

SETTLEMENT AGREEMENT

This Settlement Agreement ("Agreement") which satisfies disputed claims against Pennaco Energy, Inc., and Marathon Oil Company (collectively "Pennaco") is made between Designated Class Representatives ("Plaintiffs") acting on behalf of the Plaintiffs in the suit identified below, and Pennaco this 10th day of November, 2003.

RECITALS

WHEREAS, Plaintiffs have filed suit against Pennaco in Wyoming State District Court for Campbell County ("Court"), Civil Action No. _____, (as severed from Civil Docket No. 23706) alleging private claims and class action claims seeking, among other things, declaratory, injunctive, compensatory and other relief ("Class Suit");

WHEREAS, Pennaco has leased lands and/or produced natural gas and associated hydrocarbons from coal bed seams ("Shallow Gas") in wells within Campbell County, Johnson County and Sheridan County, Wyoming, and may drill further wells in these counties after the effective date of this Agreement;

WHEREAS, Pennaco paid and will pay royalties and/or overriding royalties and/or other non-cost bearing interests to specific payees set forth in Exhibit A ("Royalty Payees") for such Shallow Gas produced from wells in which Pennaco operates, owns an interest or disburses proceeds ("Royalties" or "Royalty");

WHEREAS, Pennaco entered into or obtained leases covering lands in the aforementioned counties which have not produced as of the Effective Date, but upon production being obtained would require the payment of future Royalties to the owners listed on Exhibit B ("Future Lease Payees");

WHEREAS, Plaintiffs derived their royalty and overriding royalty interests from Producers 88 Paid Up lease forms, variations thereof or other written instruments which do not expressly contain language altering the definitions of royalty and overriding royalty provided in Wyoming Statute Section 30-5-304;

WHEREAS, Plaintiffs have made claims in the Class Suit against Pennaco for the insufficient payment of Royalties and alleged violations of the *Wyoming Royalty Payment Act*, Wyo. Stat. §§ 30-5-301 to 30-5-305, arising from alleged improper deductions from Royalties for costs of production as defined by that *Act*, including, without limitation, the cost, expense or value of fuel consumed or services performed by Pennaco or various third parties for the gathering and/or transportation, compression, pressuring, dehydration or separation between the wellhead and the outlet of the Big Horn/Bear Paw pipeline segment ("Disputed Deductions");

WHEREAS, Plaintiffs have made claims in the Class Suit against Marathon and Pennaco for alleged interest due to Plaintiffs for non-payment of the Disputed Deductions pursuant to Wyoming law, including without limitation Wyo. Stat. § 30-5-303(a) ("Interest");

WHEREAS, Plaintiffs have made claims in the Class Suit against Marathon and Pennaco for amounts due for failure to account for and report Disputed Deductions and other information under Wyoming law, including without limitation Wyo. Stat. § 30-5-303(c) (“Reporting Assessments”);

WHEREAS, Plaintiffs have made claims in the Class Suit against Marathon and Pennaco to recover all court costs and reasonable attorney’s fees incurred in the Class Suit to prosecute individual and class claims, including those provided in Wyo. Stat. § 30-5-303(b) (“Attorney’s Fees”);

WHEREAS, Plaintiffs intend to seek certification of a class, including Plaintiffs, under Wyo. R. Civ. P. 23(b)(2) for declaratory and injunctive relief, and a class under Wyo. R. Civ. P. 23(b)(3) for money damages allegedly due to Royalty Payees arising from Disputed Deductions, Interest, Reporting Assessment, Attorney’s Fees and Under-valuation Claims allegedly owed by Pennaco to Royalty Payees;

WHEREAS, Plaintiffs contend that Royalties have not been properly valued, paid or reported;

WHEREAS, Pennaco contends that it has fairly and properly valued and paid royalties to the Royalty Payees based upon the fair market value proceeds for its production and sales of Shallow Gas and believes that it has fully complied with its reporting obligations;

WHEREAS, Pennaco denies all of the allegations in the Class Suit and denies that it has violated the *Wyoming Royalty Payment Act*, or violated any other law or breached any contract or other agreement with or obligation owed to the Royalty Payees, and denies any and all liability for the claims the Plaintiffs and Royalty Payees allege;

WHEREAS, all parties to this litigation recognize that they will expend substantial resources in continuing this litigation;

WHEREAS, the Parties desire to settle and resolve all past claims so that the Plaintiffs and the Settlement Class Members are bound by a release of past claims against Pennaco associated with its valuation, measurement, payment and reporting of Royalties to the Royalty Payees for production from Pennaco wells;

WHEREAS, the Parties also desire by this Agreement to establish Royalty valuation and reporting requirements to govern future Royalties so as to eliminate future conflict or litigation over Royalty payment and reporting, and which will be binding on the Parties and on the Settlement Class Members as to future Royalties paid by Pennaco for Shallow Gas produced in Campbell, Johnson and Sheridan Counties, Wyoming;

WHEREAS, Pennaco has or will likely pay Royalties pursuant to various agreements, Producer 88 leases, royalty conveyances, instruments or other writings that

grant or reserve or create or define the royalty or overriding royalty interests or non-cost bearing interests owned by the Plaintiffs, the Royalty Payees and Future Lease Payees (collectively “Instruments”);

WHEREAS, the Class Suit raises disagreements between the Parties concerning the meaning of the royalty provisions of the Instruments, and concerning the meaning and/or application to those Instruments of definitions contained within the *Wyoming Royalty Payment Act*;

WHEREAS, for future purposes, the Parties wish to agree on a Royalty payment methodology that shall apply to all of Pennaco’s future Royalties to be paid to the Settlement Class Members for Shallow Gas produced from wells, whether existing or subsequently drilled, in the aforementioned three counties in which Pennaco pays Royalties and which the Parties have agreed will satisfy the requirements of the Instruments and the *Wyoming Royalty Payment Act* regardless of any variations in the terms and provisions of the Instruments; and

WHEREAS, the Parties wish to establish a format by which Pennaco may report such future Royalties without risk of incurring future Reporting Assessments using a reporting format to be called the Future Royalty Reporting Format as defined in this Agreement;

NOW, THEREFORE, for good and valuable consideration between Pennaco and the Plaintiffs and Settlement Class Members as provided in this Agreement and in consideration of the foregoing Recitals which are substantive provisions hereof, the Parties agree as follows:

1. DEFINITIONS

The following definitions shall apply solely for purposes of this Agreement and any pleadings, motions or documents used to implement this Agreement:

1.1 “Administration Costs” shall mean all actual costs which Plaintiffs’ counsel will incur in administering the settlement, including, among others, responses to inquiries, expenses for printing and mailing the Settlement Class Notice, for producing and mailing Distribution Checks payable to Settlement Class Members, and for producing and mailing form 1099 tax information.

1.2 “Approval Event” shall mean the earliest date on which all of the following conditions are met:

1.2.1 Settlement Class Notice has been provided to Potential Settlement Class Members by mail or as the Court may otherwise determine is appropriate;

1.2.2 The Settlement Order and Judgment approving the terms of this Agreement has been entered; and

1.2.2.1 The time for appeal of any objections to the Settlement Order and Judgment has expired without appeal; or

1.2.2.2 The Settlement Order and Judgment has been affirmed following any appeal by an objecting party. In the event such an appeal is filed but on grounds which the Plaintiffs and Pennaco agree should not preclude completion of the settlement, they may agree in writing to waive this Paragraph 1.2.2.2 and consider the Approval Event to have occurred.

1.3 **“Attorney’s Fees Claims”** shall mean claims Attorney’s Fees as defined in the Recitals. The term does not include Attorney’s Fees for future benefits procured for Settlement Class Members, and no claim is or will be made for Attorney’s Fees for such future benefits.

1.4 **“Designated Class Representatives”** shall mean Patsy Larson, Middle Prong Land & Livestock, L.P. acting through Joy Voiles, and Duane Odegard, and such persons from the named Plaintiffs as they may designate to act on their behalf.

1.5 **“Disputed Deductions”** shall have the meaning set forth in the Recitals.

1.6 **“Distribution Check”** shall mean a check, with Endorsement Language, payable to a Settlement Class Member to accomplish distribution of the net amount that is payable to such Settlement Class Member pursuant to this Agreement.

1.7 **“Distribution Date”** shall mean the date of the Distribution Check payable to each Settlement Class Member.

1.8 **“Endorsement Language”** shall be the release language contained on each Distribution Check to a Settlement Class Member which states: “In full accord, satisfaction and payment in full for Payee’s Settled Claims as Settled Claims are defined in the Settlement Agreement with Pennaco Energy, Inc. and for the future undertakings provided in Paragraph 2.10 of the Settlement Agreement. A copy of the Settlement Agreement and Notice of Proposed Class Action Settlement may be obtained from Class Counsel, Freudenthal, Salzburg & Bonds, P.C., 123 East 17th Street, P.O. Box 387, Cheyenne, WY 82003-0387.”

1.9 **“Future Gas Royalty Claims”** shall mean all claims for Disputed Deductions, Interest, and Attorney’s Fees for Royalties paid to Settlement

Class Members attributable to Shallow Gas produced after November 30, 2003.

1.10 “Future Royalty Payment Methodology” shall mean the following:

1.10.1 For Shallow Gas produced subsequent to November 30, 2003, from wells, whether existing or subsequently drilled, for which Pennaco pays Royalties after November 30, 2003 production, Future Royalty Payment Methodology shall mean: Royalties paid on the arm's-length sales price(s) received by Pennaco for the Shallow Gas, less the actual costs (i.e., monetary charges, fuel, etc.) incurred or paid to unaffiliated third parties for transporting, processing and marketing the production of Shallow Gas (“Allowed Costs”) from the exit of the first pipeline segment (e.g. Bear Paw/Big Horn pipeline) (“Market Point”). For purposes of this settlement, the first pipeline segment consists of all activity in moving the gas from the well through a pipeline or to a point where single-stage screw compression, second stage reciprocating compression, and dehydration has been performed (“Market Point”). By way of example, and subject to Paragraph 1.10.2 Royalties would be free of all costs from the well through the first pipeline segment (e.g., Bear Paw/Big Horn), but then bear their proportionate share of all Allowed Costs from the Market Point or entry into subsequent pipeline segments (e.g., Fort Union, Thunder Creek and other pipelines) to the end point of sale. The Settlement Class Members will bear their proportionate share of taxes, however, they will not receive any tax benefits or credit associated with the costs or expenses they do not bear. If Pennaco does not have an arm's-length sale for particular transaction(s), the sales price for royalty purposes shall be based upon arm's-length sale(s) for the applicable month that are obtainable, comparable in terms of quality and quantity, and in closest proximity to the Market Point. Comparable arm's-length sales price shall be less any Allowed Costs applicable to the specific arms-length transaction that is utilized. If in the future Pennaco does not have an arm's-length arrangement for any services permitted as an Allowed Cost, the cost of such service for royalty purposes shall be based upon the cost of comparable third party services in the same location which are available and enable the gas to be sold at the point of sale.

1.10.2 The future payment of Royalties referenced in Paragraph 2.4 shall be based on well head production volume less gas used, lost, flared, vented or consumed on or for the benefit of the lease, which occurs from the well head through the operation of the first screw compressor (“Primary Measurement Point”). Gas used, flared,

vented or consumed between the Primary Measurement Point and the Market Point shall not be deducted for purposes of calculating Royalties. Volume on which Royalties shall be paid will be further reduced pro rata by amounts used or dollar charges measured by MMBTU used in the transportation of the Shallow Gas from the Market Point to the point of sale.

1.10.3 Royalties paid to Settlement Class Members will be increased by a bonus equivalent to \$.03 per MMBTU of the Settlement Class Member's proportionate share of sales for each month when the Pennaco weighted average sales price, prior to any Allowed Costs, exceeds \$2.70 per MMBTU ("Bonus"). Upon prior written notice to the Settlement Class Member, the \$2.70 per MMBTU price threshold, which triggers the gas bonus, can be adjusted by Pennaco by the amount of the increase in the Allowed Costs when the Allowed Costs increase ten percent (10%) or more from the current weighted average costs of \$.80 per MMBTU.

1.11 "Future Royalty Reporting Format" shall mean the reporting of Royalties paid to Settlement Class Members according to the following content and format:

Pennaco will report to Settlement Class Members with a monthly check stub or remittance substantially in the same form and content shown on Exhibit E. The "Gas Credit" shown on Exhibit E will consist of the Bonus and reimbursements for any costs charged prior to the Market Point. The Future Royalty Reporting Format shall be implemented within four (4) months from the Approval Event. In the event of a transfer, the Future Royalty Reporting Format may vary in form provided the substantive content of information reported remains the same.

1.12 "Gas Royalty Claims" shall mean those claims for royalty payments for production from the inception of production commencing on or after January 1, 1998 through November 30, 2003, inclusive, including, but not limited to, Under-valuation Claims and Disputed Deductions.

1.13 "Interest" shall have the meaning found in the Recitals and includes all interest imposed under Wyoming law.

- 1.14 **“Opt-Out Claimant”** shall mean a Potential Class Member who submits a timely and valid request for exclusion of their particular identified lease(s) in accordance with the Order of Preliminary Approval and the Notice of Proposed Class Action Settlement, and who does not revoke that request for exclusion from the Settlement Class in writing prior to the Settlement Hearing. Such requests for exclusion must apply to all of that Opt-Out Claimant’s interest in all lease(s) containing the same or similar terms.
- 1.15 **“Opt-Out Claims”** shall mean those Settled Claims that belong to Opt-Out Claimants. Opt-Out Claims are not settled by this Agreement
- 1.16 **“Parties”** shall mean Marathon, Pennaco and Plaintiffs.
- 1.17 **“Pennaco Suit”** shall mean all individual claims and Settlement Class Claims as alleged in the Class Suit against Marathon and Pennaco.
- 1.18 **“Potential Class Members”** shall mean those Royalty Payees and/or Future Lease Payees identified in either or both of Exhibits A and B.
- 1.19 **“Preliminary Approval Hearing”** shall mean the hearing to be held before the Court on or about November 10, 2003, to determine (a) whether this Agreement, including the Exhibits, should be provisionally approved as fair, adequate and reasonable; (b) whether the Settlement Class and any subclasses should be provisionally certified; (c) whether the form of the Notice of Proposed Class Action Settlement should be approved and mailed to the Potential Class Members; and (d) any other matter necessary to effectuate the terms of this Agreement.
- 1.20 **“Preliminary Approval Order”** shall mean the order in a form similar to Exhibit C entered by the Court after the Preliminary Approval Hearing provisionally certifying the Settlement Class, approving the form of the Notice of Proposed Class Action Settlement and directing that notices be mailed to the Potential Class Members as soon as practicable.
- 1.21 **“Reporting Assessments”** shall have the meaning found in the Recitals.
- 1.22 **“Reporting Claims”** shall mean all claims, whether in tort or contract or under statutes, or regulations or other authority, and whether equitable or arising under common law, held by Settlement Class Members and associated with Pennaco’s past reporting of Royalties, including without limitation such claims for Reporting Assessment that were or could have been alleged for violations of the reporting requirements of the *Wyoming Royalty Payment Act*, including those specifically provided in Wyo. Stat. § 30-5-305(b).

- 1.23 **“Royalties” or “Royalty”** shall have the meaning found in the Recitals.
- 1.24 **“Settled Claims”** shall mean all claims, arising out of (a) Gas Royalty Claims, whether known or unknown; (b) Future Gas Royalty Claims provided that Paragraph 2.4 has been complied with, whether known or unknown; (c) Reporting Claims for all future time periods (provided that Paragraph 2.4 has been complied with) and past time periods whether known or unknown; (d) Interest (provided that Paragraph 2.4 has been complied with); and (e) Attorney’s Fees Claims (provided that Paragraph 2.4 has been complied with), whether known or unknown; excluding any future clerical errors by Pennaco in accounting for the volume, deductions, price, value or decimal interests.
- 1.25 **“Settlement Amount”** shall be Six Million Nine Hundred Twenty-Six Thousand Dollars (\$6,926,000.00) for settlement of all past alleged royalty deficiencies, including without limitation, Disputed Deductions, Under-Valuation Claims, Interest, Reporting Assessments, Attorney’s Fees and Administration Costs, and shall be allocated as follows:
- 1.25.1 Five Million Eight Hundred Eighty-Seven Thousand One Hundred Three Dollars (\$5,887,103.00) to be distributed to Plaintiffs and Settlement Class Members as provided herein;
- 1.25.2 One Million Thirty-Eight Thousand Eight Hundred Ninety-Seven Dollars (\$1,038,897.00) for Attorney’s Fees and Administration Costs, provided that such amount shall not exceed fifteen percent (15%) of the amount specified in 1.25.
- 1.26 **“Settlement Class”** shall mean Settlement Class Members including without limitation the Plaintiffs.
- 1.27 **“Settlement Class Claims”** shall mean Settled Claims allegedly due to Settlement Class Members.
- 1.28 **“Settlement Class Members”** shall mean Potential Class Members other than Opt-Out Claimants.
- 1.29 **“Settlement Class Notice”** shall mean that notice as approved by the Court at the Preliminary Approval Hearing pursuant to Wyo. R. Civ. P. 23(c)(2) and to be mailed to Potential Class Members.
- 1.30 **“Settlement Hearing”** shall mean that hearing held by the Court on or about December 31, 2003, after the Preliminary Approval Hearing and the mailing of the Settlement Class Notice at which the Plaintiffs shall request the Court, pursuant to Wyo. R. Civ. P. 23(c)(1) to determine that: (i) the terms of this Agreement, including the Exhibits and distribution to

Settlement Class Members, are fair, adequate, and reasonable; (ii) the Settlement Classes should be finally certified; (iii) the Settlement Order and Judgment should be entered; and (iv) the application of Class Counsel for Attorney's Fees should be approved.

- 1.31 "Settlement Order and Judgment"** shall mean the order and judgment to be entered after the Settlement Hearing on December 31, 2003, and pursuant to Wyo. R. Civ. P. 23(d), finding that the Settlement Class Members are bound by the settlement approved by the Court; finding that the Settlement Class should be finally certified; approving the terms of the settlement as set forth in this Agreement; entering judgment as to the composition of the Settlement Class; and approving Class Counsel's application for Attorney's Fees to be paid from the Settlement Amount. The Plaintiffs and Pennaco agree that the "Settlement Order and Judgment" entered pursuant to this Agreement shall be a Final Judgment as defined by Wyo. R. Civ. P. 54(b), and further agree that the form of order will so provide for entry of final judgment as to disposition of the Settled Claims and approved expenses in accordance with Rule 54(b).
- 1.32 "Uncashed Settlement Class Members"** shall means those Settlement Class Members, if any, whose Distribution Checks are not endorsed and presented to payor banks within 180 days after the Distribution Date.
- 1.33 "Under-valuation Claims"** shall mean all claims of any nature, whether in tort or contract or arising under statutes, regulations, or other authority, and whether equitable, legal or arising under any other legal authority or common law, which Plaintiffs or the Settlement Class asserted or could have asserted in the Class Suit and associated with either (1) the royalty value and measurement of any and all Shallow Gas produced from wells for which Pennaco paid or pays Royalties to Settlement Class Members, or (2) Disputed Deductions allegedly taken from the Royalties they paid to Settlement Class Members.

Any defined terms contained in this Agreement are incorporated by reference in this Paragraph 1 ("Definitions") unless otherwise defined in the Definitions.

2. SETTLEMENT

The parties agree to the settlement and release of all Settled Claims, whether or not pled or alleged against Pennaco, under the following terms and conditions:

2.1 Preliminary Approval Hearing; Determination of Portion of Total Settlement Amount Due to Settlement Class Members

The Parties agree (i) no other parties except Settlement Class Members and Pennaco will be bound by holdings made in the Pennaco Suit to effectuate this Agreement and Pennaco shall be bound only as to those matters related to the Settled Claims for wells on which Pennaco paid or will pay Royalties; and (ii) the formation of a Settlement Class for the Settled Claims is not and shall not be construed or used as an admission regarding any fact or any substantive or procedural issue.

Pennaco and Plaintiffs agree to an order stipulating that Pennaco shall provide tax identification numbers to the extent available of all Potential Class Members. Pennaco shall provide the last known address, tax identification numbers for Royalty Payees and internal owner numbers for Potential Class Members maintained in its corporate records to Plaintiffs' Counsel as soon as reasonably practicable but no later than the Approval Event.

Pennaco shall provide Settlement Class Member names, addresses, ownership information, accounting information, sufficient data and supporting documentation (in both hard copy and usable electronic form) for Class Counsel to administer this settlement and calculate the allocation of settlement proceeds to Settlement Class Members. Class Counsel shall have the right to inspect, review and confirm all data and documentation provided by Pennaco, subject to the June 23, 2003, Confidentiality Agreement, except to the extent required by the Court to evaluate the Settlement Agreement.

Prior to the Settlement Hearing, the Parties shall consult upon the amounts to be paid to each of those Potential Class Members but the Plaintiffs and Class Counsel shall make the final determination of those amounts, subject to the approval of the Court.

Notwithstanding anything to the contrary, Plaintiffs and Pennaco hereby agree and acknowledge that this Agreement and any of its terms shall not be admissible, estop or be used by either party in this proceeding or others for any purpose other than to carry out this settlement. Pennaco shall not be estopped or precluded in any way from contesting the appropriateness or manageability of a class or certification of a class for any purpose other than to carry out this settlement.

2.2 Permissible Attorney's Fees; Payment

Plaintiffs represent to Pennaco that the portion of the Settlement Amount identified in Paragraph 1.25.2 shall pay all Attorney's Fees, costs and expenses of administering this settlement subject to approval of this Agreement by the Court as embodied in the Settlement Order and Judgment.

2.3 Pennaco's Obligation to Pay Settlement Amount

Pennaco shall deposit the Settlement Amount, less any portion of said amount attributable to Opt-Out Claimants, by wire transfer to a trust account designated by Class Counsel within two business days of the occurrence of (a) the Approval Event, and (b) receipt of written notice from Class Counsel that Distribution Checks are ready to be mailed to Settlement Class Members. Interest earned on the Settlement Amount, if any, shall be treated as interest earned on an IOLTA account and distributed accordingly. In no event, shall Class Counsel receive or benefit from any interest earned on such account. Upon receipt of Pennaco's wire transfer of the net Settlement Amount, Pennaco shall have complied with its obligations as to past Settled Claims.

Plaintiffs' Counsel will provide Pennaco, within five (5) days after entry of the Settlement Order and Judgment, with an itemization of the portions of the Settlement Amount attributable to Opt-Out Claimants. Within 240 days after the Distribution Date, any amounts attributable to Uncashed Settlement Class Members shall be paid to the State of Wyoming pursuant to the Wyoming Uniform Unclaimed Property Act, Wyo. Stat. § 34-24-101, et seq. A list of Uncashed Settlement Class Members shall be provided to Pennaco by Class Counsel within 260 days after the Approval Event.

2.4 Future Claims and Proceedings

2.4.1 Payment of Royalties to Settlement Class Members for Shallow Gas Produced After November 30, 2003.

For Shallow Gas produced after November 30, 2003, Pennaco agrees to pay Royalties to Settlement Class Members on the Future Royalty Payment Methodology with the following conditions:

2.4.1.1 Pennaco and Plaintiffs acknowledge that Pennaco needs to make system changes to accommodate the new accounting methodology. For the production periods commencing December 1, 2003 through 120 days following the Approval Event, Marathon and Pennaco may pay according to its present methodology but shall make prior period adjustments within the 120 days following the Approval Event to conform payments for those periods to the Future Royalty Payment Methodology.

2.4.2 Reporting of Royalties to Settlement Class Members for Shallow Gas Produced After November 30, 2003.

For Shallow Gas produced after November 30, 2003, Pennaco agrees to report Royalties to Settlement Class Members within the time period provided in Paragraph 2.4.1 and according to the Future Royalty Reporting Format.

2.4.3 Acceptance of Royalty Valuation Methodology and Reporting Format.

Plaintiffs and Settlement Class Members, for themselves and their heirs, successors and assigns agree that the payment and reporting of future Royalties according to the Future Royalty Payment Methodology and Future Royalty Reporting Format, if adhered to by Pennaco and reported accurately, shall fully satisfy Pennaco's legal obligations to Plaintiffs under all Instruments, statutes and case law, with respect to Pennaco's payment and reporting of Royalties.

After the Approval Event, Pennaco may, at its own option and expense, file a copy of the Settlement Order and Judgment, including this Agreement and all Exhibits, and may also file at its sole election and expense a short form of notice of the Settlement Order and Judgment with the appropriate County Clerk and Recorder, accompanied by the legal descriptions of the lands subject to leases or overriding royalty interests under which Pennaco paid, pays or will pay Royalties to Settlement Class Members, and which includes a reference to the Settlement Order and Judgment in the Court's docket, in order to assure notice of this Agreement to successors and assigns of the Parties.

2.4.4 Disputes Arising Out of Obligation Imposed By Paragraph 2.4.2 For Shallow Gas Produced After November 30, 2003.

For Shallow Gas produced after November 30, 2003, Pennaco and Plaintiffs agree the Court shall retain jurisdiction over the Parties, Settlement Class Members and their heirs, successors and assigns, to resolve any disputes arising out of the Parties' future undertakings pursuant to this Paragraph 2.4.

2.5 Entry of Settlement Order and Judgment

Plaintiffs and Plaintiffs' Counsel acknowledge that they will take all steps necessary, individually and jointly, to obtain entry of (1) the Preliminary Approval Order with respect to the Settled Claims and (2) the Settlement Order and Judgment on the Settled Claims for the Class Suit. The parties further agree that upon the Approval Event and wire transfer of the net

Settlement Amount they shall stipulate to and cooperate to obtain an Order of Dismissal with Prejudice of the Settled Claims substantially in the form of Exhibit D.

2.6 Request for Exclusion by Potential Class Members

Any Potential Class Member may request not to participate as a Settlement Class Member by submitting a timely request for exclusion in accordance with the Preliminary Approval Order and the Notice of Proposed Class Action Settlement, provided however, a Potential Class Member who elects to opt-out must opt-out as to all of that Opt-Out Claimant's interest in all lease(s) containing the same or similar terms.

2.6.1 Any Potential Class Member who submits a timely request for exclusion, and who does not revoke that request for exclusion in writing prior to the Settlement Hearing, is an Opt-Out Claimant. An Opt-Out Claimant is deemed to have waived any and all claims to any part of Pennaco's Payable Settlement Amount attributable to those opt-out claims.

2.6.2 A Potential Class Member who submits a timely request for exclusion, but who thereafter revokes that request for exclusion in writing prior to the Settlement Hearing, will be deemed to be a Settlement Class Member and not an Opt-Out Claimant.

2.6.3 Pennaco may, at its option, terminate this Agreement without liability prior to the Settlement Hearing if: (i) the number of Opt-Out Claimants is 10% or greater of the number of Royalty Payees on Exhibit A; or (ii) the portion of the Settlement Amount attributable to all of the Opt-Out Claimants is five percent (5%) or more of the portion of the Settlement Amount listed in Paragraph 1.25.1. Any election to terminate under this Paragraph shall be in writing and provided to Plaintiffs Counsel within three (3) days of Pennaco being provided the final Opt-Out under Paragraph 2.6.7.

2.6.4 The Plaintiffs agree to (i) participate as Settlement Class Members; (ii) not request exclusion; (iii) not object to the Court's approval of this Agreement; and (iv) affirmatively present their support for final judicial approval of this Agreement.

2.6.5 Neither Plaintiffs, Class Counsel, Pennaco nor Pennaco's Counsel shall in any way encourage or counsel any Potential Class Members to opt out of the class, object to the class, appeal from an order approving the class or seek to reduce the size of the class except as to those persons identified in writing between Class Counsel and Pennaco's counsel.

2.6.6 Plaintiffs and Pennaco waive any right to appeal or collaterally attack the Settlement Order and Judgment.

2.6.7 By December 22, 2003, Class Counsel and Pennaco shall exchange with one another by telefacsimile a list of all objections and requests to opt out of the Settlement Class which have been received from Potential Class Members.

2.7 Exclusion of Other Working Interest Owner Royalty Payees

In regards to Royalty Payees for which Pennaco remitted on behalf of other working interest owners, Pennaco will provide Plaintiffs' counsel with a list of any Royalty Payees for which their respective lessees did not elect to participate in the terms of this Settlement Agreement ("Excluded Payees"). The list of Excluded Payees will be provided in writing on or before December 22, 2003, and specify whether the respective payee is excluded entirely from the Settlement Class or just in respect to future claims and proceedings as described in Paragraph 2.4.

2.8 Entry of Judgment

With the exception of Pennaco's agreements as to future payment and reporting of Royalties to Settlement Class Members and the Parties' and Settlement Class Members' agreements to be bound by same, it is intended that the Settlement Order and Judgment shall provide with respect to all Settled Claims, that Pennaco's liability for the Settled Claims shall be extinguished.

2.9 Future Events

As to Settlement Class Members, the parties agree that Pennaco shall pay and report Royalties to Settlement Class Members according to the Future Royalty Payment Methodology and the Future Royalty Reporting Format for all Shallow Gas production after November 30, 2003 as provided in this Agreement regardless of whether the Wyoming Supreme Court subsequently rules or the Wyoming Legislature subsequently clarifies or amends the provisions of the *Wyoming Royalty Payment Act* concerning the payment or reporting of Royalties.

2.10 Release of Settled Claims and Agreement to Be Prospectively Bound

Following the Approval Event, and upon Pennaco's payment of the net Settlement Amount as provided in Paragraph 2.3, Plaintiffs, and each member of the Settlement Class, and their respective heirs, assigns, trustees, executors, administrators and agents, agree:

2.10.1 They and each of them hereby release, acquit, hold harmless and forever discharge Pennaco and their parent, subsidiaries, affiliates, divisions, officers, directors, shareholders, employees, agents and attorneys to the fullest extent permitted by law, for and from any and all Settled Claims which they now hold, whether known or unknown, asserted or unasserted and which were or could have been asserted in the Class Suit. This release applies to all Gas Royalty Claims, including any costs, expenses or losses associated therewith and subject to compliance with Paragraphs 2.10.2 through 2.10.5, including Future Gas Royalty Claims.

2.10.2 The above release of Reporting Claims for Shallow Gas by each Settlement Class Member for gas produced after November 30, 2003, shall be effective only if and to the extent for those periods and Settlement Class Members that Pennaco substantially complies with the provisions of Future Royalty Reporting Format and Paragraph 2.4.2 of this Agreement for the affected accounting period and Settlement Class Member.

2.10.3 Settlement Class Members shall be bound prospectively by the Future Royalty Payment Methodology, provided Pennaco's payment of Royalties to those Settlement Class Members conforms to the Future Royalty Payment Methodology.

2.10.4 Settlement Class Members shall be bound prospectively by the Future Royalty Reporting Format provided Pennaco's reporting of Royalties to those Settlement Class Members conforms to the Future Royalty Payment Format.

2.10.5 The provisions of Paragraphs 2.10.3 and 2.10.4 shall be appurtenant to and run with the respective interests of Pennaco, Plaintiffs and the Settlement Class Members in the Shallow Gas produced or to be produced from the wells in which Pennaco pays Royalties to the Settlement Class Members.

2.11 Court's Settlement Orders

The Plaintiffs and Pennaco further agree, and the Court's order shall provide that:

2.11.1 As of the Approval Event, any Settlement Class Member who has not timely and properly opted out of the Class shall be deemed, by that fact, to have released Pennaco whether or not the Settlement Class Member endorses and presents a Distribution Check.

2.11.2 The foregoing release of the Settlement Class Claims made by Plaintiffs and Settlement Class Members is effective to release any interests or claims of Plaintiffs' Counsel against Pennaco with respect to the Settlement Class Claims and Settled Claims.

2.11.3 As of the Approval Event, Settlement Class Members shall be deemed, by that fact, to have agreed and accepted prospectively the provisions of Paragraphs 2.10.3, 2.10.4 and 2.10.5.

The release and agreements set forth herein shall constitute a full and complete defense to any action, claim or proceedings brought by any Settlement Class Members, and to the fullest extent permitted by law their heirs, successors and assigns for such claims, except for any action to enforce the terms of this Agreement.

3. EFFECT OF DISAPPROVAL

The Parties further agree as follows:

3.1 District Court Disapproval

If for any reason the Settlement Order and Judgment is not approved or entered by the District Court:

3.1.1 This Agreement shall terminate;

3.1.2 Any order(s) or judgment(s) entered pursuant to this Agreement shall be vacated;

3.1.3 The Class Suit against Pennaco shall proceed as if this Agreement and its terms, had never been executed; and

3.1.4 This Settlement Agreement, its terms and all negotiations relating thereto may not be used in this Class Suit, any other proceedings or otherwise for any purpose except to the extent necessary to enforce this Agreement.

3.2 Appeal Following District Court Approval

In the event that the Settlement Order and Judgment entered by the District Court is followed by an appeal taken by any Potential Class Members based upon an objection duly made to the Proposed Class Settlement, then:

3.2.1 Either Plaintiffs or Pennaco shall have the right in their respective discretion, to declare this Agreement terminated by written notice

to the other Party within twenty (20) days of the filing of such appeal, and if either Party does so, the provisions of 3.1.2 through 3.1.4 shall apply.

3.2.2 The Parties may agree to waive any unsatisfied condition for release of the Payable Settlement Sum and otherwise agree to consummate this Agreement if no stay of the Settlement Order and Judgment has been entered.

4. MISCELLANEOUS

4.1 For the purposes of this Agreement, any notice required or permitted to be given pursuant to this Agreement shall only be deemed to have been given if provided in writing by (i) personal delivery, (ii) certified mail, return receipt requested or (iii) overnight delivery (with delivery confirmation) addressed to the respective party at the address below:

Pennaco Energy, Inc.:

Frank D. Neville
Williams, Porter, Day & Neville, P.C.
159 North Wolcott, Suite 400
P.O. Box 10700
Casper, WY 82602-3902
(307) 265-0700
(307) 266-2306 (fax)

Kirby Iler, Legal Counsel
Marathon Oil Company
150 Stampede Avenue
Cody, WY 82414
(307) 527-2221
(307) 527-2216 (fax)

Plaintiffs/Class Counsel:

Steven F. Freudenthal
Freudenthal, Salzburg & Bonds, P.C.
123 East 17th Street
P.O. Box 387
Cheyenne, WY 82003-0387
(307) 634-2240
(307) 634-0336 (fax)

Howard M. Schrinar
509 Edward Drive
Cheyenne, WY 82009
(307) 631-3912

In addition to the above, the Parties agree that all notices shall be sent by facsimile to the fax numbers noted above (with receipt confirmed) in addition to the other required notice. The address for any party may be changed by providing notice in the same manner as set forth above.

4.2 Nothing in this Agreement shall be construed to create a partnership or other association between the Parties with respect to the actions contemplated in this Agreement.

4.3 This Agreement and the attached Exhibits set forth the entire agreement among the Parties concerning the Pennaco Settlement and the resolution of the claims asserted therein. This Agreement and the attached Exhibits are intended to be a fully integrated agreement of the Parties, and there are no covenants, promises, agreements, conditions or other understandings either oral or written with respect to the subject matter except as set forth in the Agreement. All previous covenants, promises, agreements, conditions or other understandings, either oral or written, with respect to the subject matter are deemed superseded by this Agreement. No subsequent amendments or alterations of the terms of this Agreement shall be valid unless made in writing and signed by the authorized representative of all the Parties. The following Exhibits referred to herein are incorporated by this reference and are made a part of the Agreement as though fully stated in the Agreement:

Exhibit A	-	List of Potential Class Members-Royalty Payees
Exhibit B	-	List of Potential Class Members-Future Lease Payees
Exhibit C	-	Form of Preliminary Approval Order
Exhibit D	-	Form of Dismissal of Marathon and Pennaco
Exhibit E	-	Format of Monthly Payment Stub Information

4.4 The Parties agree to execute documents or instruments as may be required and take whatever action may be reasonably necessary to effectuate the purpose and intent of this Agreement.

4.5 This Agreement shall be binding upon and inure to the benefit of the Parties, the Settlement Class Members and their respective successors and assigns.

4.6 The waiver by any Party to this Agreement of the breach of any provision shall not constitute a waiver of any subsequent breach of the same or any other provision.

4.7 The Parties have entered into this Agreement after investigation of the facts, examination of the respective claims, controversies and disputes (whether asserted or unasserted) and defenses, due consultation with counsel and other experts, have read and fully understand the terms of this Agreement, and are fully advised and satisfied with the terms of the settlement and release and represent that the person signing on behalf of each such party has full authority to bind such party to the terms set forth herein.

4.8 The Parties agree that the settlement embodied in this Agreement, and all actions taken pursuant hereto, is made to compromise and settle the Settled Claims without further limitation. It is not and shall not be

interpreted as an admission of any liability or wrongdoing by Pennaco, nor shall it be construed as an admission of any strength or weakness in the Class Claims against Pennaco. Pennaco believes that it has properly paid and reported royalties in Wyoming, and Pennaco denies any wrongdoing or liability. No statement appearing in this Agreement or in any Exhibit to this Agreement or any other document to carry out the terms of this Agreement is, or should be interpreted as, an admission or statement against interest by Pennaco. This Settlement Agreement, its terms and all negotiations relating thereto shall not be used by any person in this Class Suit, any other proceedings or otherwise for any purpose except to the extent necessary to enforce this Agreement.

- 4.9** Prior to any Party or Settlement Class Member filing any suit, motion or action to enforce the terms of this Agreement, the Party shall give notice of any alleged breach or default to the other Party as set forth in Paragraph 4.1 and give that Party thirty (30) days within which to cure or resolve any dispute.
- 4.10** In the event of a dispute over the terms of this Agreement, the prevailing party shall be entitled to recover its reasonable attorney's fees and costs incurred in enforcing the provisions of the Agreement.
- 4.11** Each of the Parties shall bear its own costs, expenses, and attorney's fees in connection with this settlement and performance of the obligations imposed hereunder, except as otherwise specifically provided in this Agreement.
- 4.12** In construing this Agreement and in determining the rights of the Parties and Settlement Class Members, no Party shall be deemed to have solely drafted or created the Agreement.
- 4.13** This Agreement shall be governed by and construed in accordance with the laws of the State of Wyoming without regard to any conflict of laws principle that would cause this Agreement to be construed in accordance with the laws of any other State.
- 4.14** The Parties agree that the provisions of this Agreement are severable. If, following the Approval Event and distribution of checks hereunder, any provision of this Agreement is found to be void or unenforceable for any reason, the Parties' intend that such provision shall be severed and that all other provisions shall remain binding and enforceable.
- 4.15** This Agreement may be signed in original counterparts, and when so executed by each party shall for all purposes be considered an original.

4.16 The provisions of this Agreement shall, where possible, be interpreted in a manner to sustain their legality and enforceability.

Signed this _____ day of _____, 2003.

PENNACO ENERGY, INC.

By: _____
Title: _____

MARATHON Oil COMPANY

By: _____
Title: _____

PLAINTIFFS and DESIGNATED CLASS REPRESENTATIVES

PATSY LARSON; MIDDLE PRONG LAND & LIVESTOCK, L.P. ACTING THROUGH JOY VOILES;
AND DUANE ODEGARD

By: _____
Title: _____

By: _____
Title: _____

By: _____
Title: _____

All Exhibits referenced in this document may be reviewed as attachments to the Settlement Agreement on file at the Clerk of the District Court, Campbell County, Wyoming at 500 South Gillette Avenue, Suite 348, Gillette, Wyoming.