

FARMOUT LETTER AGREEMENT

Baum North

BETWEEN

YATES PETROLEUM CORPORATION
YATES DRILLING COMPANY
ABO PETROLEUM CORPORATION
MYCO INDUSTRIES, INC.

AND

SUNBURST EXPLORATION, INC.

STATE OF NEW MEXICO OIL AND GAS LEASE NO. LG-4904

TOWNSHIP 13 SOUTH, RANGE 33 EAST, N.M.P.M.

SECTION 18: S $\frac{1}{2}$ SW $\frac{1}{4}$

LEA COUNTY, NEW MEXICO

DATED: MARCH 15, 1984

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FARMOUT LETTER AGREEMENT

Sunburst Exploration, Inc.
P. O. Box 2608
Roswell, New Mexico 88201

Gentlemen:

YATES PETROLEUM CORPORATION, YATES DRILLING COMPANY, ABO PETROLEUM CORPORATION,
and MYCO INDUSTRIES, INC., all New Mexico corporations,
represent(s) that they are the owner(s) of the following Oil and Gas
Lease(s) covering lands in Lea County, New Mexico :

STATE OF NEW MEXICO LEASE NO. LG-4904, INSOFAR AS SAID LEASE COVERS THE FOLLOWING
DESCRIBED LANDS:

Township 13 South, Range 33 East, N.M.P.M.
Section 18: S $\frac{1}{2}$ SW $\frac{1}{4}$
Lea County, New Mexico

subject to the royalty reserved in said leases by the Lessors, all burdens on production which have heretofore been created and are shown of record, and the overriding royalty reserved herein by the undersigned. Said Oil and Gas Lease covering the above described lands down to a depth of the stratigraphic equivalent of the deepest depth drilled in the initial test well hereunder, but in any event not to exceed 10,500 feet below the surface, subject to the said burdens on production, is hereinafter referred to as "Lease Acreage."

If you comply with all the terms covenants and conditions of this letter and drill and complete the test well provided for herein, we will execute and deliver to you, without warranty of title, either express or implied, an appropriate instrument conveying the lease acreage. The terms and covenants and conditions to which this farmout letter are subject are as follows:

1. INITIAL TEST WELL

1.1 You shall commence on or before 120 days from date of this agreement the actual drilling of a well for oil or gas upon SW $\frac{1}{4}$ SW $\frac{1}{4}$ Section 18, Township 13 South, Range 33 East, NMPM, Lea County, New Mexico, and prosecute the drilling of said well with due diligence and in a good and workmanlike manner to a depth sufficient to adequately test the PERMO PENN formation, at approximately 10,300 feet.

This test well shall be drilled and completed by you within ninety (90) days from the date of its commencement. All zones or formations encountered which, in our opinion, justify testing for oil or gas, shall be adequately tested to our satisfaction. ~~As a special and additional consideration, the Muddy formation will be drill stem tested utilizing bottom hole sampler.~~

1.2 In the event you do not commence the test well on or before 120 days from date of this agreement, or after commencing the same do not complete it within the time and manner provided in Paragraph 1.1, at our election, all of your right, title and interest in and to the lease acreage shall ipso facto terminate.

2. DRILL AND EARN

2.1 After such time as you have drilled and completed the initial test well as a well capable of producing oil and/or gas in paying quantities, we shall, upon your written demand after said completion, deliver to you an appropriate instrument conveying, without warranty of title, either express or implied, all of our operating rights in, to and under the lease acreage, reserving an overriding royalty equal to the difference between existing lease burdens and 25% of 8/8ths of the net proceeds received from the sale of all of the oil, gas and other hydrocarbon substances produced, saved and marketed from the lease acreage, giving you a 75% net revenue interest lease.

3. RISK, COST AND EXPENSE OF OPERATIONS

3.1 All of your operations on the lease acreage shall be conducted at your sole cost, risk and expense, and you shall hold us harmless from any and all claims of whatsoever character or description resulting from or arising in connection with your operations thereon. You shall comply with all of the terms and provisions of said oil and gas leases and all applicable rules and regulations pertaining to your operations hereunder. You shall carry or cause to be carried the following insurance, protecting us against loss by reason of your operations hereunder, to-wit:

- (i) Workmens' Compensation and Employer's Liability Insurance as required by the laws of the State of New Mexico;
- (ii) Liability Insurance in the amount of \$200,000.00 per person and \$500,000.00 per accident for personal injury and \$25,000.00 for property damage.

You shall furnish us with Certificates of such insurance prior to the time you commence operations hereunder.

4. GEOLOGICAL DATA

4.1 You will allow us or our representative full access to the derrick floor; and we shall have access to all cores, cuttings, logs, testing completion data and all other information pertaining to any wells drilled hereunder. Further, requirements are set forth in Exhibit "A" attached hereto and made a part hereof.

5. BOND AND DESIGNATION OF OPERATOR

5.1 Prior to the time you commence drilling operations upon the lease covered by this farmout letter agreement, we will use our best efforts to furnish you with a Designation of Operator on such lease in the form approved by the United States Geological Survey. In the event we do not have a lease bond filed on any such lease, then prior to commencing operations we will furnish the Bureau of Land Management with an approved bond. Prior to commencing operations under our bond, you shall furnish us with a \$10,000.00 hold-harmless bond with approved corporate surety indemnifying us against loss by reason of your operations under our bond.

6. OVERRIDING ROYALTY RESERVED

6.1 There is reserved from this farmout letter and there shall be reserved from any operating agreement granted hereunder an overriding royalty equal to See Paragraph 2.2 of the net proceeds from the sale of all (8/8ths) of the oil, gas and other hydrocarbon substances produced, saved and marketed from the lease acreage under the terms of said oil and gas lease and all extensions and renewals thereof; said overriding royalty to be reserved by the undersigned, their heirs, successors and assigns in proportion to their percentage ownership of the lease acreage. This overriding royalty shall be computed and paid at the same time and in the same manner as royalties payable to the lessor under the terms of said oil and gas lease are computed and paid but the undersigned shall be responsible for their proportionate part of all taxes and assessments levied against or measured by the production of oil or gas from said premises.

6.2 We recognize the existence of 43 CFR 3103.3-6 and agree that so long as said regulation or one similar thereto is in force and effect, this overriding royalty reservation shall be made in compliance with the provisions of said regulation, provided that during the period of any suspension required under said regulation, we shall be entitled to a carried working interest which will return to us a net amount of money equal to the sum we would have been entitled to receive for such suspended overriding royalty.

7. RENTALS

7.1 We will use our best efforts to pay the rentals and shut-in royalty, if any, to the lessor, but shall not be liable in damages for the failure to pay the same, and you shall reimburse us for such rentals and shut-in royalty so paid on the lease as follows: All

8. ABANDONED WELLS

8.1 You shall notify us of your intention to abandon any well on the lease acreage and we shall have thirty days (twenty-four hours when a drilling rig is on location) after receipt of such notice of intention to abandon a well in which to elect to take over the well you propose to abandon. In the event we elect to take over the well, we will pay to you the reasonable market value of the salvage materials in the well and in such event you shall furnish us with a release of the lease acreage. In the event we do not notify you of our election to take over the well within the time herein provided, you shall plug and abandon the well in accordance with applicable rules and regulations.

8.2 If oil and gas is discovered and produced hereunder, the conveyance provided for in Paragraph 2 will nevertheless terminate and revert to the undersigned with respect to each well and all lands in the proration unit dedicated to the well under applicable rules and regulations of the New Mexico Oil Conservation Division, after the expiration of sixty (60) consecutive days within which no oil or gas is produced from said well and no diligent drilling or reworking operations are being conducted on the well. This reversion shall occur separately with respect to each well and each proration unit dedicated to the well. In the event of reversion, you will execute and deliver to us a reassignment of the well and the proration unit dedicated to the well, free and clear of all liens, encumbrances, overriding royalties, production payment interests, and other burdens on production which are not in existence on the date hereof. We shall have the option to take over any well upon which reversion has occurred by paying to you the reasonable market value

of the salvable materials in the well, less the cost of salvage. In the event we do not exercise this option to take over the well, you shall plug and abandon the well in accordance with applicable rules and regulations.

9. FORCE MAJEURE

9.1 The performance by you of any of the terms and provisions of this farmout letter shall be excused in the event such performance is prevented by strikes, fire, flood, tornado, lightning, explosion, acts of God or the public enemy, State or Federal rules or regulations or any things or happenings either similar or dissimilar beyond your control, provided, however, that such performance shall be resumed within reasonable time after such cause has been removed.

10. NOTICES

10.1 All notices provided for in this farmout letter shall be deemed to have been sufficiently given if sent by telegram or certified mail, addressed as follows:

SEE ATTACHED GEOLOGICAL REQUIREMENTS

All information required to be delivered to the undersigned shall be delivered at the addresses above set forth. For the purpose of this paragraph, either party may change his address by giving written notice to the other party thereof.

11. RESTORATION OF PREMISES

11.1 You agree to fill in all pits which may be dug in connection with any operations hereunder and to restore the surface of the lands on which such operations are conducted as nearly as possible to its original conditions, and to plug and abandon any of the wells provided for herein, all at your sole cost, risk and expense and in accordance with any regulation promulgated by any governmental regulatory body having jurisdiction thereof.

12. OPERATING AGREEMENT

12.1 Upon conveyance of the rights earned by the performance of the obligations set forth herein, all subsequent operations on the lease acreage will be conducted in accordance with the terms of a mutually acceptable Operating Agreement. Said Operating Agreement shall be on A.A.P.L. Form 610 and include a 300% non-consent provision, a provision stating that consent to drill is not consent to case, the deletion of the Preferential Right to Purchase paragraph, a mutually acceptable gas balancing agreement, and such other provisions that shall be mutually agreed upon.

13. SUBSTITUTE TEST WELL

13.1 If, in the drilling of the Initial Test Well, Operator loses the hole or encounters mechanical difficulties rendering it impracticable, in the opinion of the Operator, to drill the well to the Objective Depth, then and in any such events, on or before thirty (30) days after completion of the Initial Test Well, Operator shall have the option to commence the actual drilling of another well ("Substitute Test Well") at a lawful location of Operator's selection on the lease acreage. The Substitute Test Well shall be drilled in the same manner as provided for in the Initial Test Well. For all purposes of this agreement, the drilling of the Substitute Test Well shall be considered as the drilling of the Initial Test Well.

14. PRODUCTION IN KIND

14.1 We shall have the continuing option to purchase or designate a purchaser whether overriding royalty or working interest at any time and from time to time, at the market price prevailing in the area on the date of purchase, our share of any oil, gas, casinghead gas or other hydrocarbon substances that may be produced from the lands assigned pursuant to this agreement, whether by reason of such interest or portion thereof being included in any pool or in any pooling agreement or unit, planned or otherwise.

14.2 Before you enter into any contract for the sale, purchase or processing of gaseous hydrocarbons from the interests involved herein, you shall submit to us in writing the contract into which you propose to enter. We shall have the right and option, at our election, to (1) take in kind or otherwise dispose of our share of the gas on such terms and conditions as we deem advisable, or (2) allow you to dispose of all of the gas and account to us, all in accordance with the terms of the proposal submitted, provided, however, that if you are in any way affiliated with the purchaser of such gas, then you shall account to us on the basis of the highest price offered or paid in the area by any purchaser or prospective purchaser. If we fail to notify you of our election hereunder within sixty (60) days after receipt of such notice from you, then it shall be considered that we made election (2) above. For the purpose of election (2) above, the interest of ours shall be considered to be only the overriding royalty interest reserved under this farmout agreement and shall not include our working interest gas. In the event that we exercise our reserved option to convert our overriding royalty to a working interest upon payout of any well herein provided for, or at any time during which we may have a working interest in any well, we shall at all times have the express right to take our proportionate share of the working interest gas in kind or to independently market or dispose of the same and nothing herein contained shall be construed as giving or granting to you the right to market or otherwise dispose of the proportionate share of the working interest gas of ours without express authorization from time to time to do so.

~~15. NO ELECTION OUT OF SUBCHAPTER K~~

15.1 Section 26 of the Operating Agreement referred to above shall be superseded and the following provisions shall apply to the arrangement between the parties hereto. The relationship between the parties hereto shall be such that it will, for Federal and State income tax purposes, be treated as a partnership. For all other purposes, this agreement is not intended to create, nor shall it be construed as having created, a partnership or mining venture between the parties hereto, and it is expressly agreed that the rights and obligations hereunder are separate and several and neither joint nor collective.

15.2 No election shall be made for this arrangement between the parties hereto to be excluded from the provisions of Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code or similar provisions of state income tax law, except that such election may be made by the Operator for any year subsequent to the end of the taxable year by which all costs of drilling the Test Well have been expended. The Operator shall timely prepare and file partnership income tax returns for this arrangement until the election mentioned above is properly exercised. The election to deduct intangible drilling and development costs when paid or incurred shall be properly made on the partnership income tax returns.

15.3 To the extent permitted by law, all deduction and credits, including, but not limited to, intangible drilling and development costs, depreciation, rental expenses, and the investment qualifying for the investment tax credit where applicable, shall be allocated to the party who has been charged with the expenditure giving rise to such deductions and credits, and to the extent permitted by law, such parties shall be entitled to such deductions and credits in computing taxable income or tax liabilities to the exclusion of any other party. Any recapture of such costs, deductions, allowances and credits shall be allocated in the same ratio as the item being recaptured was initially allocated.

15.4 Should there be a transfer of an interest under this agreement, income and deductions attributable to such interest shall not be allocated between the transferor and transferee in a pro rata manner, but shall be allocated according to the date the income was accrued and the date the expense was incurred.

15.5 When requested, each party agrees to provide Operator with all information readily available from the regularly maintained accounting records.

16. NON-ASSIGNABILITY

16.1 This farmout letter is personal to you and neither this farmout letter nor any interest herein shall be assigned by you without our express consent in writing, the breach of which shall, at our election, automatically terminate this farmout letter.

17. BINDING EFFECT

17.1 This farmout letter shall be covenant running with the ownership of the lease acreage and, as such, shall be binding upon and inure to the benefit of the parties hereto, their heirs, personal representatives, successors, and when assigned as herein provided, upon the assigns of the parties hereto.

18. ACCEPTANCE

18.1 This letter is not binding upon us until such time as it has been accepted by you and one (1) fully executed copy returned to us within ten (10) days from the date hereof.

YATES PETROLEUM CORPORATION

By [Signature] ^{RS}

ABO PETROLEUM CORPORATION

By [Signature] ^{RS}

YATES DRILLING COMPANY

By [Signature] ^{RS}

MYCO INDUSTRIES, INC.

By [Signature] ^{RS}

The foregoing farmout letter agreement and all of its terms, covenants and conditions are hereby accepted and agreed to this 22nd day of March, ~~1984~~ 1984.

ATTEST:

By [Signature]

Asst. Secretary

SUNBURST EXPLORATION, INC.

By [Signature]

President

EXHIBIT "A"
GEOLOGICAL REQUIREMENTS

Mr. Ray Beck
Yates Petroleum Corporation
207 South 4th Street
Artesia, New Mexico 88210
(505) 746-3558 (office)
(505) 748-2565 (home)

Ms. Leslie Bentz
(505) 752-3750 (home)

Mr. Norbert Rempe
(505) 885-3836 (home)

I. Notification

- A. You shall immediately notify the above company representative (or alternate) by telephone, at your expense, sufficiently in advance of the following events in order that a representative of the company may be present to witness same:
1. Spudding of any test well hereunder
 2. All drill stem or other tests of said well
 3. Logging or other downhole surveys
 4. Any coring operations
 5. Any plugging operations
- B. You shall, at your expense, furnish us current progress reports on said well with full information thereon each day by telephone. This requirement may be waived and well progress reports may be mailed daily where practicable.

II. Other Requirements

- A. Unless waived by us, you shall run:

1. A dual laterolog, dual induction or equivalent saturation log.
2. And a compensated neutron-formation density or equivalent porosity log.

- B. You shall furnish us the following data and information:

1. Two copies of field prints and two copies of final prints of all electric logs or other downhole surveys run in said well; this includes dipmeter logs and any derivative logs such as "Coriband" or "Saraband" or equivalent survey analyses.
2. Two copies of all drill stem test reports
3. Two copies of all core analysis reports
4. One copy of all fluid analysis reports
5. One copy of the preliminary mud log sheets and one copy of the final mud log
6. One copy of any paleontological report
7. One copy of any geological report
8. One copy of the sample description
9. One copy of the drilling time
10. One copy of all governmental reports
11. One copy of production reports for sixty (60) days after completion of the well

- C. Representative samples to be filed with Midland Sample Cut