested. (See Attachment D)

Credit due Reallocation of Nasser CPD

#### EXCEPTION NO. 5

##### **Incorrect allocation**

5/00 Production. There were 2 errors in this production month that created a misallocation of volumes and gross values. First, the incorrect allocation volume was used. This created a small underpayment for the Nasser CPD as a whole. Second, 3 well volumes were included in the allocated volumes at actual volume instead of being allocated pro rata. This causes improper calculation of gross value distributions between the wells. The higher the price and volume, the greater the miscalculation. Over a period of months, differences of \$500 to \$1,200 could result in misallocations of between \$6,000 to over \$14,000 for which the Nasser would be underpaid and the Little Box #2 & 3, Sweet Thing 36 #1 and Sweet Thing Fed #2 being overpaid. The same problem occurred in several other months, however, the differences in allocation were relatively immaterial. Reallocation between properties and credit for underpayment is requested. (See Attachment E)

Credit due \$179.18 and Reallocation of Nasser CPD

#### EXCEPTION NO. 6

##### **Non-payment of purchasers revised price**

05/00 Production. It appears that the increased gross value resulting from a revised price paid by Agave Energy Company for May 2000 production per the revised statement dated August 16, 2000, was not paid to the owners. (See Attachment F)

Credit due \$25,106.13

## EXCEPTION NO. 7

### **Non-payment of purchasers revised price calculations**

04/00 Production. It appears that the increased gross value resulting from a revised price paid by Agave Energy Company for April 2000 production per the revised statement dated May 30, 2000, was not paid to the owners. (See Attachment G)

Credit due \$22,464.28

## EXCEPTION NO. 8

### **Pricing difference**

09/00 Production. The MCF on the check dated 11/28/00 agrees with the allocations schedule for the B & C Federal #1. However, the price used for calculating the gross value for the B & C Federal #1 appears to be lower than that used on the other Nasser CPD allocations, causing the gross value to be lower than it should be. (See Attachment H)

Credit due \$522.91

## EXCEPTION NO. 9

### **Pricing difference**

09/00 Production. The pricing for the allocated production on the Little Box #3 appears to be significantly lower than the price used for the Little Box #4 for September, 2000 production on the 11/28/00 check. These are both allocated from the same sales meter and the price should be the same. (See Attachment I)

Credit due \$2,773.81

## EXCEPTION NO. 10

### **Undocumented adjustment**

11/00 Production. The correct volume but incorrect gross value for the Little Box State #4 (Little Box State #2, DOI 002) was reversed and a lesser volume and value input. However, there is no documentation for the change in the volume and the total gross value paid does not agree with the allocation calculations. It appears that the change was an attempt to correct the original incorrect price paid. The allocated volumes and gross values for the other Nasser CPD wells appear to be substantially correct. (See Attachment J)

Credit due \$28,831.61

#### EXCEPTION NO. 11

##### **Loss of cash flow**

11/00 Production. A negative adjustment for over \$1 million dollars in October 2001 on the Sweet Thing Federal Unit #2 left owners with a net loss in cash flow interest. Such a large negative adjustment gave the operator use of funds and denied producers rightful use of funds. (See Attachment K)

Credit due \$3,094.59

#### EXCEPTION NO. 12

##### **Incorrect distribution**

12/00 Production. The volume and gross revenue for the Little Box #4 are significantly below the allocation amounts. There is no documentation for the difference in the allocation amounts. (This production month was the month given as an example for the method of allocation.) (See Attachment L)

Credit due \$47,234.56

#### EXCEPTION NO. 13

##### **Undocumented adjustment**

12/00 Production. The Sweet Thing Federal #2 had numerous adjustments (as did most of the wells for this month). It appears that the final adjustment was short a few MCF's and allocation for Flash Gas was possibly not included. This resulted in an underpayment to the well. (See Attachment M)

Credit due \$628.20

#### EXCEPTION NO. 14

##### **Undocumented adjustment**

01/01 Production. The Bullseye had a negative adjustment for which there is no documentation. Although the amount is not materially significant, undocumented negative adjustments are not acceptable. (See Attachment N)

Credit due \$413.10

#### EXCEPTION NO. 15

##### **Undocumented adjustment**

02/01 Production. Nearly all properties included in the Nasser CPD allocation received adjustments on the 10/22/01 check for 02/01 production. There is no documentation as to why these adjustments were made. The original distributions appear to be correct. Although the amount of difference is not significant in terms of dollars, the percentage difference is as much as 18% on some of the wells with lower production. This results in incorrect payments up to several hundred dollars for some properties that may be significant for those properties. A correction of the allocation is requested. (See Attachment O)

Credit due \$391.62 and reallocation of Nasser CPD

#### EXCEPTION NO. 16

##### **Undocumented adjustment**

02/01 Production. The Sweet Thing Federal #2 had a negative adjustment for which there is no documentation. Although the amount is not materially significant, undocumented negative adjustments are not acceptable. (See Attachment P)

Credit due \$311.15

#### EXCEPTION NO. 17

##### **Incorrect distribution**

05/01 Production. It appears that the Nasser Federal #1 Morrow and the Nasser Federal #1 Upper Penn are combined on the checks. The aggregate distribution is short \$200.28 of the allocation calculation. Also, the amount on the check for the B & C Federal 25 #1 is short \$212.44 of the allocation calculation. (See Attachment Q)

Credit due \$412.73

#### EXCEPTION NO. 18

##### **Incorrect distribution**

05/01 Production. The amount distributed on the 07/20/01 check for the Little Box #2 does not agree with the total per the Agave purchaser statement plus the Flash Gas allocation from the Nasser CPD. (See Attachment R)

Credit due \$451.87