

THE ROYALTY ESTATE

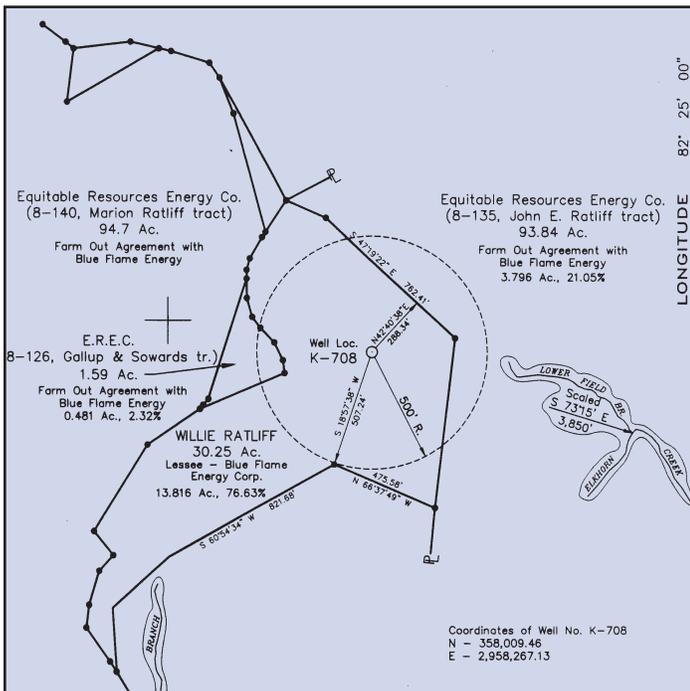
American law pertaining to ownership of land is largely based on English Common Law, under which land has been granted to individuals for more than 800 years. In the 18th century, the King of Spain granted land to settlers of North and South America, but retained rights to 1/5th of all production from mines developed on these lands (a share of production for “royalty”).

Under current U.S. Law, land ownership is three dimensional. The land owner (fee simple owner) of a tract of land holds the right to use, occupy and enjoy the surface of the land and the air space above it (surface rights), plus all rights to minerals beneath it (mineral rights). The fee-simple owner may divide (sever) the rights to his land. In the case of severance, the surface rights and the mineral rights become two separate and distinct estates. The mineral owner holds the exclusive right to explore for and to produce oil or gas or other minerals from his property. Instead of undertaking production of these minerals himself, he may lease or sell these mineral rights to another party. An oil and gas lease agreement creates two specific interests: a royalty interest and a working interest. The royalty interest is the right to a cost free share of the proceeds resulting from production of oil or gas. In most states, royalty interests are expressed as a fractional part of the whole, 1/8th or 3/16th's for example. The working interest is the exclusive right to explore for and produce oil and gas on the tract of land covered by the lease and includes the obligation to pay 100% of the costs of exploration and production of any oil or gas found.



Left to Right: L. Buettner - Pres., WILLIE RATLIFF – ROYALTY OWNER, K. Hall – Land Manager and J. Hallberg – Investor.

In the Big Sandy Gas Field, Blue Flame Energy’s holdings consist of approximately 15,000 acres comprised of many, many different mineral estates. Competing with major corporations, dealing with government bureaucracies, engineering technicalities, sub-contractor networks and drilling multiple wells, it is easy to overlook the human element that is a very important part of on-going gas field developments. One field success involves the story of Willie Ratliff and his 30.25 acres which comprises the majority of a single wellsite called K-708 (see survey sample). Willie Ratliff (see photo), a 96 year old, life long resident of Pike County, Kentucky, living on a fixed income, repeatedly withheld his mineral lease from development for decades. Due to a bad experience with a logging company that took advantage of him years before, Willie remained skeptical of any new business proposals affecting his property. After multiple visits and extensive assurances by Ken Hall, our local staff landman, Willie Ratliff agreed to have us drill a well on his property. The K-708 wellsite (featured article in *Oil & Gas Investor*, *Bull & Bear Financial Report* and *Dwights Petroleum Info.*), came in as a *flowin’ and goin’* big gas well. This well was part of a package designed for our investors. The monthly checks to the royalty estate, off that single wellsite, are expected to generate cashflow for decades. Congratulations Willie!



Wellsite survey/location map details mineral boundaries/ownership. Blue Flame Energy is our Kentucky land management company and as lessee of a wellsite controls 100% of operations and revenues, less royalty burdens.