

G-5557

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July 25, 1988

RECEIVED

JUL 26 1988

United States Department  
of the Interior  
Minerals Management Service  
Gulf of Mexico OCS Region  
P.O. Box 7944  
Metairie, Louisiana 70010

Minerals Management Service  
Leasing & Environment

Attention: LE-3-1 Ms. Boehm

Re: Leases OCS-G 5557 and OCS-G 5558

Gentlemen:

General Sandefer Offshore Partnership and PSI, Inc. have executed an Exploration Funding Agreement relating to the oil, gas and mineral leases referenced above.

The addresses of the parties to the Exploration Funding Agreement are as follows:

General Sandefer Offshore Partnership  
1001 Fanin, Suite 2225  
Houston, Texas 77002-6785  
Attention: Mr. Jeff Sandefer

PSI, Inc.  
5347 San Felipe Plaza, Suite 910  
Houston, Texas 77057  
Attention: Vice President - Gathering

To place third persons on notice as to the execution and efficacy of the aforementioned Exploration Funding Agreement, please file the enclosed duplicate original of the Exploration Funding Agreement in the appropriate file maintained by your office. We also request that you file one copy of this letter in the appropriate files in your office relating to each of the captioned leases.

THESE DOCUMENTS WILL BE FOUND  
AT MORTGAGE FILE M. 5557

United States Department of the Interior  
July 25, 1988  
Page 2

Please acknowledge that filing has been accomplished pursuant to this request by signing in the space provided on the xerox copies of this letter.

Very truly yours,

MANGHAM, HARDY, ROLFS & ABADIE

  
Donald J. LaBauve

Enclosures

Filing Accomplished  
As Requested.

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July \_\_, 1988.

**EXPLORATION FUNDING AGREEMENT**

**February 8, 1988**

**Between**

**GENERAL SANDEFER OFFSHORE PARTNERSHIP, as "Operator"**

**and**

**PSI, INC., as "Participant"**

**RECEIVED**

**JUL 27 1988**

**Minerals Management Service  
Leasing & Environment**

**THESE DOCUMENTS WILL BE FOUND  
AT MORTGAGE FILE M-5557**

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## EXPLORATION FUNDING AGREEMENT

This Exploration Funding Agreement (the "Agreement") is made and entered into this eighth day of February, 1988, by and between General Sandefer Offshore Partnership, a Texas partnership, herein after referred to as "Sandefer" and PSI, Inc., a Missouri corporation, herein after referred to as "PSI", hereinafter jointly referred to as the "Parties."

### WITNESSETH

WHEREAS, Sandefer has acquired the right to earn, subject to certain conversion rights, all of the rights to explore, drill, produce and sell one hundred percent (100%) of the oil and gas reserves and the right to earn one hundred percent (100%) of the working interest in the Federal Offshore, Ship Shoal Blocks 201 and 202, offshore Louisiana (the "Prospect") pursuant to that certain farmout agreement among Sandefer, Primary Fuels, Inc. ("Primary Fuels") and Tenneco Oil Company ("Tenneco") dated January 15, 1988, (the "Farmout Agreement");

WHEREAS, the Existing Well, as such term is hereinafter defined, on the Prospect indicates the presence of recoverable oil and gas reserves in the "W" Fault Block;

WHEREAS, Sandefer desires to complete such Existing Well for commercial production;

WHEREAS, Sandefer additionally desires, prior to the completion of the Existing Well, to drill a Test Well, as such term is hereinafter defined, and to construct the necessary platform, facilities and pipeline to produce and market the production recovered from the Prospect;

WHEREAS, PSI desires to provide Sandefer with the funds necessary to drill the Test Well and to develop the reserves in the Existing Well, in return for a one hundred percent (100%) working interest in the Existing Well and, absent PSI's election not to participate in the completion of the Test Well pursuant to Paragraph B(3) of Article III hereof, a one hundred percent (100%) working interest in the Test Well, both interests being subject to Sandefer's reversionary rights as provided in Article V hereof, and the right of first refusal to participate in all subsequent development activities in the Prospect, in PSI's sole discretion, pursuant to the terms of Article VII of this Agreement;

WHEREAS, PSI also desires to control and oversee the design and construction of the PSI Platform and Prospect Gathering Lines, as such terms are hereinafter defined; and

WHEREAS, PSI further desires to obtain an exclusive right to market all Gas owned by Sandefer or its Affiliates, as such term is hereinafter defined, in the Prospect for the life of the Prospect reserves pursuant to the terms of Article IX of this Agreement.

NOW THEREFORE, in consideration of the premises and the mutual covenants and other good and valuable considerations, subject to the rights and reservations noted in the Farmout Agreement, the Parties agree as follows:

#### ARTICLE I

##### Definitions

For all purposes of this Agreement, the following terms are defined as follows:

- A. "Abandonment Costs" shall mean those costs reasonably incurred by Sandefer in plugging and abandoning the Existing Well, Test Well in the event PSI elects to participate in the completion thereof pursuant to Paragraph B(3) of Article III hereof and Future Wells in which PSI has elected to participate pursuant to Article VII hereof, plus any costs reasonably incurred to remove the production platforms and abandon the flow lines to which such wells are connected.
- B. "Affiliate" shall mean any company, existing or created in the future, that controls, is controlled by or is under common control with another company.
- C. "Commission" shall mean the Federal Energy Regulatory Commission and any successor agency thereto.
- D. "Day" shall mean twenty-four (24) consecutive hour period commencing at 7:00 a.m., local standard time.
- E. "Drilling Contract" shall mean that certain drilling agreement to be entered into between Sandefer and Sandefer's Drilling Contractor whereby said contractor shall drill the Test Well on a "turn-key" basis.
- F. "Drilling Contractor" shall mean that certain third-party drilling contractor selected by Sandefer to drill and complete the Test Well pursuant to Paragraph B of Article III hereof.

- G. "Escrow Account" shall mean that certain escrow account established by Sandefer and PSI pursuant to Paragraph B of Article III hereof into which PSI deposits the Escrowed Funds.
- H. "Escrowed Funds" shall mean the one million seven hundred thousand dollars (\$1,700,000) deposited by PSI into the Escrow Account to cover the actual costs of drilling the Test Well.
- I. "Existing Encumbrances" shall mean with respect to the Prospect, all royalties, overriding royalties, carried interests or other burdens with which such Prospect was burdened at the time of acquisition by Sandefer pursuant to the Farmout Agreement and the lien of ad valorem taxes relating thereto which are not yet due and payable.
- J. "Existing Well" shall mean the existing well which has been previously drilled and temporarily abandoned on the Prospect prior to the effective date of this Agreement and located in the Federal Offshore, Ship Shoal Block 203, Offshore Louisiana, as shown in Exhibit "A" attached hereto and made a part hereof.
- K. "Existing Well Completion Costs" shall mean those actual costs incurred by Sandefer, pursuant to Paragraph D of Article III hereof, which are associated with the completion of the Existing Well, said amount estimated to be nine hundred thousand dollars (\$900,000).
- L. "Exploration Costs" shall mean those actual costs incurred by Sandefer, pursuant to Paragraph B of Article III hereof, which are associated with the drilling of the Test Well, said amount estimated to be one million seven hundred thousand dollars (\$1,700,000), and those costs associated with the drilling and completing of any Future Well in which PSI elects to participate.
- M. "Exploration Funding Amount" shall mean the sum of (1) the Sandefer Development Fee; (2) the Exploration Costs; (3) the Facilities Construction Costs; (4) in the event PSI elects to participate in the completion of the Test Well, the Test Well Completion Costs; and the Existing Well Completion Costs.
- N. "Facilities Construction Cost" shall mean all costs directly attributable to the design, engineering, construction, fabrication and installation of the PSI Platform and Prospect Gathering Line, said amount estimated to be one million seven hundred thousand dollars (\$1,700,000).

- O. **"Force Majeure"** shall mean acts of God, strikes, lockouts or other industrial disturbances, acts of the public enemy, wars, blockades, insurrections, riots, epidemics, landslides, lighting, earthquakes, fires, explosion or other casualty, storms, floods, washouts, arrests and restraints of government (federal, state, civil or military) and of people, civil disturbances, the breakage, freezing, rupture, blockage or unavailability of machinery, equipment or lines of pipe, the necessity or desirability for making repairs to or maintenance or alterations of machinery, equipment or lines of pipe, freezing of wells, equipment or lines of pipe, outages or shutdowns of power plant machinery or other facilities for repairs, maintenance or alterations, failure of wells, equipment, lines of pipe, interruption of necessary third-party transportation agreements and any other cause or causes, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension and which, by the exercise of due diligence, such party is unable, wholly or in part, to prevent or overcome; in addition, such term shall likewise include (i) in those instances where either party hereto is required to obtain servitudes, right-of-way grants, permits or licenses to enable such party to fulfill its obligations hereunder, the inability of such party to acquire or the delay on the part of such party in acquiring, at reasonable cost and after the exercise of reasonable diligence, such servitudes, right-of-way grants, permits or licenses and (ii) in those instances where either party hereto is required to furnish materials and supplies for the purpose of construction or maintaining facilities or is required to secure permits or permission from any governmental agency to enable such party to fulfill its obligations hereunder, the inability of such party to acquire or the delay on the part of such party in acquiring, at reasonable cost and after the exercise of reasonable diligence, such materials and supplies, permits or permission; provided, however, in no event shall the term "Force Majeure" mean or include any cause which by the exercise of reasonable diligence the party claiming suspension could overcome or should have prevented.
- P. **"Future Wells"** shall mean all wells, excluding the Test Well, which are drilled and completed on the Prospect subsequent to the effective date of this Agreement.
- Q. **"Gas"** shall mean and include all vapor phase hydrocarbons and gaseous substances.



- R. **"Month"** shall mean the period commencing on the first Day of each calendar month and ending on the first Day of the next succeeding calendar month.
- S. **"Net Proceeds"** shall mean those revenues received from the sale of the Subject Minerals by PSI from the Existing Well, Test Well in the event PSI elects to participate in the completion thereof pursuant to Paragraph B of Article III hereof and any Future Well in which PSI elects to participate less the Production Costs.
- T. **"Participation Percentage"** shall mean the appropriate percentage of the working interest and the appropriate percentage of the Subject Minerals or the Net Proceeds attributed to the Subject Minerals from the Existing Well, Test Well in the event PSI elects to participate in the completion thereof pursuant to Paragraph B of Article III hereof or Future Well in which PSI has elected to participate, whichever is applicable, as specified in Article V hereof, to which each of the Parties shall be entitled.
- U. **"Payout"** shall mean the Day after that Day on which PSI shall have received cumulative Net Proceeds equal to the Exploration Funding Amount. For purposes of this calculation, the Net Proceeds for the Month in which Payout is achieved shall be prorated equally among the number of Days in that Month.
- V. **"Post Payout"** shall mean the Day after that Day on which PSI shall have received cumulative Net Proceeds equal to one hundred fifty percent (150%) of the Exploration Funding Amount. For purposes of this calculation, the Net Proceeds for the month in which Post Payout is achieved shall be prorated equally among the number of Days in that month.
- W. **"Production Costs"** shall mean the total out-of-pocket costs incurred in connection with the production of the Subject Minerals from the Existing Well, Test Well in the event PSI elects to participate in the completion thereof pursuant to Paragraph B of Article III hereof and any Future Well in which PSI elects to participate pursuant to Article VII hereof, including but not limited to operating costs, production taxes, lease royalties, marketing, gathering and transportation costs, and overriding royalties including but not limited to that overriding royalty due Tenneco and Primary Fuels pursuant to the Farmout Agreement.

- X. "Prospect Gathering Lines" shall mean those pipeline and related facilities, constructed by PSI pursuant to Paragraph C of Article III, estimated to be approximately ten thousand one hundred feet (10,100') of six-inch (6") diameter pipeline, together with such metering and interconnection facilities as may be necessary to effect deliveries from the PSI Platform to Tenneco's "J" Platform located in Federal Offshore, Ship Shoal Block 198, Offshore Louisiana.
- Y. "PSI Platform" shall mean that certain offshore platform and related facilities built by PSI in Federal Offshore, Ship Shoal Block 202, Offshore Louisiana pursuant to Paragraph C of Article III hereof.
- Z. "Sandfer Development Fee" shall mean a three hundred thousand dollar (\$300,000) fee due Sandfer as reimbursement of Sandfer's actual overhead and out-of-pocket costs associated with the Prospect prior to the execution of this Agreement.
- AA. "Subject Minerals" shall mean all minerals in and under the Prospect including, but not limited to oil, gas and condensate, which may be produced and saved from the Existing Well, the Test Well in the event PSI elects to participate in the completion thereof, and/or any Future Wells in which PSI elects to participate.
- BB. "Test Well" shall mean the proposed exploratory well to be drilled by Sandfer's Drilling Contractor at a location on the Prospect acceptable to Tenneco and Primary Fuels in the "B" Fault Block to an initial Total Vertical Depth ("TVD") of eleven thousand five hundred feet (11,500') and such further depth pursuant to the provisions of Paragraph B of Article III hereof in Federal Offshore, Ship Shoal Block 202, Offshore Louisiana.
- CC. "Test Well Completion Costs" shall mean those actual costs incurred by Sandfer, pursuant to Paragraph B of Article III hereof which are associated with the completion of the Test Well.
- DD. "Year" shall mean a period of three hundred sixty-five (365) Consecutive Days; provided, however, that any such period which contains a date of February 29 shall consist of three hundred sixty-six (366) consecutive days.

## ARTICLE II

### Term

This Agreement shall be effective as of the date first written above and shall, unless sooner terminated pursuant to the terms hereof, remain in effect so long as the Farmore Agreement shall remain in effect and thereafter until all claims, liabilities and obligations incurred hereunder shall have been settled.

## ARTICLE III

### Exploration Funding Commitments

A. Sandefer Development Fee: PSI shall pay Sandefer the Sandefer Development Fee within fifteen (15) Days after the execution of this Agreement.

B. Test Well:

(1) Escrow Account: PSI shall deposit the Escrowed Funds into the Escrow Account within forty-eight (48) hours after the execution of this Agreement. Upon presentation of Invoices by Sandefer's Drilling Contractor from time to time pursuant to the terms of the Drilling Contract, Sandefer and PSI shall release to the Drilling Contractor an amount equal to said invoiced amount. In the event the cumulative invoiced amounts are less than the amount of the Escrowed Funds, Sandefer and PSI shall release all such remaining amounts in the Escrow Account to PSI within twenty-four (24) hours after the release of funds to the Drilling Contractor.

(2) Drilling: Sandefer shall, upon execution of this Agreement, negotiate and enter into a Drilling Contract which provides for the drilling of the Test Well in the "E" Fault Block to an initial depth of eleven thousand five hundred feet (11,500') on a "turn-key" basis and at a total price of one million seven hundred thousand dollars (\$1,700,000) or less. Thereafter, Sandefer shall log the existing hole and, if commercially practicable in Sandefer's and PSI's opinion, continue drilling to a depth of thirteen thousand five hundred feet (13,500') or the top of the "M-I" sand or to mud weight pressure of twelve and five-tenths (12 5/8) ppg, whichever first occurs.

(3) Completion:

(a) Upon conclusion of the successful drilling and casing out prior to completion of the Test Well,

Sandefor shall provide PSI or its assignee all available data from Sandefor's files; copies of all drilling records relating to the Test Well; and Sandefor's best estimate of the work required to prudently complete the Test Well and the anticipated Test Well Completion Cost.

(b) Upon receipt of such information, PSI shall, by notifying Sandefor in writing within thirty (30) Days of receipt of said information, elect to participate in the completion of the Test Well or grant all of its rights in the Test Well to Sandefor pursuant to Paragraph B(2) of Article V hereof.

(c) In the event PSI elects to participate in the completion of the Test Well, then the Participation Percentage in such Test Well shall be owned pursuant to the provisions of Paragraph B(1) of Article V hereof and PSI shall pay Sandefor the Test Well Completion Costs in the manner provided for in Paragraph D(2) hereof.

(d) In the event PSI fails to respond within said thirty (30) Day period or elects not to participate in the completion of the Test Well, Sandefor shall have the right to complete the Test Well through its own funding program.

(e) In the event Sandefor elects to complete the Test Well under its own funding program pursuant to subparagraph (d) above, Sandefor shall be immediately granted a one hundred percent (100%) Participation Percentage in the Test Well pursuant to Paragraph B(2) of Article V hereof.

- (4) Recompletions: As each existing producing sand in the Test Well is depleted or deemed noncommercial, Sandefor shall recomplete the Test Well at the next higher sand level capable of producing in commercial quantities. PSI shall pay its share of said costs based on its Participation Percentage at the time of recompletion, subject to adjustments, for such recompletion costs in the manner provided for completion costs pursuant to Paragraph 3 (C) hereof.

C. PSI Platform and Prospect Gathering Line:

- (1) Design: PSI shall, within twenty (20) Days from receipt of a written request from Sandefor, begin to design the PSI Platform and Prospect Gathering Line. PSI shall have complete control over the design and construction of

the PSI Platform and Prospect Gathering Line. PSI shall provide Sandefer with periodic status and progress reports regarding the design and construction and Sandefer shall have free access to said facilities at all times.

(2) Independent Contractor: PSI shall be deemed to be an independent contractor in the construction of the PSI Platform and Prospect Gathering Line and shall assume all responsibility and liability for the completion of said facilities.

(3) Capacity Priority: PSI shall have the absolute right to transport all Gas which it owns or has exclusive marketing rights to pursuant to Article IX hereof in the Prospect on the Prospect Gathering Line prior to the transportation of any other Gas to be transported on said line.

(4) Prospect Gathering Line Extensions: PSI and Sandefer shall have the option to construct and own, at their sole expense, all extensions of the Prospect Gathering Line necessary to serve any and all production in the surrounding areas in which Sandefer is an interest owner or operator.

(5) Completion: PSI shall notify Sandefer within five (5) Days upon completion of the PSI Platform and Prospect Gathering Line.

(6) Gathering Fee: Prior to initial operations of the Prospect Gathering Line, Sandefer and PSI shall mutually agree upon a fee to be charged for all transportation through said Prospect Gathering Line.

D. Completion of Existing Well:

(1) Completion Attempt:

(a) Unless otherwise notified by PSI pursuant to subparagraph (b) hereof, Sandefer shall attempt to complete the KM Sands in the Existing Well in the "W" Fault Block within thirty (30) Days from receipt of notice from PSI that the PSI Platform is complete.

(b) It is specifically recognized that the data generated through the drilling and completion of the Test Well may indicate the existence of commercially producible reserves below the KM Sands in the Existing Well. In such event, PSI shall determine, in its sole

discretion, and notify Sandefer of the depth it desires Sandefer to attempt to complete the Existing Well. In the event PSI notifies Sandefer of its election to complete the KM Sands, Sandefer shall complete the Existing Well pursuant to subparagraph (a) above. In the event PSI elects to attempt completion of the Existing Well below said KM Sands, Sandefer shall attempt to complete the Existing Well at the sands indicated by PSI within thirty (30) Days from the latter of (i) receipt of notice from PSI that the PSI Platform is complete or (ii) receipt of the depth at which PSI desires to complete the Existing Well.

(2) Completion Costs: PSI shall pay Sandefer the Existing Well Completion Costs within five (5) Days of presentation of invoices by Sandefer accompanied by signed AFE's indicating that Sandefer is committed to the completion of the Existing Well at the depth elected by PSI. Upon final computation of actual costs, Sandefer shall invoice or refund the difference between the actual Existing Well Completion Costs and the amount received by Sandefer from PSI hereunder within five (5) Days of said determination of actual costs.

(3) Recompletion: As each existing producing sand in the Existing Well is depleted or deemed non-commercial, Sandefer shall recomplete the Existing Well at the next higher sand level capable of producing in commercial quantities. PSI shall pay its share of said costs based on its Participation Percentage at the time of recompletion, subject to adjustments, for such recompletion costs in the manner provided for completion costs pursuant to subparagraph (2) hereinabove.

#### ARTICLE IV

##### Assignment of Working Interests

Sandefer hereby grants, sells, conveys, delivers and sets over to PSI, subject to Existing Encumbrances and Sandefer's reversionary rights as provided in Article V, Paragraph A hereof, a one hundred percent (100%) Participation Percentage in the Existing Well and, subject to Existing Encumbrances and Sandefer's reversionary rights in the event PSI elects to participate in the completion of the Test Well as provided in Article V, Paragraph B hereof or Sandefer's accelerated reversionary rights in the event PSI

elects not to participate in the completion of the Test Well as provided in Article V, Paragraph C hereof, whichever is applicable, a one hundred percent (100%) Participation Percentage in the Test Well.

## ARTICLE V

### Reversionary Working Interest

#### A. Existing Well:

1. Pre-payout: Until Payout, PSI shall own a one hundred percent (100%) Participation Percentage in the Existing Well.
2. After Payout and until Post Payout: Commencing from Payout and continuing until Post Payout, PSI shall own a fifty percent (50%) Participation Percentage in the Existing Well and Sandefer shall own a fifty percent (50%) Participation Percentage in the Existing Well.
3. Post Payout: Commencing from Post Payout and continuing until permanent abandonment of the Existing Well, PSI shall own a twenty-five percent (25%) Participation Percentage in the Existing Well and Sandefer shall own seventy-five percent (75%) Participation Percentage in the Existing Well.

#### B. Test Well

- (1) PSI Participation: In the event PSI elects to participate in the completion of the Test Well, PSI and Sandefer shall own and be entitled to the Participation Percentage as provided in accordance within the provisions of Paragraph A of this Article V.
- (2) PSI Non Participation: In the event PSI fails to timely elect to participate in the completion of the Test Well pursuant to Article III Paragraph B (3)(b) or elects not to participate in said completion, Sandefer shall be granted a one hundred percent (100%) Participation Percentage in the Test Well effective as of the date of PSI's failure to elect or election not to participate in the completion of the Test Well.
- (3) Overriding Royalty Conversion: In the event either and/or both Farmer's under the Farmout Agreement elect to convert their existing overriding royalty interest into a

thirty percent (30%) working interest, the Participating Percentages specified in subparagraphs (1) and (2) of this Paragraph B shall be reduced proportionately in relation to the actual percentage of working interest conversion.

(4) Reversion Restriction: Notwithstanding anything herein to the contrary, it is specifically recognized and agreed that in the event PSI elects to participate in the completion of the Test Well, PSI's Participation Percentage shall not be reduced below one hundred percent (100%) unless and until PSI has received and recovered the total tangible and intangible costs of drilling, testing, completing and producing, including any reworking or recompletion costs, if applicable, the Test Well from the Net Proceeds attributable to the Test Well.

## ARTICLE VI

### Farmout Agreement Compliance

#### A. Compliance:

Sandfer hereby expressly agrees that it has and will continue to comply with all provisions of the Farmout Agreement, including but not limited to payment of all required processing fees, operation payments and any and all other payments required therein. In the event PSI is unable to recover the Exploration Funding Amount due directly to Sandfer's refusal to fulfill or negligence in fulfilling the provisions of this Article, in addition to any other remedies PSI has in law or equity, Sandfer shall immediately refund all monies received to date from PSI pursuant to the terms of this Agreement and this Agreement shall thereupon terminate; provided, however, PSI shall remain liable for any expense incurred by Sandfer in the pursuit of rights in the Farmout Agreement not so caused.

#### B. Surrender:

In the event Sandfer, for any reason, elects or is otherwise compelled due to Sandfer's negligence to surrender or abandon the Farmout Agreement, Sandfer shall provide PSI twenty-four (24) hours prior written notice of such situation. PSI shall, within said (10) Day period, notify Sandfer of PSI's election, at its sole discretion, to either (1) terminate this Agreement pursuant to the provisions of Section A of this Article VI or (2) receive a full assignment of Sandfer's interest in the Farmout Agreement. In the event PSI elects to receive a full assignment of the Farmout Agreement as herein provided,



Sandfer shall, within twenty-four (24) hours of receipt of said election by PSI, assign all of its interest in such agreement to PSI in a form acceptable to PSI, in PSI's sole discretion, and shall in no event allow said Farmout Agreement to be surrendered or abandoned prior to such assignment.

C. Interrelation:

It is specifically recognized that those rights retained under the Farmout Agreement shall be superior to PSI's rights hereunder. In addition, PSI shall not be relieved of any obligations hereunder due to forfeiture of the Farmout Agreement by Sandfer in the event such forfeiture was through no fault of Sandfer and Sandfer was performing its duties prudently and with due diligence.

ARTICLE VII

Subsequent Activity

A. Right of First Refusal: It is specifically recognized that the activity contemplated in Article III hereof may establish opportunity for Future Wells on the Prospect. In the event Sandfer desires to attempt any such Future Wells on the Prospect, Sandfer shall first offer PSI an opportunity to participate in all such Future Wells pursuant to mutually acceptable terms and conditions. In the event the Parties cannot agree on the terms and conditions for the drilling of such Future Wells, said Future wells shall at PSI's option, be drilled on the same terms as the Test Well.

B. Non Participation Election:

(1) "W" Fault Block: In the event PSI elects not to participate in any Future Wells in the "W" Fault Block, Sandfer shall be granted a one hundred percent (100%) Participation Percentage in such wells that PSI elected not to participate.

(2) "B" Fault Block:

(i) In the event PSI elects not to participate in the completion of the Test Well pursuant to Paragraph B(3) of Article III hereof, Sandfer shall be granted a one hundred percent (100%) Participation Percentage in the "B" Fault Block.

- (ii) In the event PSI elects to participate in the completion of the Test Well pursuant to Paragraph B(3) of Article III hereof, but elects not to participate in any Future Well in the "B" Fault Block, Sandefer shall be granted a one hundred percent (100%) Participation Percentage in such wells that PSI elected not to participate.

(3) Other Fault Blocks: In the event PSI elects not to participate in any Future Wells in Fault Blocks outside Blocks "B" and "W", Sandefer shall provide PSI an area of development covering its estimate of the extent of reserves to be developed by the Future Well in which PSI has elected not to participate. PSI shall have thirty (30) Days from receipt of said area of development to either accept or reject its use hereunder. In the event PSI accepts the area of development provided hereunder, Sandefer shall be granted a one hundred percent (100%) Participation Percentage in said area of development provided hereunder. In the event PSI declines the area of development provided hereunder, PSI and Sandefer shall specify one geologist each and the two geologists so selected shall select a third geologist. The three geologists so selected shall thereupon determine the extent of reserves to be developed by the Future Well in which PSI has elected not to participate, and Sandefer shall be granted a one hundred percent (100%) Participation Percentage in the area of development specified by said three geologists.

## ARTICLE VIII

### Continued Operations & Abandonment

#### A. Continued Operations:

Sandefer hereby agrees that it will continue to operate or find a suitable substitute to operate all of the wells on the Prospect in which PSI is a participant for so long as each such well is capable of providing Net Proceeds.

#### B. Abandonment:

PSI shall be obligated to reimburse Sandefer for a portion of the Abandonment Costs equal to PSI's Participation Percentage at the time of abandonment.

## ARTICLE IX

### Marketing Rights

A. PSI's Right to Market: Sandefer and PSI hereby specifically agree that all gas owned by Sandefer and PSI in the Prospect, regardless of any election by PSI not to participate in the completion of the Test Well or the drilling and completion of any Future Wells, shall be exclusively marketed by PSI under a "netback" arrangement for the life of such reserves. The price to be paid for Gas purchased by PSI pursuant to this Article IX shall be an amount equal to ninety-five percent (95%) of PSI's resale price of such Gas, less any and all transportation fees, tariffs and other fees and charges, if any, paid by PSI to transport such Gas from the purchase point of delivery to the receipt point of the resale market.

B. Minimum Commitment Price: PSI shall obtain Sandefer's approval prior to committing any of Sandefer's Gas which PSI is marketing hereunder to any sales contract where the contract price to be received by PSI is less than ninety five percent (95%) of the "Gas Daily" published price for onshore, South Louisiana and the applicable pipeline as of the Day of PSI's commitment to its sales contract providing for the resale of the Gas hereunder.

C. Long-Term Sales Agreements: PSI shall obtain Sandefer's approval prior to committing any of Sandefer's Gas which PSI is purchasing for resale hereunder to any sales contract committing the sale of such Gas for a period in excess of two (2) Years. In the event Sandefer elects to commit its Gas to PSI for resale under a sales contract in excess of two (2) Years, PSI shall receive five percent (5%) of the netback wellhead price received by Sandefer under said contract as a marketing fee.

D. Third-Party Gas: Sandefer shall use its best efforts to allow PSI an opportunity to match or exceed the highest offer to purchase for all Gas sold from the Prospect.

## ARTICLE X

### Inspections, Reviews and Audits

#### A. Inspections:

PSI shall have the right, exercisable during regular business hours and upon twenty four (24) hours prior written or verbal notice, to physically inspect all facilities and equipment installed or used by Sandefer in

its operations hereunder. Sandefer agrees that all such facilities and equipment shall be maintained in compliance with governmental and industry standards pertaining to same.

**B. Reviews:**

In addition to the foregoing physical inspection, PSI shall have the right to require Sandefer to provide data, information and technical review of the functional adequacy of the processing facilities installed by Sandefer hereunder. Sandefer agrees that such processing facilities shall be designed and constructed with sufficient capacity to permit Sandefer, under normal operating conditions, to perform its obligation hereunder.

**C. Accuracy Verification:**

Each party shall have the right during reasonable business hours to examine the books and records of the other party to the extent necessary to verify the accuracy of any statement, change, credit, computation, account or payment made pursuant to any provision hereof. If any such examination shall reveal or if either party shall discover any error or inaccuracy in its own or the other party's statement, charge, credit, computation, account or payments, then proper adjustment and correction thereof shall be made as promptly as practicable thereafter.

**D. Adjustment Claims:**

No adjustment or correction shall be required of any error or inaccuracy occurring in any statement, payment, account, calculation or determination following two (2) years from the making or rendering of the same. Failure of the Parties to make a claim for adjustment within such period shall establish the correctness and preclude the filing of exceptions or making claims for adjustment.

**ARTICLE XI**

**Warranty of Title**

Sandefer agrees that all Subject Minerals hereunder are and shall be kept free and clear of all liens, claims, encumbrances and specific limitation as to use during the term of the Agreement, other than the Existing Encumbrances. Any interest represented herein is without warranty of title, except as to

claims of all persons claiming the same or any part thereof, by, through, or under Sandefer, but with full subrogation and substitution in and to all actions in warranty.

#### ARTICLE XII

##### Indemnity

Sandefer shall indemnify, defend and hold PSI harmless from and against all loss, cost and expense, including court costs and attorney fees, for any claims, suits, judgments, demands, actions or liabilities growing out of the operations conducted hereunder by Sandefer. Likewise, PSI shall indemnify, defend and hold Sandefer harmless from and against any loss, cost and expense, including court costs and attorney fees, for any claims, suits, judgments, demands, actions or liabilities growing out of PSI's operations hereunder. Each party shall bear operational expenses to the extent of their working interest at the time of the expense.

#### ARTICLE XIII

##### Force Majeure

If either party is rendered unable, wholly or in part, by Force Majeure, to perform or comply with any obligation or conditions of this Agreement, upon giving written notice and reasonably full particulars to the other party, such obligation or condition shall be suspended during the continuance of the inability so caused and such party shall be relieved of liability and shall suffer no prejudice for failure to perform the same during such period; provided, however, obligations to make payments then due shall not be suspended and the cause of suspension (other than strikes or lockouts) shall be remedied so far as possible with reasonable dispatch. It is understood and agreed that the settlement of strikes or lockouts shall be entirely within the discretion of the party having the difficulty and that the above requirement of the use of diligence in restoring normal operating conditions shall not require the settlement of strikes or lockouts by acceding to the terms of the opposing party when such course is inadvisable in the discretion of the party having the difficulty.

#### ARTICLE XIV

##### Regulatory Authority

This Agreement and each provision hereof shall be subject to all valid applicable federal and state laws and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction. Either party shall have the right to contest the validity of any such law, order, rule or regulation and neither acquiescence therein or compliance therewith for any period of time, nor any other provision contained herein, shall be construed as a waiver of such right.

#### ARTICLE XV

##### Prohibition of FERC Regulations

Sandefer hereby represents that all Gas to be produced from the Prospect has not been dedicated to "interstate commerce" as such term is defined in the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978. Sandefer and PSI further represent and agree that neither party shall take any action which leads to the assertion or jurisdiction over the Agreement or any of the facilities of either party by the Commission pursuant to the Natural Gas Act, as amended. The Parties agree that the representations and agreements of this Article constitute a major part of the consideration for the other party entering into this Agreement and that, therefore, violation or breach of said representations and agreement shall entitle the other party to immediate cancellation of the Agreement, in addition, to all other relief in law and in equity which may be afforded to such other party, including, but not limited to, damages for breach of contract.

#### ARTICLE XVI

##### Successors and Assigns

(A) Assignability This Agreement shall be binding upon and inure to the benefit of the respective representatives, successors and assigns of the Parties hereto; provided, however, that this Agreement may not be transferred or assigned by operation of law or otherwise, in whole or in part, by either party except to Affiliates, subsidiaries or successors-in-interest of substantially all of the business of either party or with the prior written consent of the other party.

(B) Sale of Property It is specifically recognized and agreed that in the event either party to this Agreement desires or elects to commence negotiations for the sale of any or all of its interests in property acquired pursuant to this Agreement; the party so desiring to dispose of its interests shall conduct such property disposition as follows:

- a. The party desiring to sell its property interest shall immediately notify the other party of the interest it desires to sell. Thereafter, the parties shall, in good faith, negotiate for the sale of such interest pursuant to mutually acceptable terms and conditions.
- b. In the event the parties are unable to mutually agree upon the provisions for the sale of said interest within thirty (30) Days from the commencement of such negotiations, the party electing to dispose of its interest in the property may solicit bids for said interest from third-parties.
- c. Upon receipt of a bona fide offer from a third-party buyer, the disposing party shall provide the other party written notice and appropriate documentation of the provisions of such offer.
- d. Upon receipt of such notice, the non-disposing party shall, by notifying the disposing party in writing within fifteen (15) Days of receipt of said notice, elect to meet the terms of the third-party offer or release the disposing party to accept said third-party offer.
- e. In the event the non-disposing party elects to meet the third-party offer, the disposing party shall enter into a sales agreement with the non-disposing party pursuant to the terms of the third-party offer.
- f. In the event the non-disposing party fails to respond within said fifteen (15) Day period or elects not to meet with the third-party offer, then the disposing party shall be released to accept said third-party offer.

## ARTICLE XVII

### Interpretation

#### A. Headings:

The Table of Contents and headings contained in this Agreement are used solely for convenience and do not

constitute a part of the agreement and shall not be used to aid in any manner in construing this Agreement.

**B. Context of Words**

Whenever the plural, masculine or neuter is used in this Agreement, the same shall mean the singular, feminine, body politic or corporate and vice versa where the context so requires.

**C. Choice of Law:**

This Agreement shall be governed by and construed in accordance with General Maritime law, or where applicable, the laws of the State of Louisiana.

**ARTICLE XVIII**

**Notices**

Any notice, request, demand, payment or statement provided for in this Agreement shall be in writing and shall be deemed to be given when deposited in the U.S. Mail, postage prepaid and shall be conclusively presumed to be received on the same day as sent and directed to each of the Parties at the following addresses or at such other addresses as shall be designated in writing from time to time:

**For Payments/Invoices:**

PSI, Inc.  
1044 N. 114th Street  
Suite 400  
Omaha, Nebraska 68154  
Attn: Controller

General Sandefer Offshore Partnership  
1001 Fannin, Suite 2225  
Houston, Texas 77002-6785  
Attn: Mr. Sterling Paddock

**For All Other Matters:**

PSI, Inc.  
5847 San Felipe Plaza  
Suite 910  
Houston, Texas 77057  
Attn: Vice President-  
Gathering

General Sandefer Offshore Partnership  
1001 Fannin  
Suite 2225  
Houston, Texas 77002-6785  
Attn: Mr. Jeff Sandefer



## Article XIX

### Operating Agreement

Sandefer Offshore Operating Co. ("SOOCO") shall be the designated operator of the Prospect pursuant to the operating agreement attached hereto as Exhibit B. All operations contemplated hereunder shall be performed in accordance with the terms of Exhibit B, however, should a conflict exist between this Agreement and Exhibit B, this Agreement shall control. SOOCO shall have complete control and authority over operations conducted herein as they relate to activities conducted on the Prospect. SOOCO shall have the right to recover from PSI its actual overhead incurred with respect to services provided PSI pursuant to this Agreement and the attached operating agreement. Such reimbursement shall include the direct and overhead fees permitted under the terms of said operating agreement. It is expressly provided, however, that there shall not be any duplication of charges and that SOOCO shall not receive any such fees permitted under the operating agreement during any period of time when such costs and expenses are being reimbursed to Sandefer under the provisions of this Agreement.

## ARTICLE XX

### Miscellaneous

#### A. Relationship:

It is not the purpose of the Parties hereto to create the relationship of agency or employer-employee, and neither this Agreement nor any of the operations hereunder shall be construed or considered as creating any such relationship.

#### B. Entire Agreement:

The terms contained herein constitute the entire agreement of the Parties and there are no agreements, understandings, obligations, promises, assurances or conditions, precedent or otherwise, except those expressly set out herein.

#### C. Further Acts:

Each party shall, from time to time and at all times, do all such further acts and execute and deliver all of such further deeds and instruments as shall be reasonably required in order to fully perform and carry out the terms of the Agreement.

D. Changes:

Any change, modification or alteration of this Agreement shall be in writing and signed by the Parties hereto and no course of dealing between the Parties shall be construed to alter the terms hereof.

E. Waivers:

No waiver by either party of any default of the other under this Agreement shall operate as a waiver of any future default, whether of a like or different character.

F. Insurance:

Sandfer shall provide documentation of PSI's inclusion as an Insured pursuant to Sandfer's existing insurance policies as listed in Exhibit "B" of the Joint Operating Agreement attached hereto immediately after execution of this Agreement.

IN TESTIMONY WHEREOF, with ss the execution of the Agreement by the Parties on the date first written above.

ATTESTATION

PSI, INC.

By: James J. Kille

Title: Secretary

By: Marc L. Petersen

Marc L. Petersen  
President

ATTESTATION

GENERAL SANDEFER OFFSHORE  
PARTNERSHIP

By: Rituli Padda

Title: Secretary

By: Jeff Sandfer

Jeff Sandfer  
Managing Partner

STATE OF TEXAS        &  
                                 &  
COUNTY OF HARRIS    &

BEFORE ME, the undersigned authority, on this day personally appeared Goff Sandefer known, to me by the person and general partner whose name is subscribed to the foregoing instrument and acknowledged to me that the same was the act of the said GENERAL SANDEFER OFFSHORE PARTNERSHIP, and that he has executed the same as the act of such partnership for the purposes and consideration therein expressed, and in the capacity therein stated.

Given under my hand and seal of office this 9th day of February, 1988.

Margaret Simon  
Notary Public in and for Lamar Co.  
The State of Texas

October 8, 1990  
My Commission Expires

