

SHALLOW GAS LEASE

This agreement is entered into by and between Kelly Constance Hurley, dealing in her sole and separate property, whose address is 3421 East 1st Street, Duluth, MN 55804 ("Lessor"), and Pinnacle Gas Resources, Inc., whose address is 1 East Alger, Suite 206, Sheridan, Wyoming 82801 ("Lessee").

Lessor, for and in consideration of ten and more dollars (\$10.00+) in hand paid, receipt of which is hereby acknowledged, and of the covenants and agreements herein contained on the part of the Lessee to be paid, kept and performed hereby grants and leases to the Lessee the exclusive right to explore for, produce and sell gas, including coalbed methane gas, on the following described property in Sheridan County, Wyoming:

Township 55 North, Range 78 West, 6th P.M.
Section 24: S $\frac{1}{2}$ SW $\frac{1}{4}$
Section 25: N $\frac{1}{2}$ NW $\frac{1}{4}$
containing 160.00 acres, more or less.

This lease and the rights granted hereunder are limited to gas produced from the surface of the ground to 2500 feet below the surface, or the base of the Fort Union formation, whichever is deeper.

1. **Term.** This lease shall remain in force for a term of three (3) years from the date of this lease (hereafter referred to as the "Primary Term") and as long thereafter as gas is produced in paying quantities from the leased premises.

This lease shall terminate at the end of the Primary Term as to all the leased lands except those within the "well unit" on which is located a well producing gas in paying quantities or on which Lessee is actively engaged in drilling, dewatering or reworking operations. Lessee will deliver promptly to Lessor a recordable release for all lands as to which this lease has terminated at the end of the Primary Term. The term "well unit" as used in this agreement shall mean the quarter-quarter section (or comparable legal subdivision) on which the well is located if there is no order of the Wyoming Oil and Gas Conservation Commission ("WOGCC") establishing a drilling unit and shall mean the drilling unit for the well established by the WOGCC if there is an order of the WOGCC establishing a drilling unit for the leased premises.

If at the expiration of the Primary Term, gas is not being produced paying quantities from any portion of the premises but the Lessee is then engaged in drilling, dewatering or reworking operations thereon, then this lease shall continue in force so long as such operations are being continuously prosecuted. Operations shall be considered to be continuously prosecuted if not more than ninety (90) days shall elapse between the completion or abandonment of one well and the beginning of operations for the drilling of a subsequent well.

If after discovery of gas on the leased premises, the production thereof should cease from any cause after the Primary Term, this lease shall not terminate as to the well unit on which the producing well was located if Lessee commences additional drilling, dewatering or reworking operations within ninety (90) days from the date of cessation of production or from the date of completion of a dry hole. If gas should be discovered and produced as a result of such operations after the expiration of the Primary Term of this lease, this lease shall continue in force as to the well unit on which the producing well was located so long as gas is produced in paying quantities from the leased premises.

2. **Royalty.** Lessee shall pay to Lessor as royalty the following:

- a. As royalty on all gas produced from any well on the leased premises, sixteen percent (16%) of the market value of all gas produced from the leased premises. Lessor shall not be entitled to take gas in kind. The market value of the gas shall be the gross price received by the Lessee from the sale of gas at the point of the first good faith, arms length contract to a third party who is not an affiliate of Lessee; provided, however, if the gas is not sold under a good faith, arms length contract to a third party who is not an affiliate of Lessee, the market value shall be the current fair market value of similarly situated gas in Sheridan County, Wyoming sold pursuant to an arms length transaction embodying the covenant of good faith and fair dealing. An "affiliate" shall mean any person or entity which controls, is controlled by or is under common control with the Lessee. "Gas" is defined herein as any gas of whatsoever nature or kind, including coalbed methane gas, liquid hydrocarbons and their respective constituent elements, casinghead gas or other gaseous substances, produced from the leased premises.
- b. All royalties shall be calculated and paid to Lessor without deduction for the cost of producing, gathering, storing, separating, treating, dehydrating, compressing, processing and/or transporting the gas to the point of sale, marketing and making the gas ready for sale. All royalties shall be paid in accordance with the state of Wyoming laws, rules and regulations.

3. **Development.** Lessee shall exercise the diligence of a reasonably prudent operator in drilling such wells as may be reasonably necessary for the proper development of the leased premises and to protect

the leased premises against drainage, and Lessee shall exercise reasonable diligence in marketing the production from the leased premises.

4. **Lesser interest.** If Lessor owns a lesser interest in the gas in the above-described land than the entire and undivided fee simple interest therein, then the royalties herein provided shall be paid to Lessor only in the proportion which the Lessor's interest bears to the whole and undivided fee estate.
5. **No Warranties.** In entering into this lease, Lessor makes no representations or warranties of title or otherwise, express or implied, and Lessor does not warrant or agree to defend title to the leased premises. Lessor shall not be liable for the return of any bonus, royalties or other monies paid hereunder. This lease is subject to all exceptions, reservations, rights-of-way, easements, agreements and restrictions of record and to any state of facts which would be disclosed by an accurate survey and an inspection of the premises. Lessee may, at its option, discharge any tax, mortgage or other lien upon the leased premises and be subrogated thereto and have the right to apply to the repayment to Lessee any royalties accruing hereunder.
6. **Pooling and Unitization.** Lessee may not pool or unitize the leased premises or any part of the leased premises without the prior written consent of Lessor. However, Lessor shall not unreasonably withhold such consent.
7. **Partial Release.** Lessee may at any time release this lease as to all or part of the lands described. Any partial release must cover not less than governmental quarter-quarter sections or comparable legal subdivisions. Lessee may not release a specific strata or horizon without the prior written consent of Lessor. A partial release shall not release Lessee from obligations and payments already incurred with respect to the released lands.
8. **Assignments.** Either party may assign their interests in this lease. Lessee shall notify Lessor of the name and address of any party to which Lessee assigns any interest in this lease. No change in ownership of the leased premises or assignment of rentals or royalties shall be binding on the Lessee until after the Lessee has been furnished with copies of the documents evidencing the assignment. Lessee may not execute a partial assignment of this lease covering less than a governmental quarter-quarter section or comparable legal subdivision, and Lessee may not assign a specific strata or horizon to a third party without the prior written consent of Lessor. However, Lessor shall not unreasonably withhold such consent.
9. **Default.** If Lessee defaults under this agreement and such default is not cured by Lessee within forty-five (45) days after written notice by Lessor to Lessee of such default, Lessee shall pay all costs Lessor incurs in enforcing this agreement, including reasonable attorney's fees.
10. **Time.** Time is of the essence in this agreement.
11. All express or implied covenants of this Lease shall be subject to all Federal and State Laws, Executive Orders, Rules or Regulations, and this Lease shall not be terminated, in whole or in part, nor Lessee held liable in damages for failure to comply therewith if compliance is prevented by, or if such failure is the result of, any such Law, Order, Rule or Regulation. Any delay or interruption caused by storm, flood, act of God or other event of force majeure shall not be counted against Lessee. If, due to the above causes or any cause whatsoever beyond the control of Lessee, Lessee is prevented from conducting operations hereunder, such time shall not be counted against Lessee, and this Lease shall be extended for a period of time equal to the time Lessee was so prevented, anything in this Lease to the contrary notwithstanding.
12. **Indemnification.** Lessee will indemnify and hold Lessor, its officers, directors, employees, agents, successors and assigns (hereafter collectively referred to as "Indemnified Parties") harmless from any and all claims, demands, suits, losses, damages, and costs (including, without limitation, any attorney fees) incurred by the Indemnified Parties which may be asserted against the Indemnified Parties by reason of or which may arise out of or which may be related to Lessee's activities on the leased premises (including, without limitation, any claims by any owners or lessees of minerals that Lessee's operations hereunder are either illegal, unauthorized, or constitute an improper interference with their rights).
13. **Compliance with law.** All operations and activities conducted by Lessee under the terms of this agreement shall be in accordance with existing local, state and federal laws, rules and regulations.
14. **Release.** To the maximum permitted by law, Lessee releases, waives and discharges Lessor, its officers, directors, employees, agents and assigns from any and all liabilities or claims for personal injury, death, property damage, or otherwise arising out of Lessee's operations under this agreement or use of the leased premises.
15. **Notice.** Notice may be given to either party to this agreement by depositing the same in the United States mail, postage prepaid, by certified mail, duly addressed to the other party at the address set out above. Such notice shall be deemed delivered when so deposited in the United States mail.
16. **Applicable law.** This agreement shall be construed under the laws of the State of Wyoming. Both

parties have participated in the drafting of this agreement and the terms of this agreement shall not be more strictly construed against either the Lessor or the Lessee.

17. **Shut-In Clause.** If Lessee shuts in any gas well because the Lessee is unable to market the gas produced from that well, Lessee shall pay Lessor the sum of \$500.00 for each such well. The payment shall be made within 60 days after Lessee shuts in such well. If such payment is made, such well shall be considered to be a well capable of producing gas in paying quantities from the well unit on which the shut-in well is located, and the shut-in gas well payment shall extend the lease as to and only as to the lands within the well unit on which the shut-in well is located; provided, however, this lease may not be extended by the payment of shut-in gas well payments for more than two years beyond the primary term. Notwithstanding any other provision of this paragraph, if, while this lease is being maintained in force and effect by the shut-in gas well payment, gas is marketed from a well on the above described lands that is situated within 2000 feet of the shut-in well and completed in the same producing strata as the shut-in well, the right to extend this lease shall cease and the lease shall remain in force and effect as to the well unit in which the shut-in well is located by virtue of the shut-in well payment only for three months from the date gas from the well within 2000 feet of the shut-in well commenced to be marketed. Nothing in this paragraph shall relieve Lessee of the obligation of reasonable development or of the obligation to protect the leased premises against drainage.

18. **Date.** This lease is dated as of March 15, 2007, which shall be deemed to be the date of this lease.

X Kelly Constance Hurley
Kelly Constance Hurley

Kelly Constance Briggs Hurley

X STATE OF Minnesota)
COUNTY OF St. Louis)§

X The aforesaid oil and gas lease was acknowledged before me this 8th day of June, 2007, by
Kelly Constance Hurley, dealing in her sole and separate property

X Witness my hand and official seal.

My Commission Expires: 1-31-2010

