

Inst # 1993-18202

06/22/1993-18202
01:19 PM CERTIFIED
SHELBY COUNTY JUDGE OF PROBATE
007 MCD 22.50

SG METHANE COMPANY

SOURCES OF TITLE:

Tuscaloosa Co., Ala.
Deed Book 1016 at 17

1151 at 5

1151 at 5

1151 at 58

August 14, 1990

McKenzie Methane Corporation
7880 San Felipe Road
Suite 100
Houston, Texas 77063

1151 0093

RECORDED IN ABOVE
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17 JUNE 93 03:52:35 PM

W. HARDY MCCOLLUM
TUSCALOOSA COUNTY, ALABAMA

Attention: Mr. Michael McKenzie

Gentlemen:

You have heretofore advised the undersigned (collectively "Smith-Gordy") by letter dated May 21, 1990 of the proposed third Subsequent Program pursuant to a separate Development Agreement, as amended (the "Development Agreement"), between you ("McKenzie") and SG Methane Company, Smith-Gordy Methane Company, Smith-Gordy Methane Company (Additional Interest) and The Northwestern Mutual Life Insurance Company ("Northwestern"), respectively, all of which instruments are dated effective as of March 17, 1989 and provide for the ownership and the development of coal seam gas leases in certain areas in the States of Alabama and Colorado. This letter is to confirm the agreement reached at a meeting on August 6, 1990 concerning our participation in such third Subsequent Program; provided that the Trustees of the Estate of Bernice Pauahi Bishop ("Bishop Estate") formally agree to participate with Smith-Gordy in such third Subsequent Program. At a meeting between representatives of Smith-Gordy and the Bishop Estate held in Honolulu, Hawaii on July 19, 1990, representatives of the Bishop Estate verbally agreed so to participate, but the Bishop Estate's agreement is subject to approval by such Trustees at their regularly scheduled meeting to be held on August 21, 1990. It is anticipated that the Trustees will approve such participation and will wire transfer funds to Smith-Gordy on August 22, 1990, in which event the first cash call for the third Subsequent Program will be funded by Smith-Gordy on August 23, 1990. Should such Trustees not formally approve such participation, however, Smith-Gordy cannot participate therein. Such agreement, subject to the foregoing, is as follows:

SG 010116

a. The third Subsequent Program will be based upon the amount of \$47,750,000 of total Turnkey Costs instead of \$45,000,000 as stated in your letter; provided, that if Northwestern does not change its decision not to participate in such program and is not replaced as a participant on or before October 15, 1990, the third Subsequent Program will be based upon the amount of \$38,200,000 of total Turnkey Costs and the number of wells to be drilled will be reduced accordingly. The dollar commitment of Smith-Gordy will be the same in either event but the Participation Percentages will differ. Such amounts and percentages with respect to the third Subsequent Program are as follows:

If Northwestern participates or is replaced:

	<u>Amount</u>	<u>Participation Percentage</u>
SG Methane Company	\$15,916,667	33-1/3%
Smith-Gordy Methane Company	2,387,500	5%
Smith-Gordy Methane Company (Additional Interest)	955,000	2%
	<u>\$19,259,167</u>	<u>40-1/3%</u>

If Northwestern does not participate and is not replaced:

	<u>Amount</u>	<u>Participation Percentage</u>
SG Methane Company	\$15,916,667	41.67%
Smith-Gordy Methane Company	2,387,500	6.25%
Smith-Gordy Methane Company (Additional Interest)	955,000	2.50%
	<u>\$19,259,167</u>	<u>50.42%</u>

b. McKenzie agrees to use its best efforts in implementing the two separate gas gathering ventures, one for Alabama and the other for Colorado, along the lines which have been discussed with the percentage ownership of Smith-Gordy in each of the ventures to be not less than the total of the participation percentages in the program subscribed by Smith-Gordy in the Development Agreement. The participants in

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TUSCALOOSA COUNTY, ALABAMA

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the ventures will bear the actual costs incurred in the construction and operation of the systems in proportion to their ownership of the gas gathering systems, and each venture will be structured so as not to be a profit or loss center to the operator thereof. If Northwestern does not participate in the third Subsequent Program, it is anticipated that Northwestern's ownership in the gas gathering systems will be adjusted in some equitable manner. All of the compressors presently being utilized should be owned by the particular venture which relates to the area where the compressors are located; in any event, the compressors should be purchased or leased by the program participants (or ventures) at a price not greater than the cost charged by the manufacturer (if purchased or leased from the manufacturer) or the dealer (if purchased or leased from a dealer). Smith-Gordy agrees to enter into appropriate contracts or agreements to reflect its ownership and obligations with respect to such compressors if the ventures do not own the same.

c. A number of wells, particularly wells in the Cahaba Area, have not been drilled to the contract depth specified in Section 3.01 of the Development Agreement and do not satisfy the requirements of the Development Agreement. Smith-Gordy, however, has been pre-billed and has paid in advance its portion of the Turnkey Costs for each well. By our letter of May 2, 1990 and your response of May 22, 1990, an effort was made to identify those wells in the Cahaba Area that were not in compliance with the spirit of the Development Agreement as to the depth requirement. We realize you have not had an opportunity fully to evaluate the situation as set forth below in this paragraph, and you do not by signing this letter acknowledge the accuracy of same, but we estimate that 34 wells (and perhaps more) were drilled to 3,000 feet or less in the Cahaba Area to an average depth of 2,463 feet for all wells (the contract depth being approximately 3,800 feet). We calculate the average depth of wells drilled in Well Group I is 3,770 feet; those drilled in Well Group II is 3,660 feet; those drilled in Well Group III is 3,575 feet; and those in Well Group IV is 3,595 feet. At this time we are not asking for reimbursement of our share of the Turnkey Costs for such wells, but some equitable adjustment must be made.

d. There are a number of items covered by Turnkey Costs which McKenzie has billed or proposes to bill to Smith-Gordy in addition to Turnkey Costs. These items include (but are not limited to):

(1) Plastic pit liners. It is our understanding that the pit liners are incidental to and a part of the drilling, testing and attempted completion, or plugging

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W. HARDY MCCOLLUM

and abandoning, operations and, therefore, are a part of Turnkey Costs pursuant to Section 3.03 (f) of the Development Agreement.

(2) Title and curative. All necessary independent legal expense and costs of title searches and title investigations, together with costs of abstracts, run sheets, title opinions and title curative work incurred up to the point in time which is the earlier of the plugging and abandoning of an Initial Well or the tying in of the well to the infield gathering system are a part of Turnkey Costs pursuant to Section 3.03 (e) of the Development Agreement. With respect to each well, McKenzie will have the examining attorney identify which of such expenses and costs relate to the Drilling Title Opinion portion (which is included in Turnkey Costs for such well) and which of such expenses and costs relate to the Division Order Title Opinion portion (which is not included in Turnkey Costs for the well). Smith-Gordy and McKenzie will review the information furnished by the examining attorneys and agree as to which of such costs and expenses are to be included in each portion, and Smith-Gordy will be billed accordingly.

(3) Pulling jobs. The first two pulling jobs to clean up the sand accumulated therein are included in Turnkey Costs with respect to each well drilled, and Smith-Gordy will be billed separately for its share of the actual costs of any additional jobs of that nature.

(4) Security bonds and permit fees; service deposits. Section 3.03 (g) of the Development Agreement (as amended by paragraph 12 of the Second Amendment to Development Agreement) provides that included in Turnkey Costs is the cost of all permits and licenses relating to the drilling of wells and bonds (other than state plugging bonds required), except for any county zoning or inspection fees or permits (Section 3.04 [i], as so amended by paragraph 16 of the Second Amendment to Development Agreement). Any charge by McKenzie for "security bonds and permit fees" or "service deposits" it contends is not covered by Turnkey Costs should be explained and documented. Permit and bonding fees required to own and operate water disposal facilities are not included in Turnkey Costs (Section 3.04 [d] of the Development Agreement, as amended by said paragraph 16).

e. The Development Agreement and the Operating Agreement should be amended so as to provide that on non-Turnkey Costs,

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TUSCALOOSA COUNTY, ALABAMA

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Smith-Gordy shall have 30 days after receipt of an invoice within which to pay its share thereof. Smith-Gordy agrees that it will pay such invoices sooner than 30 days if it has funds available therefor.

f. Smith-Gordy should be furnished evidence in recordable form satisfactory to it that all consents required pursuant to any lease, farmout or other agreement to an assignment of its various interests from McKenzie (and from Smith-Gordy to its investors) have been secured. McKenzie will assist Smith-Gordy in obtaining any consents that are required to assignments to its investors, and will coordinate the efforts to obtain the same since it has the contractual relationships with the lessors, farmers and others. It is presently contemplated that McKenzie will request all necessary consents at the conclusion of the Program outlined in the Development Agreement. Nothing herein shall preclude Smith-Gordy from taking such steps as it deems appropriate to obtain any such consent. Assignments of such interests should be made as soon as is practicable.

g. Accounting and production data and information should be furnished more timely and in greater detail. McKenzie shall use its best efforts to hire as an employee a production engineer who resides in Alabama. The expense of such engineer is to be covered by the Operating Agreement. Specifically, Smith-Gordy requires accounting information for the timing and amount of expenditures, supported by documentation so as to enable us to verify same, and payment of the interest calculated pursuant to Section 3.02 (c) of the Development Agreement (as amended by paragraph 9 of the Second Amendment to Development Agreement). McKenzie agrees to use its best efforts in furnishing such information timely, and will pay such interest immediately after such calculation is made.

h. McKenzie has agreed to finance the costs in excess of Turnkey Costs (those provided in the Development Agreement as well as those provided in the Operating Agreement) that are attributable to the 2% interest (Additional Interest) of Smith-Gordy Methane Company, payable out of 50% of the revenues on production accruing to such interest from all wells in the Program. All such revenues will be payable to Smith-Gordy directly, and Smith-Gordy will thereupon remit 50% thereof (without deduction) to apply on such loan.

If the foregoing represents your understanding of the agreement which we have reached, please so indicate in the space

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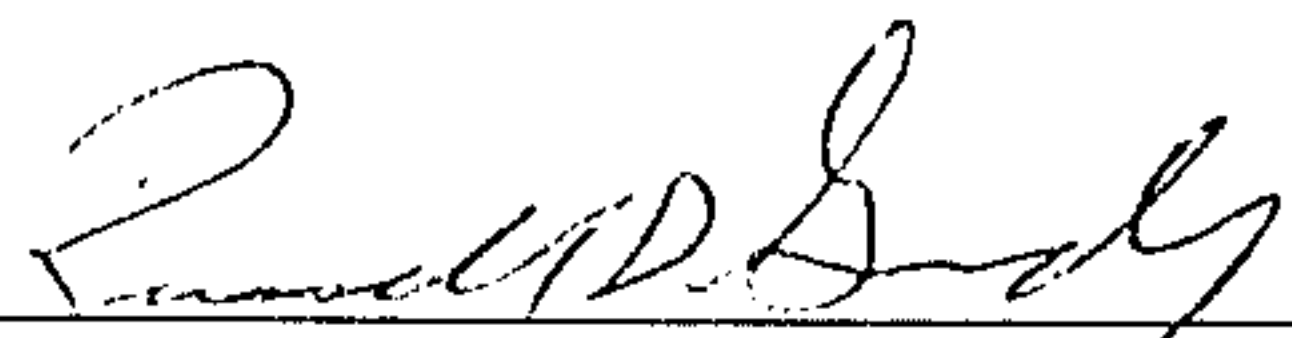
McKenzie Methane Corporation
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provided below on a copy of this letter and return the same to
us on or before August 16, 1990.

Very truly yours,

SG METHANE COMPANY
SMITH-GORDY METHANE COMPANY

By 
Lester H. Smith, Partner

By 
Russell D. Gordy, Partner

ACCEPTED AND AGREED to this
15 day of August, 1990.

McKENZIE METHANE CORPORATION
By 
Michael McKenzie, President

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17 JUNE 93 03:53:10 PM
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TUSCALOOSA COUNTY, ALABAMA
17 JUNE 93 03:53:20 PM 00029838 0083
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REC RECORDING FEES 16.00
SOT 1ST SRCE TITLE 1.75
PJF P J FEES 2.00

SG 010121

Inst # 1993-18202

06/22/1993-18202
01:19 PM CERTIFIED
SHELBY COUNTY JUDGE OF PROBATE
007 MCD 22.50

HARDY McCOLLUM, JUDGE OF PROBATE, DO HEREBY CERTIFY THAT
THE FOREGOING IS A FULL, TRUE AND CORRECT COPY OF THE
INSTRUMENT(S) HEREWITH SET OUT AS SAME APPEARS OF RECORD IN

Deed BOOK, 1151 AT PAGE 93, IN SAID COURT.
WITNESS MY HAND AND SEAL THIS 22 DAY OF June, 1993

Hardy McCollum
JUDGE OF PROBATE,
MUSCALOOSA COUNTY, ALABAMA