

SECURITIES & EXCHANGE COMMISSION EDGAR FILING

PEDEVCO CORP

Form: 10QSB

Date Filed: 2004-08-11

Corporate Issuer CIK: 1141197

Symbol: PED

SIC Code: 1382

Fiscal Year End: 12/31

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2004

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from to

333-64122

(Commission file number)

VERDISYS, INC.

(Exact name of small business issuer as specified in its charter)

California 22-3755993

(State or other jurisdiction (IRS Employer of incorporation or organization) Identification No.)

14550 Torrey Chase, Blvd., Suite 330

Houston, Texas 77014

(Address of principal executive offices)

(281) 453-2888

(Issuer's telephone number)

25025 I-45 North, Suite 525

The Woodlands, Texas 77380

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

The number of shares outstanding of each of the issuer's classes of common equity as of June 30, 2004 - 31,373,777 shares of common stock

The common stock of Verdisys, Inc. is traded over-the-counter on the Pink Sheets under the symbol "VDYS.PK".

Transitional Small Business Disclosure Format (check one): Yes No

Verdisys, Inc.

Index

PART I.	FINANCIAL INFORMATION	
Item 1.	Financial Statements	3
Item 2.	Management's Discussion and Analysis of Financial Condition and Plan of Operations	11
Item 3.	Controls and Procedures	12
Part II.	OTHER INFORMATION	
Item 1.	Legal Proceedings	13
Item 2.	Change in Securities and Use of Proceeds	13
Item 3.	Defaults Upon Senior Securities	13
Item 4.	Submission of Matters to a Vote of Security Holders	13
Item 5.	Other Information	14
Item 6.	Exhibits and Reports on Form 8-K	14
SIGNATURES		15

VERDISYS, INC.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

	Page Number
	<hr/>
Balance Sheet as of June 30, 2004	4
Statements of Operations, for the three and six months ended June 30, 2004 and 2003	5
Statements of Cash Flow, for the six months ended June 30, 2004 and 2003	6
Notes to Financial Statements	7

Page 3

VERDISYS, INC. BALANCE SHEET

June 30, 2004

		Assets
Current Assets:		
Cash		\$166,948
Accounts receivable, net of allowance for doubtful accounts of	\$50,000	158,549
Accounts receivable from related parties		20,547
Total Current Assets		<hr/> 346,044
Property and equipment,		

net of accumulated depreciation of	\$118,370	690,114
License, net of accumulated amortization of \$	382,642	4,652,511
		<hr/>
Total Assets		\$5,688,669
		<hr/>
Liabilities and Stockholders' Deficit		
Current Liabilities		
Accounts payable		\$423,360
Accrued expenses		765,838
Deferred revenue		783,948
Guarantee of third party debt		300,000
Customer deposit		428,250
Notes payable to related parties, net of unamortized discount of \$	30,761	204,238
		<hr/>
Total Current Liabilities		2,905,634
Long Term Liabilities		
Deferred revenue, less current portion		120,859
		<hr/>
Total Liabilities		3,026,493
		<hr/>
Commitments & Contingencies		
Stockholders' Equity		
Common Stock, \$.001 par value, 50,000,000 shares authorized;	
31,373,777 shares issued and outstanding		31,374
Additional paid-in capital		24,297,146
Accumulated deficit		(21,666,344)
		<hr/>
Total Stockholders' Equity		2,662,176
		<hr/>
Total Liabilities and Stockholder's Equity		\$5,688,669
		<hr/>

VERDISYS, INC. STATEMENTS OF OPERATIONS

Three and Six Months Ended June 30, 2004 and 2003

	For The Three Months Ended		For The Six Months Ended	
	June 30, 2004	2003	June 30, 2004	2003
	<hr/>	<hr/>	<hr/>	<hr/>
Revenue				
Satellite Services				
Third parties	\$155,049	\$197,843	\$246,799	\$334,291
Drilling Services				
Third parties	152,504	-	266,661	-
	<hr/>	<hr/>	<hr/>	<hr/>
Total Revenue	307,553	197,843	513,460	334,291
	<hr/>	<hr/>	<hr/>	<hr/>
Cost of Services Provided				
Satellite Services				
Third parties	147,128	281,500	311,206	390,064

Drilling Services				
Third parties	161,564	-	416,826	-
Total Cost of Services Provided	308,692	281,500	728,032	390,064
Gross Margin (Loss)	(1,139)	(83,657)	(214,572)	(55,773)
Selling, general and administrative	753,014	2,948,282	2,445,463	3,178,380
Depreciation and amortization	136,108	46,274	265,931	46,714
Debt forgiveness income	-	(460,235)	-	(460,235)
Total Operating Expenses	889,122	2,534,321	2,711,394	2,764,859
Operating Loss	(890,261)	(2,617,978)	(2,925,966)	(2,820,632)
Other expense				
Interest expense	(156,301)	(60,197)	(439,860)	(96,838)
NET LOSS	\$(1,046,562)	\$(2,678,175)	\$(3,365,826)	\$(2,917,470)
Basic and diluted net loss per share	\$(0.04)	\$(0.15)	\$(0.11)	\$(0.18)
Weighted average outstanding	31,313,963	18,376,272	30,716,019	16,199,706

VERDISYS, INC.
STATEMENTS OF CASH FLOWS

	For the Six Months Ended	
	June 30, 2004	June 30, 2003
Cash Flows From Operating Activities		
Net loss	\$ (3,365,826)	\$ (2,917,470)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock issued for services	735,192	1,315,929
Issuance of options and warrants for services	160,198	1,596,238
Depreciation and amortization	265,931	46,714
Amortization of discount on notes payable	4,397	-
Debt forgiveness income	-	(460,235)
Changes in:		
Accounts receivable	(14,991)	(69,105)
Other current assets	-	8,070
Accounts payable	102,673	(157,323)
Accrued expenses	326,950	(162,595)
Customer deposit	291,218	60,000
Deferred revenue	112,362	104,224
Net Cash Used In Operating Activities	(1,381,896)	(635,463)
Cash Flows from Investing Activities:		
Purchase of property and equipment	-	(100,000)
Cash payments for license	-	(100,000)
Net Cash Used In Investing Activities	-	(100,000)

Cash Flows from Financing Activities:		
Proceeds from sales of common stock	359,000	764,150
Proceeds from exercise of warrants	81,217	151,500
Proceeds from notes payable to stockholders	235,000	50,000
Payments on notes payable to stockholders	-	(35,894)
Payments on note payable on license	(500,000)	(96,886)
Net Cash Provided By Financing Activities	175,217	832,870
Net change in cash	(1,206,679)	97,407
Cash at beginning of period	1,373,627	135
Cash at end of period	\$ 166,948	\$ 97,542
Non-cash transactions:		
Stock issued for notes payable license	\$ 1,184,808	\$ -
Discount on notes payable	\$ 35,157	\$ -

VERDISYS, INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited interim financial statements of Verdisys, Inc. ("Verdisys") have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission ("SEC"), and should be read in conjunction with the audited financial statements and notes thereto contained in Verdisys' Annual Report filed with the SEC on Form 10-KSB and the unaudited financial statement and notes thereto in the Verdisys Annual Report filed with the SEC on Form 10-QSB for the quarter ended March 31, 2004. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year. Notes to the financial statements which would substantially duplicate the disclosure contained in the audited financial statements for 2003 as reported in the 10-KSB and in the Form 10-QSB have been omitted.

Revenue recognition. Revenue is recognized on well drilling operations when persuasive evidence of an arrangement exists, the lateral drilling is complete, the price is fixed or determinable and collectibility is reasonably assured.

NOTE 2 – STOCK OPTIONS AND WARRANTS

Verdisys accounts for non-cash stock-based compensation issued to non-employees in accordance with the provisions of SFAS No. 123 and EITF No. 96-18, Accounting for Equity Investments That Are Issued to Non-Employees for Acquiring, or in Conjunction with Selling Goods or Services. Common stock issued to non-employees and consultants is based upon the value of the services received or the quoted market price, whichever value is more readily determinable. Verdisys accounts for stock options and warrants issued to employees under the intrinsic value method. Under this method, Verdisys recognizes no compensation expense for stock options or warrants granted when the number of underlying shares is known and the exercise price of the option or warrant is greater than or equal to the fair market value of the stock on the date of grant.

In the first quarter of 2004, Verdisys granted 310,000 ten year options to officers and non-employee directors with exercise prices at the then market price of \$4.28. The options to officers vest monthly over 12 months and the options to non-employee directors vest immediately. There was no intrinsic value associated with the grants; however, fair value totaled \$1,200,623 with \$755,232 vesting during the first six months of 2004.

In the second quarter of 2004, Verdisys granted 72,000 options to non-employee directors with an exercise price of \$2.20. The options vest immediately. There was no intrinsic value associated with the grants, however, fair valued totaled \$156,913.

The following table illustrates the effect on net loss and net loss per share if Verdisys had applied the fair value provisions of FASB

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net loss as reported	\$ (1,046,562)	\$ (2,678,175)	\$ (3,365,826)	\$ (2,917,470)
Less: stock based compensation determined under fair value based method	(379,610)	-	(912,145)	-
Pro forma net loss	\$ (1,426,172)	\$ (2,678,175)	\$ (4,277,971)	\$ (2,917,470)
Basic and diluted net loss per common share:				
As reported	\$ (.04)	\$ (.15)	\$ (.11)	\$ (.18)
Pro forma	\$ (.05)	\$ (.15)	\$ (.13)	\$ (.18)

The weighted average fair value of the stock options granted during 2004 and 2003 was \$3.55 and \$.50, respectively. Variables used in the Black-Scholes option-pricing model include (1) 2.0% risk-free interest rate, (2) expected option life is the actual remaining life of the options as of each year end, (3) expected volatility is zero, and (4) zero expected dividends.

VERDISYS, INC.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

NOTE 3 – LATERAL DRILLING LICENSE & NOTE PAYABLE ON LICENSE TO RELATED PARTY

Verdisys did not make the December 2003 or January 2004 payment on the note payable. In February 2004, Verdisys and the licensor agreed to restructure the note payments. Verdisys agreed to issue the licensor 300,000 shares of common stock, \$100,000 cash and a note payable for \$400,000 due on May 15, 2004 for the unpaid amounts due under the original note. The 300,000 shares had a value of \$1,920,000 with \$1,184,808 reducing the overall note balance and \$735,192 recognized as compensation expense. On May 14, 2004 Verdisys paid the final installment on the Note.

NOTE 4 – CUSTOMER DEPOSITS

In May 2004, Verdisys agreed to a second contract to drill laterals for Maxim Energy (“Maxim”), a company controlled by Verdisys’ former CEO, Dan Williams. Verdisys has stipulated that all services to Maxim will be paid for in advance. As of June 30, 2004, Maxim had paid Verdisys a total of \$359,500 for services to be rendered.

NOTE 5 – DEFERRED REVENUE

Satellite bandwidth contracts cover a period between 12 and 36 months. In select engagements, Verdisys receives cash in advance and recognizes revenue evenly over the contract. Deferred revenue related to satellite services totaled \$407,807. \$286,948 will be recognized in the year ended June 30, 2005 and \$120,859 will be recognized during the years ended June 30, 2005 and 2006.

Verdisys also deferred revenue collected for lateral drilling service contracts. In June 2003, Verdisys signed an agreement to drill wells for Edge Capital (“Edge”). Edge, through a third party financing source, paid Verdisys \$497,000 in 2003. Verdisys has inadequate documentation to substantiate what services were actually performed, and Edge is disputing whether the services were performed at all. Management is attempting to substantiate what services were actually performed and continues to gather evidence to substantiate the services. As of June 30, 2004, the \$497,000 is included in deferred revenue.

NOTE 6 – NOTES PAYABLE TO RELATED PARTIES

During the second quarter of 2004, a group comprised of Verdisys officers, directors and others loaned Verdisys \$185,000. The notes mature in 12 months, carry interest of 8% and have 37,000 one year warrants attached with an exercise price of \$2.00. The notes were discounted by the relative fair value of the warrants which totaled \$35,154.

The discount will be expensed over the term of the note. \$4,396 of the discount was expensed through June 30, 2004.

NOTE 7 – STOCKHOLDERS EQUITY

During the first quarter of 2004, Verdisys issued 409,935 shares of common stock pursuant to stock option exercises for total

consideration of \$40,993.

In February 2004, Verdisys issued 395,022 shares of common stock pursuant to the cashless exercise of a warrant for 400,000 shares of common stock at a price of \$0.10 per share.

In March 2004, Verdisys issued 300,000 shares of common stock to Carl Landers in connection with the renegotiation of the note payable to Mr. Landers for the licensing of his lateral drilling technology. See note 3 for additional information.

During the second quarter of 2004, Verdisys issued 402,241 shares of common stock pursuant to stock option exercises for total consideration of \$40,224.

During the second quarter of 2004, Verdisys sold 179,500 shares of common with 71,800 warrants attached for total consideration of \$359,000. The two year warrants were valued at \$86,207 and the stock was valued at \$272,793.

VERDISYS, INC.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

NOTE 8 – LITIGATION

As previously disclosed, Verdisys initiated a lawsuit against Edge Capital that requests a declaratory judgment that a purported agreement between Verdisys and Edge is not enforceable. It was filed in Montgomery County, Texas in February 2004. The lawsuit arises from Edge's contention that one of Verdisys' ex-officers committed Verdisys to purchase certain alleged oil and gas properties from Edge. Edge filed a counterclaim against Verdisys and asserts claims against Dan Williams (Verdisys' former President and CEO), Eric McAfee (Verdisys' former Vice Chairman), Ron Robinson, Frederick Ruiz, Joseph Penbera, James Woodward, John Block, and Andrew Wilson. Edge has also made claims against Solarcom, L.L.C., DeLage Landen Financial Services, Inc., and Allen Voight. Edge seeks to enforce the agreement Verdisys challenges, and alleges several causes of action including claims for fraud, breach of contract, negligence, and conspiracy. Verdisys believes it has meritorious and complete defenses to the claims asserted in the lawsuit and intends to vigorously defend itself. If Edge prevails, it may obtain significant damages that may have a material adverse effect on Verdisys' financial condition.

Edge and one of its apparent owners, Frazier Ltd., initiated a lawsuit in Summit County, Ohio against Solarcom, L.L.C., DeLage Landen Financial Services, Inc., Verdisys, Inc., and Firstmerit Bank, N.A. that sought an injunction against the draw against a letter of credit pledged as collateral for a credit advanced to Edge. Edge asserted that its transaction with Verdisys was the product of fraud and that its creditor, DeLage Landen as assignee from Solarcom, should not be allowed to draw against Edge's letter of credit from Firstmerit. The Ohio state court denied Edge's request for a temporary injunction. Verdisys is uncertain whether Edge will prosecute its claims against Verdisys in the Montgomery County, Texas action, which was filed first, or the Ohio action. The pleadings in the Ohio action do not include any claim for damages from Verdisys and Verdisys is unable to determine whether an adverse judgment would have a material adverse effect on Verdisys' financial condition.

Verdisys was informed that a default judgment was entered against us in a lawsuit brought by Scooter's Convenience, Inc. dba LSS Satellite in Hockley County, Texas. Verdisys filed a motion for new trial which was granted by the trial court, which also vacated the default judgment. In the underlying lawsuit, LSS Satellite has alleged breach of contract, violations of the Texas Deceptive Trade Practices Act, and other claims against Verdisys. Verdisys believes it has meritorious and complete defenses to the claims asserted in the lawsuit and intends to vigorously defend itself. If LSS Satellite prevails, it may obtain significant damages that may have a material adverse effect on Verdisys' financial condition.

In connection with its financing in October 2003 with Gryphon Master Fund, L.P, Verdisys agreed to register the shares issued to Gryphon on or before March 2004 or be subject to certain liquidated damages. Gryphon has made a claim against Verdisys for the maximum liquidated damages in an amount of \$400,000. It has also claimed it has sustained actual damages in excess of \$6.2 million. In July 2004, Gryphon filed a lawsuit in the state district court in Dallas County, Texas against Verdisys, alleging, among other things, breach of contract and securities fraud by Verdisys. In connection with the lawsuit, Gryphon has requested liquidated damages, actual damages, punitive damages, interest, costs and attorneys fees., among other claims. Verdisys has filed an answer to the lawsuit and intends to vigorously defend itself. If Gryphon prevails, it may obtain significant damages that may have a material adverse effect on Verdisys' financial condition.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

Verdisys is a defendant in a consolidated class action lawsuit brought by former shareholders. The lawsuit, which according to press releases about the lawsuits issued by the plaintiffs' lawyers allege that Verdisys and its former CEO, Dan Williams, and Verdisys' former CFO, Andrew Wilson, violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. The lawsuit alleges that defendants made materially misstatements about Verdisys' financial results. More specifically, the Complaint alleges that defendants failed to disclose and indicate: (1) that Verdisys had materially overstated its net income and earnings per share; (2) that defendants prematurely recognized revenue from contracts between Verdisys, Edge Capital and Energy 2000 in violation of GAAP and its own revenue recognition policy; (3) that Verdisys lacked adequate internal controls and was therefore unable to ascertain the true financial condition of the company; and (4) that as a result of recognizing revenue prematurely, Verdisys' financial results were inflated at all relevant times. Verdisys continues to evaluate its defenses to these allegations, as well as the potential impact that an adverse judgment would have on it.

In July, 2004 Verdisys was informed that a former Chief Executive Officer of Verdisys filed a lawsuit against Verdisys for breach of contract and wrongful discharge. These claims seek relief in excess of \$500,000 related to an alleged employment agreement and also seeks damages related to an excess of 4,000,000 stock options claimed due pursuant to the alleged agreement. The company has only recently received notice of these claims. The lawsuit was filed in state court in San Diego, California. Verdisys intends to vigorously defend itself.

NOTE 9 – FINANCINGS

In May 2004, Verdisys issued 179,500 shares of common stock for \$359,000 in a private placement for \$2 per share. Two year warrants to purchase 71,800 common shares at \$2 per share were attached to the common stock. The proceeds were allocated between the common stock and the warrants based on their respective relative fair values.

NOTE 10 – SUBSEQUENT EVENTS

Verdisys was notified that legal action has been filed against Verdisys by Gryphon Master Fund, L.P. for the liquidated damages described in Note 8.

Verdisys was informed that a former Chief Executive Officer of Verdisys filed a lawsuit against Verdisys seeking damages described in Note 8 Verdisys filed a motion for new trial in the Scooter's Convenience, Inc. dba LSS Satellite lawsuit. The trial court granted the motion and vacated the default judgment.

Verdisys has brought \$100,000 of new financing into the treasury in the form of a Convertible Note from third parties with an interest rate of 8% and a term ending December 31, 2005. The notes are convertible at Verdisys' discretion when the underlying shares have been registered and the average price exceeds \$2 per share for more than 20 trading days. 50,000 seventeen month warrants to purchase common shares at \$0.001 per share were attached to the notes.

In July 2004, Verdisys received a loan of \$35,000 from a director. The loan is on a short term unsecured basis and bears no interest or other benefits. Funds from this loan are being used for operations.

Item 2. Management's Discussion and Analysis of Financial Condition and Plan of Operations

Forward-Looking Statements

This statement may include projections of future results and "forward looking statements" as that term is defined in Section 27A of the Securities Act of 1933 as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934 as amended (the "Exchange Act"). All statements that are included in this Quarterly Report, other than statements of historical fact, are forward looking statements. Although management believes that the expectations reflected in these forward looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Any statements made in this filing other than those of historical fact, about an action, event or development, are forward looking statements under the Private Securities Litigation Act of 1995. The forward looking statements in this filing involve known and unknown risks and uncertainties, which may cause Verdisys' actual results in future periods to be materially different from any future performance that may be suggested in this release. Such factors may include risk factors including but not limited to: changes in technology, reservoir or sub-surface conditions, the introduction of new services, commercial acceptance and viability of new services, fluctuations in customer demand and commitments, pricing and competition, reliance upon subcontractors, the ability of Verdisys' customers to pay for our services,

together with such other risk factors as may be included in the Company's periodic filings on Form 10-KSB, 10-QSB, and other current reports.

Financial Summary

Three Months Ended June 30, 2004 Compared to Three Months Ended June 30, 2003

Verdisys incurred \$307,533 in revenues and a net loss of \$1,046,562 for the quarter ended June 30, 2004 as compared to revenues of \$197,843 and net loss of \$2,678,175 for the quarter ended June 30, 2003. Revenues increased as a result of an increase in lateral drilling activity for the quarter, which offset a decline in satellite service revenues. There were no comparable lateral drilling revenues in 2003 as the license to the Landers lateral drilling technology was acquired in April 2003. The Net Loss decreased as a result of lower selling, general and administration expenses ("SG&A") associated with a decrease in non-cash stock, stock option and warrant expense in the prior year quarter.

In January, 2004 the focused on small- to medium-sized independent oil and gas production companies seeking to enhance production from their existing fields in the U.S. and Canada. It also adopted a new business model that emphasizes a payment for services rather than production participation rights. To date, the Company has signed contracts with the following independent oil and gas companies; Amvest Osage, Blue Ridge Natural Gas Partners, U.S. Department of Energy, Enervest Operating, Maxim Energy and VJI Resources. Also as previously disclosed, Verdisys has redesigned its down-hole drilling equipment and is in the process of deploying the modified equipment into the field in order to improve the reliability of its drilling operations. The Company expects to continue such focus for the balance of fiscal year 2004.

Revenues

Lateral Drilling Services

Lateral Drilling Services' revenues were \$152,504 and \$0 for the three months ended June 30, 2004 and three months ended June 30, 2003, respectively. The increase in revenues for the quarter was primarily associated with revenues from the commencement of the Amvest Osage and Maxim Energy contracts and recovery of certain third party expenses from related parties.

Satellite Communications Services

Satellite Communication Services' revenues for the quarter ended June 30, 2004 were \$155,049 compared to the quarter ended June 30, 2003 of \$197,843. Revenue decreased in the quarter due to lower hardware sales of satellite equipment. As hardware is sold, Verdisys recognizes the revenue in the period it is delivered to the customer. The associated bandwidth revenue is amortized over the period benefited. Cash collected for bandwidth is recorded as deferred revenue. At June 30, 2004 there was \$407,807 reflected in balance sheet as deferred revenue relating to Satellite Communications.

Net Loss

The Net Loss for the quarter ended June 30, 2004 decreased over the prior quarter primarily as a result of lower SG&A expenses associated with a decrease in non-cash stock, stock option and warrant expense in comparison to the prior year quarter.

Six Months Ended June 30, 2004 Compared to Six Months Ended June 30, 2003

Net Loss

The Net Loss for the six months ended June 30, 2004 increased primarily as a result of higher SG&A expenses associated with the start up of the lateral drilling services business, an increase in management personnel, liquidated damages resulting from the failure to file a timely registration statement and non-cash compensation expense associated with the renegotiation of the Landers note payable, partly offset by debt forgiveness income.

Liquidity and Capital Resources

Capital Expenditures

There were no significant capital expenditures in the quarter.

Liquidity

As of June 30, 2004 the Company's cash balance was \$166,948. As noted in the Independent Auditors Report (See Financial Note 2 to the December 31, 2003 Financial Statements) due to the continued substantial operating losses that the Company has incurred

raises substantial doubt as to the Company's ability to continue as a going concern. The Company is in an early stage of development and is rapidly depleting its cash resources, therefore it has determined that it will need to raise additional financing in the short term to continue in operation and fund future growth. The Company has also incurred liquidated damages up to a cap of \$400,000 related to the timing of providing registration rights for the private financing that it arranged in November 2003. If we are unable to finance the liquidated damages, this would have a material adverse effect on the Company. The Company is also subject to significant contingent liabilities as more fully described in the Notes to the Financial Statements. See Note 8, Litigation.

The Company currently plans to raise additional financing in the quarter ending September 30, 2004. The use of stock for currency in financing or making acquisitions may be heavily curtailed while the Company is under SEC investigation. (See Financial Note 16 to the December 31, 2003 Financial Statements) If we are unable to arrange new financing or generate sufficient revenue from new business arrangements, the Company will be unable to continue in its current form and will be forced to restructure or seek creditor protection.

Item 3. Controls and Procedures

The Company's Principal Executive Officer and Principal Financial Officer have undertaken an evaluation of the Company's disclosure controls and procedures as of June 30, 2004. The Company's Principal Executive Officer and Principal Financial Officer have concluded that the existing disclosure controls and procedures, when combined with further investigations which have been undertaken are effective to provide reasonable assurances that the information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

12

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Full disclosure of prior or other legal activities may be found in the audited financial statements and notes thereto contained in Verdisys' Annual Report filed with the SEC on Form 10-KSB., and in the Quarterly Report on Form 10-Q for the quarter ended March 31, 2004, and in the notes to the financial statements in this report. See Note 8 of the financial statements included in this report.

Item 2. Change in Securities and Use of Proceeds

During the second quarter of 2004, Verdisys sold 179,500 shares of common stock with 71,800 two year warrants attached for a total consideration of \$359,000. The proceeds will be allocated between the common stock and the warrants based on their respective relative fair values. The transactions were a private offering exempt from registration under Regulation D promulgated under Section 4(2) of the Securities Act. The sales of stock were to individuals or entities, each of whom was an accredited investor, as that term is defined in Rule 501 of Regulation D promulgated under Section 4(2) of the Securities Act. The Company granted to the holders certain registration rights covering the shares.

In May 2004, Verdisys borrowed \$185,000 under one year promissory notes with interest of 8%. 37,000 warrants to purchase common shares at \$2 per share were attached to the notes. The notes will be discounted for the relative fair value of the warrants. The investors were accredited investors as defined in Rule 501 of Regulation D promulgated under Section 4(2) of the Securities Act. Furthermore, the majority of the investors were officers and directors of Verdisys.

The funds raised during the quarter were primarily utilized in paying the final installment on the note associated with the lateral drilling license.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

Verdisys, Inc. conducted an Annual Meeting of Shareholders on May 27, 2004; and discloses herein final voting results as pertaining to the matters voted upon at the annual meeting.

58.284% (18,147,643 of 31,136,619) of the shares outstanding as of the record date were voted.

Proposal One – Elections of Directors:

YES

NO

ABSTAIN

Ronald J. Robinson, Ph.D.	91.346%	8.392%	0.262%
	16,577,185	1,522,990	47,468
John R. Block	99.259%	0.382%	0.359%
	18,013,243	69,332	65,068
Joseph J. Penbera, Ph.D.	93.880%	5.808%	0.312%
	17,036,999	1,053,958	56,686
Frederick R. Ruiz	99.520%	0.154%	0.325%
	18,060,575	28,000	59,068
O. James Woodward III	99.523%	0.008%	0.469%
	18,061,075	1,500	85,068

Proposal Two – Approval of Independent Public Accountant:

	YES	NO	ABSTAIN
Malone and Bailey, PLLC	92.639%	6.572%	0.789%
	16,811,735	1,192,640	143,268

13

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

Reports on Form 8-K

During the period ending June 30, 2004 and through the date of the filing of this Quarterly Report on Form 10-QSB; Verdisys, Inc. had filed the following Reports on Form 8-K with the Securities and Exchange Commission on the dates indicated:

May 17, 2004	re: Press Release – Drilling License Final Payment
May 7, 2004	re: Financial Statements – Amendment #2 to the Report on Form 8-K filed with SEC on July 18, 2003, as amended September 29, 2003; re: revision of certain financial statements.
July 27, 2004	re: Press Release – Verdisys Provides Operational Update

Exhibits

Verdisys, Inc. includes herewith the following exhibits.

Exhibits 4.1 thru 4.5 are form agreements used in financing activities.

- 4.1 Form of Subscription Agreement
- 4.2 Form of Warrant Agreement
- 4.3 Form of Promissory Note
- 4.4 Form of Convertible Promissory Note
- 4.5 Form of Registration Rights Agreement

Exhibits 10.1 thru 10.3 are disclosure of recent material contracts.

- 10.1 Master Service Contract – BlueRidge Gas Partners, LLC – June 23, 2004
- 10.2 Master Service Contract – VJI Natural Resources, LLC – July 20, 2004
- 10.3 Contract/Order – U. S. Department of Energy – June 4, 2004 and Letter of Intent, Radial Drilling Optimization Services – April 14, 2004

Exhibits 31.1, 31.2, 32.1 and 32.2 are officer certifications.

- 31.1 Certification of Principal Executive Officer pursuant to Section 302
- 31.2 Certification of Principal Accounting Officer pursuant to Section 302
- 32.1 Certification of Principal Executive Officer pursuant to Section 1350
- 32.2 Certification of Principal Accounting Officer pursuant to Section 1350

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Verdisys, Inc.

By: _____ /s/ David M. Adams, COO

David M. Adams
Co- Chief Executive Officer
Chief Operating Officer
Principal Executive Officer

Date: August 10, 2004

By: _____ /s/ John O'Keefe, CFO

John O'Keefe
Co-Chief Executive Officer
Chief Financial Officer
Principal Accounting Officer

Date: August 10, 2004

MASTER SERVICE CONTRACT

THIS AGREEMENT (this "Contract"), made and entered into and shall be effective as of this 24th day of June, 2004, by and between the parties herein designated as "Company" and "Contractor".

Company: **BlueRidge Gas Partners, LLC**
Address: **4606 FM 1960, Suite 390**
Houston, TX 77069

Contractor: **Verdisys, Inc.**
Address: **25025 I-45 North**
The Woodlands, TX 77380

WITNESSETH: THAT,

WHEREAS, Company in the course of such operations regularly and customarily enters into contracts with independent contractors for the performance of service relating thereto; and

WHEREAS, Company desires, as a matter of company policy, to establish and maintain an approved list of Contractors and to offer work or contracts only to those Contractors who are included on such approved list; and

WHEREAS, Contractor represents that it has adequate equipment in good working order and fully trained personnel capable of efficiently operating such equipment and performing services for Company.

NOW THEREFORE IN CONSIDERATION of the mutual promises, conditions and agreements herein contained, the sufficiency of which is hereby acknowledged, and the specifications and special provisions set forth in the exhibits attached hereto and made a part hereof, the parties mutually agree as follows:

1.0 AGREEMENT

Upon execution of this Contract, Company agrees that the name of Contractor shall be added to the Company's approved list of Contractors and this Contract shall remain in force and effect until canceled by either party by giving the other party ten (10) days prior written notice at the respective address of either party. If current work extends past such ten-day period, then cancellation shall not be effective until work is completed. This Contract shall control and govern all work performed by Contractor for Company, under subsequent verbal and/or written work orders. Agreement or stipulations in any such work order, delivery ticket, or other instrument, used by Contractor not in conformity with the terms and provisions hereof shall be null and void. No waiver by Company of any of the terms, provisions or conditions hereof shall be effective unless said waiver shall be in writing and signed by an authorized officer of Company and specifically referencing this Contract.

2.0 LABOR, WARRANTY, EQUIPMENT, MATERIALS, SUPPLIES AND SERVICES

2.1 All work or services rendered or provided by Contractor shall be in accordance with Contractor's proposal as set forth in Exhibit B. Upon acceptance of same by Company, Contractor shall commence operations diligently and without delay, in strict conformity with the specifications and requirements contained herein.

2.2 Contractor shall not employ in any work for Company any employee whose employment violates any labor, employment or other applicable laws. Contractor shall not employ in any work for Company any employee who is a minor.

2.3 All work or services rendered or performed by Contractor shall be done with due diligence in a good and workmanlike manner, using skilled, competent and experienced workmen and supervisors, and in accordance with good oilfield servicing practices.

(a)

NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED HEREIN, THE TERMS OF THIS PARAGRAPH APPLY TO ANY SERVICES AND TO ANY EQUIPMENT RENTED OR LEASED WITH OR WITHOUT AN OPERATOR. Contractor uses its best efforts to ensure that all service personnel furnished are competent and rental equipment is in good condition. Contractor personnel will attempt to perform the work requested; however, because of the nature of the work to be accomplished and unpredictable conditions, the results of such services cannot be and are not guaranteed. Contractor warrants the services provided hereunder for a period of thirty (30) days. NO WARRANTY IS GIVEN WITH RESPECT TO ENGINEERING AND TECHNICAL INFORMATION FURNISHED BY CONTRACTOR OR WITH RESPECT TO THE RESULTS OF THE SERVICES PROVIDED BY CONTRACTOR.

CONTRACTOR MAKES NO WARRANTY OR REPRESENTATION, EXPRESS OR IMPLIED, AS TO THE DESIGN, OPERATION, OR QUALITY OF THE MATERIAL OR WORKMANSHIP OF RENTAL EQUIPMENT USED TO SUPPLY THE SERVICES AND CONTRACTOR MAKES NO WARRANTY OF MERCHANTABILITY OR FITNESS OF THE EQUIPMENT FOR ANY PARTICULAR PURPOSE OR ANY OTHER REPRESENTATION OR WARRANTY WHATSOEVER. PROVIDED TO COMPANY HEREUNDER,

(b)

Contractor shall have no responsibility for any materials furnished and/or specified-by Company.

(c)

With regard to materials or equipment furnished by third party vendors and/or suppliers, Contractor's liability therefor shall be limited to the assignment of such third party vendor's and/or supplier's warranty to Company, provided such warranties are assignable.

(d)

NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED HEREIN, THE TERMS OF THIS PARAGRAPH APPLY TO THE SALE OF ANY EQUIPMENT TO COMPANY. Contractor warrants equipment sold pursuant hereto to be free of defects in material and workmanship for a period of one (1) year after the date equipment is delivered. The above warranty does not apply to (i) used equipment that has been repaired or worked over; (ii) equipment that has been modified or subject to improper

2

handling, storage, installation, operation or maintenance by Company, including use of unauthorized replacement parts; (iii) component parts not manufactured by Contractor, whether purchased by Contractor or furnished by Company, such parts being subject to any applicable manufacturer's warranty; (iv) parts requiring replacement because of natural wear and tear; (v) the design on those jobs where Contractor prepared drawings or lists from designs furnished by others; and (vi) models or samples furnished to Company as illustrations only of general properties of equipment. Contractor's liability for breach of this warranty is expressly limited to the repair or replacement, at its sole option, of any equipment or parts of equipment which prove to be defective during the warranty period. THIS LIMITED EXPRESS WARRANTY, AND THE STATED REMEDIES FOR BREACH THEREOF, SHALL BE IN LIEU OF ANY AND ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING WITHOUT LIMITATION, WARRANTIES FOR MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE.

2.4

Contractor agrees to maintain his equipment in good operating condition at all times and shall use all reasonable means to control and prevent fires and blowouts, protect the hole, and protect Company's equipment.

2.5

Notwithstanding anything to the contrary contained herein, except when Contractor's equipment is lost or damaged as a result of the sole negligence of Contractor, Company agrees to defend, indemnify and hold Contractor harmless from the loss of or damage to Contractor's tools or equipment occurring in the hole, or in the drill string below the level of the rotary table. Company will replace such tools/equipment or reimburse Contractor with the current replacement cost new. Should Company decide to replace lost or damaged tools/equipment, the replaced items should be new and purchased or obtained from a reputable manufacturer and should meet all original equipment manufacturer's specifications. Company agrees to reimburse Contractor for the cost of repair to such tools and equipment that are damaged other than from normal wear-and-tear during the rental period. However, before any major repairs are made to damaged equipment, approval for such repairs must be secured from an authorized representative of Company. Company shall not be responsible if Contractor's tools/equipment is damaged as a result of Contractor's negligent acts and/or omissions.

2.6

Notwithstanding anything to the contrary contained herein, it is expressly agreed and understood that in the event Contractor's equipment is leased or rented to Company pursuant to the Contract and is not returned or is damaged beyond repair, Company will replace such equipment or reimburse Contractor with the current replacement cost new of such equipment. Should Company decide to replace lost or damaged assets, the replaced items should be new and purchased or obtained from a reputable manufacturer and should meet all original equipment manufacturer's specifications. Company agrees to reimburse Contractor for the cost of repair to such tools and equipment that are damaged other than from normal wear-and-tear during the rental period. However, before any major repairs are made to damaged equipment, approval for such repairs must be secured from an authorized representative of Company. Company shall not be responsible to the extent that Contractor's equipment is damaged as a result of Contractor's negligent acts and/or omissions.

3.0 PAYMENT

3.1

Once credit is established, normal terms will be net thirty (30) days after receipt of an invoice. The Company shall pay Contractor at the rate stipulated in the Exhibit B provided for herein, subject to same being accepted by Company as fully complying with all the terms, conditions, specifications and requirements of this Contract. Should company not meet contractor's credit criteria, prepayment may be required.

3.2

Company shall have the right to audit Contractor's books and records relating to all invoices issued pursuant to this agreement. Contractor agrees to maintain such books and records for a period of two (2) years from the date such costs were incurred and to make such books and records available to Company at any time or times within such two (2) year period.

3.3

In the event that Company's account with Contractor becomes delinquent, Contractor has the right to revoke any and all discounts previously applied in arriving at the net invoice price. Upon revocation, the full invoice price without discount will become immediately due and owing and subject to collection. Notwithstanding anything herein to the contrary, Contractor may file liens if Company fails to pay Contractor's valid charges as required by this Contract or any court order.

4.0 REPORTS TO BE FURNISHED BY CONTRACTOR

4.1

The quantity, description and condition of the materials and supplies and/or services furnished shall be verified and checked by Contractor, and all delivery tickets shall be properly certified as to receipt by Contractor's representative. Contractor must obtain approval of Company's representative on the well site of delivery tickets for materials and supplies for which Contractor is to be reimbursed by Company.

4.2

Contractor shall immediately orally report to Company, as soon as practicable followed by an appropriate written report, all accidents or occurrences resulting in death or injuries to Contractor's employees, agents or third parties, or damage to property of Company or third parties arising out of or during the course of work to be performed hereunder. Contractor shall furnish Company with a copy (within ten days) of all records made available by Contractor to Contractor's insurer or governmental authorities or to others of such accidents and occurrences.

5.0 REPORTS TO BE FURNISHED BY COMPANY

Company will furnish contractor with relevant production data available prior to commencement of project as well as relevant post project production data. Contractor will obtain Company's approval prior to any public disclosure of said project production data.

6.0 INDEPENDENT COMPANY RELATIONSHIP

In the performance of any work by Contractor for Company, Contractor shall be deemed to be an independent contractor, with the authority and right to direct and control all of the details of the work, Company being interested only in the results obtained. However, all work contemplated shall meet the approval of Company and shall be subjected to the general right of inspection. Company shall have no right or authority to supervise or give instructions to the employees, agents, or representative of Contractor, but such employees, agents or representatives at all times shall be under the direct and sole supervision and control of

Contractor. Any suggestions or directions given by Company or its employees shall be given only to the superintendent or other person in charge of Contractor's crew, provided however, that in the event any employee of Company should give any order or instructions to the employees of Contractor (which employee of Company shall not in any event be authorized to do) and such order is not countermanded by Contractor's superintendent or other person in charge of Contractor's employees or crew, it shall be deemed that such orders or instructions are the orders or instructions of Contractor. It is the understanding and intention of the parties hereto that no relationship of master and servant or principal and agent shall exist between Company and the employees, agents, or representatives of Contractor, and that all work or services covered hereby shall be performed at the sole risk of Contractor.

7.0 INDEMNITY OBLIGATIONS

7.1 Definitions. The following terms shall have the designated definitions.

(a)

Company Group includes, individually or in any combination, Company, its affiliates, contractors (other than Contractor) and entities for whom Company is performing services and each of their respective directors, officers agents, representatives, employees and invitees.

(b)

Contractor Group includes, individually or in any combination, Contractor, and its affiliates and contractors, and each of their respective directors, officers, agents, representatives, employees and invitees.

(c)

Defend – the obligation of the indemnitor (i) to defend the indemnitees at its sole expense, or at the indemnitees' election (ii) to reimburse the indemnitees for the indemnitees' reasonable expenses incurred in defending themselves. Notwithstanding the indemnitee's election of option (i) above, the indemnitee shall be entitled to participate in its defense at its sole cost.

(d)

Losses – claims, demands, causes of action, losses, judgments, liabilities, indemnity obligations, costs, damages or expenses of any kind and character (including attorney's fees and other legal expenses).

6.2

Contractor. Contractor shall release, defend, indemnify, and hold harmless Company Group from and against any and all Losses arising out of bodily injury or death or property damage or loss (including patent or license infringement resulting from the use of the Contractor Group's property) suffered by any of the Contractor Group in connection with this Contract,

REGARDLESS OF WHETHER CAUSED OR CONTRIBUTED TO BY THE SOLE, JOINT OR CONCURRENT NEGLIGENCE (IN ANY AMOUNT), STRICT LIABILITY OR OTHER FAULT OF ANY MEMBER OF COMPANY GROUP.

6.3

Company. Company shall release, defend, indemnify, and hold harmless Contractor Group from and against all Losses arising out of bodily injury or death or property damage or loss (including patent or license infringement resulting from the use of the Company Group's property) suffered by any of the Company Group in connection with this Contract,

REGARDLESS OF WHETHER CAUSED OR CONTRIBUTED TO BY THE SOLE, JOINT OR CONCURRENT NEGLIGENCE (IN ANY AMOUNT), STRICT LIABILITY OR OTHER FAULT OF ANY MEMBER OF CONTRACTOR GROUP.

5

6.4

Insurance Support/Limitation. The mutual indemnity obligations in Sections 6.2 and 6.3 above shall be supported by insurance provided by the parties hereto in the amounts and the types described in Exhibit A. Notwithstanding anything in this Contract to the contrary, (i) in the event enforcement of Sections 6.2 and/or 6.3 above is governed by the Texas Anti-Indemnity Statute (Tex. Civ. Prac. & Rem. Code Ann. Secs. 127.001-127.007 (1986 & Supp. 1996) as amended) or similar statute in another jurisdiction, and (ii) to the extent the indemnified Losses under such Section 6.2 or 6.3, as applicable, result from the indemnitee's negligence, then the obligations of the indemnitor under such Section 6.2 or 6.3, as applicable, shall be limited to the extent of insurance required to be provided by both parties pursuant to this Section 6.4 (or any such greater amount allowed by law).

6.5

NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED HEREIN, COMPANY HEREBY AGREES TO ASSUME THE ENTIRE RESPONSIBILITY AND LIABILITY FOR, AND AGREES TO RELEASE, DEFEND, INDEMNIFY AND HOLD CONTRACTOR HARMLESS FROM AND AGAINST ALL CLAIMS, LIABILITIES, DAMAGES AND EXPENSES (INCLUDING WITHOUT LIMITATION ATTORNEYS' FEES, COURT COSTS, EXPERT WITNESS FEES AND ANY OTHER COST OF DEFENSE) FOR AND ARISING OUT OF THE FOLLOWING SPECIFIED TYPES OF CLAIMS, LOSSES OR EVENTS:

1. **LOSS OR LIABILITY FOR DAMAGES OR AN EXPENSE ARISING FROM PROPERTY INJURY THAT RESULTS FROM RESERVOIR OR UNDERGROUND DAMAGE, INCLUDING LOSS OF OIL, GAS, OTHER MINERAL SUBSTANCE, OR WATER OR THE WELLBORE ITSELF; OR**
2. **LOSS OR LIABILITY FOR DAMAGES OR ANY EXPENSE ARISING FROM COST OF CONTROL OF WILD WELL, UNDERGROUND OR ABOVE THE SURFACE.**

THIS OBLIGATION TO INDEMNIFY, DEFEND AND RELEASE APPLIES REGARDLESS OF WHETHER OR NOT THE CLAIM OR LOSS IS OCCASIONED BY OR RESULTS FROM THE ACTUAL OR ALLEGED NEGLIGENCE OF CONTRACTOR OR ANY OTHER PERSON, OR ENTITY, IN WHOLE OR IN PART, WHETHER SOLE, JOINT, ACTIVE OR PASSIVE, EXCEPT TO THE EXTENT THE CLAIM OR LOSS IS DUE TO CONTRACTOR'S SOLE NEGLIGENCE, GROSS NEGLIGENCE OR WILLFUL MISCONDUCT.

6.6.

NOTWITHSTANDING THE FOREGOING, CONTRACTOR SHALL HAVE SOLE RESPONSIBILITY AND LIABILITY FOR THE CONTROL AND REMOVAL OF AND SHALL HOLD COMPANY HARMLESS FROM PROPERTY LOSS OR DAMAGE, FINES AND/OR PENALTIES FROM SUCH POLLUTION OR CONTAMINATION THAT RESULTS FROM SPILLS OF FUELS, LUBRICANT, MOTOR OILS, PIPEDOPE, PAINTS, SOLVENTS, BALLAST, BILGE, METALLIC OBJECTS AND

GARBAGE IN CONTRACTOR'S SOLE POSSESSION OWNERSHIP,

REGARDLESS OF WHETHER OR NOT OCCASIONED BY OR RESULTING FROM THE NEGLIGENCE, STRICT LIABILITY, BREACH OF WARRANTY OR OTHER FAULT OF COMPANY, IN WHOLE OR IN PART, WHETHER SOLE, JOINT, ACTIVE OR PASSIVE. THE INITIATION OF CLEAN-UP OPERATIONS AND CONTROL, REGARDLESS OF

6

INCLUDING CONTROL, RESPONSE AND REMOVAL, BY EITHER PARTY SHALL NOT BE AN ADMISSION OF ASSUMPTION OF LIABILITY BY THE INITIATING PARTY OR PARTIES.

6.7

Indirect or Consequential Damages. The parties hereto waive and release all claims against the other party for indirect, special, punitive or consequential damages arising out of this Contract, **REGARDLESS OF WHETHER CAUSED OR CONTRIBUTED TO BY THE SOLE, JOINT OR CONCURRENT NEGLIGENCE (IN ANY AMOUNT), STRICT LIABILITY OR OTHER FAULT OF ANY OF THE OTHER PARTY.** As used herein, "indirect or consequential damages" shall include, but not be limited to, loss of revenue, profit or use of capital, production delays, loss of product, reservoir loss or damage, losses resulting from failure to meet other contractual commitments or deadlines and downtime of facilities or vessels.

6.8

No Limit. Except as otherwise provided herein, the foregoing indemnity obligations shall not be limited to the amount of insurance of the parties.

6.9

The provisions of this Section shall extend to and be enforceable by and for the benefit of Contractor Group and Company Group.

6.10

During the term of this Contract, Contractor and its subcontractors or their officers, directors and employees may have occasion to be upon or about property, platforms, vessels, equipment or other premises belonging to or under the control of or in the possession of or under contract to Company while performing services for another company or while in transit between a vessel and another location. In such event, Contractor's and Company's indemnification rights and obligations under this Contract shall apply to the same extent as if Contractor had been employed at the request of or for the benefit or account of Company.

6.11

Should Louisiana law be applicable to this Contract and the activities performed hereunder, Contractor and Company agree to recognize Company as the statutory employer of employees of Contractor while such employees are performing services to be supplied by Contractor under this agreement. This provision is included for the sole purpose of establishing a statutory employer relationship to gain benefits expressed in La. Rev. Stat. 23:1031 (C-E) and La. Rev. Stat. 23:1061 (A) and is not intended to create an employer/employee relationship for any other purpose.

7.0 INSURANCE

Contractor shall carry insurance (with reliable insurance companies that are satisfactory to Company) in the amounts set forth in Exhibit A, such insurance to be effective prior to the commencement of any work under this Contract. In each such policy, to the extent of the liabilities agreed to be assumed by Contractor, Contractor shall cause (i) all deductibles to be for Contractor's account, (ii) the insurer to waive all rights of subrogation against Company Group, (iii) Company Group to be listed as additional insureds, and (iv) such policy to be primary as to any other existing valid and collectible insurance of Company Group or otherwise. Before engaging in any work hereunder, Contractor shall furnish Company an executed Certificate of Insurance (in form satisfactory to Company) evidencing the foregoing insurance. Contractor shall cause each insurer to agree to give Company at least thirty (30) days written notice of cancellation or expiration of any such policies or of any other changes

7

that would materially reduce the limits of coverage of such policies. Notwithstanding any provision herein to the contrary, failure to secure the insurance coverage, or the failure to comply fully with any of the insurance provisions of this Contract, or the failure to secure such endorsements on the policies as may be necessary to carry out the terms and provisions of this Contract, (x) shall in no way act to relieve Contractor from the obligations of this Contract, and (y) shall constitute grounds for the immediate termination of this Contract by Company (in addition to any other rights or remedies available to the Company).

8.0 THIRD PARTY BENEFICIARIES

Except as provided in Section 6.9 above with regard to Company Group and Contractor Group, nothing herein shall be construed to confer any benefit on any third party not a party to this Contract nor to provide any rights to such third parties to enforce the provisions hereof.

9.0 TAXES AND CLAIMS

9.1

Contractor agrees to pay all taxes, licenses, and fees levied or assessed on Contractor in connection with or incident to the performance of this Contract by any governmental agency and unemployment compensation insurance, old age benefits, social security, or any other taxes upon the wages of Contractor, its agents, employees, and representatives. Contractor agrees to require the same agreements and be liable for any breach of such agreements by any of its sub-Contractors.

9.2

Contractor agrees to reimburse Company on demand for all such taxes or governmental charges, State or Federal, that Company may be required or deem it necessary to pay on account of employees of Contractor or its sub-Contractors. Contractor agrees to furnish Company with the information required to enable it to make the necessary reports and pay such taxes or charges. At its election, Company is authorized to deduct all sums so paid for such taxes and governmental charges from such amounts as may be or become due to Contractor hereunder.

9.3

Contractor agrees to pay all claims for labor, materials, services, and supplies furnished to Contractor hereunder and agrees to allow no lien or charge to be fixed upon the rig, the lease, the well, the land on which the well is located, or other property of Company or the party for whom Company is performing services with respect to such claims. Contractor agrees to indemnify, protect, defend, and hold Company harmless from and against all such claims, charges, and liens. If Contractor shall fail or refuse to pay any claims or indebtedness incurred by Contractor in connection with the services provided hereunder, it is agreed that Company shall have the right to pay any such claims or indebtedness out of any money due or to become due to Contractor hereunder. Notwithstanding the foregoing, Company agrees that it will not pay any such claim or indebtedness as long as same is being actively contested by Contractor and Contractor has taken all actions necessary (including the posting of a bond when appropriate) to protect the property interests of Company or any other party affected by such claim or indebtedness.

9.4

Before payments are made by Company to Contractor, Company may require Contractor to furnish proof that there are no unsatisfied claims for labor, materials, equipment, and supplies or for injuries to persons or property not covered by insurance.

8

10.0 LAWS, RULES AND REGULATIONS

10.1

Company and Contractor respectively agree to comply with all laws, rules, and regulations which are now or may become applicable to operations covered by this Contract or arising out of the performance of such operations. If either party is required to pay any fine or penalty resulting from the other party's failure to comply with such laws, rules, or regulations, the party failing to comply shall immediately reimburse the other for any such payment.

10.2

In the event any provision of this Contract is inconsistent with or contrary to any applicable law, rule, or regulation, said provision shall be deemed to be modified to the extent required to comply with said law, rule, or regulation, and this Contract as so modified, shall remain in full force and effect.

10.3

This Contract shall be governed, construed and interpreted in accordance with the laws of Texas.

11.0 FORCE MAJEURE

Except for the duty to make payments hereunder when due, and the indemnification provisions under this Contract, neither Company nor Contractor shall be responsible to the other for any delay, damage or failure caused by or occasioned by a Force Majeure Event. As used in this Contract, "Force Majeure Event" includes, but is not limited to: acts of God, action of the elements, warlike action, insurrection, revolution or civil strife, piracy, civil war or hostile action, strikes, differences with workers, acts of public enemies, federal or state laws, rules and regulations of any governmental authorities having jurisdiction in the premises or of any other group, organization or informal association (whether or not formally recognized as a government); inability to procure material, equipment or necessary labor in the open market, acute and unusual labor or material or equipment shortages, or any other causes (except financial) beyond the control of either party. Delays due to the above causes, or any of them, shall not be deemed to be a breach of or failure to perform under this Contract. Neither Company nor Contractor shall be required against its will to adjust any labor or similar disputes except in accordance with applicable law.

12.0 PATENTS

In addition to all other indemnity provisions contained herein, Contractor represents and warrants that the use or construction of any and all tools and equipment furnished by Contractor and used in the work provided for herein does not infringe on any license or patent issued or applied for, and Contractor agrees to indemnify and hold Company harmless from any and all claims, demands, and causes of action of every kind and character in favor of or made by an patentee, licensee, or claimant of any rights or priority to such tool or equipment, or the use or construction thereof, that may result from or arise out of furnishing or use of any such tool or equipment by Contractor in connection with the work.

13.0 ASSIGNMENTS

Company and Contractor agree that neither will assign or delegate this Contract or any of the work or services required hereunder, except for work normally performed by Contractors, and not to assign any sum that may accrue to Contractor hereunder, without prior written consent of the other party. If any assignment by Company is made that significantly alters Contractor's financial burden, Contractor's compensation shall be adjusted to give effect to any change in Contractor's operating costs.

14.0 TERMINATION OF WORK

14.1

Company may, with 30 days written notification, in its sole discretion, terminate work covered by any work order, oral or written, issued hereunder, in which event Contractor shall be paid at the applicable rates stipulated in Contractor's Rate Schedule or Bid for services rendered up to the date of such termination. In no event shall Contractor be entitled to be paid prospectively for work unperformed by reason of such termination, nor shall Contractor be entitled to any other compensation or damages for loss of anticipated profits or otherwise. On notice of such termination, Contractor shall promptly remove its personnel, machinery, and equipment from the location and shall further cooperate with Company or its designee to ensure an orderly and expeditious transition and completion of the work.

14.2

The foregoing paragraph shall in no way limit (other than compensation for goods and/or services already provided) Company's right

to terminate Contractor without additional compensation in the event of Contractor's breach of this Contract.

15.0 GIFTS AND GRATUITIES

It is considered to be in conflict with the Company's interest for its employees or any member of their immediate family to accept gifts, payments, extravagant entertainment, services, or loans in any form from anyone soliciting business, or who may already have established business relations with the Company. Gifts of nominal value and entertainment, meals, and social invitations that are customary and proper under the circumstances and do not place the recipient under obligation are acceptable. If any employee of the Company should solicit a gift or gratuity from the Contractor, Contractor hereby agrees to notify an officer of the Company of such act. It is agreed that the Company will hold such notification in confidence. It is further understood that failure by the Contractor to comply with the Company's policies regarding gifts and gratuities may, at the Company's option, result in the termination of this Contract and may further preclude any future dealings between the parties.

16.0 ILLEGAL DRUGS, ALCOHOL, AND FIREARMS

16.1

To help insure a safe, productive work environment, Company may establish a program designed to prohibit the use, transportation and possession of firearms, drugs and/or controlled substances, drug paraphernalia and alcoholic beverages on drilling locations, or Company's other premises. Illegal drugs include marijuana, amphetamines, barbiturates, opiates, cocaine, codeine, morphine, hallucinogenic substances (LSD) and any similar drugs and/or chemicals synthetics deemed hazardous by Company.

16.2

Such programs, if established, upon notice shall apply to Contractor's employees, agents, servants and Contractors.

16.3

Company specifically reserves the right to carry out reasonable searches of individuals, their personal effects, and vehicles when entering on and leaving

10

Company's premises. The searches will be initiated by Company without prior announcement. Individuals found in violation will be removed from Company's premises immediately. Submission to such a search is strictly voluntary; however, refusal may be cause for not allowing that individual on the wellsite or Company's other premises. It is Contractor's responsibility to notify its employees of this prohibition and its enforcement.

17.0 GOVERNMENT REGULATIONS

The following regulations, where required by law, are incorporated in the agreement by reference as if fully set out.

- (1) The Equal Opportunity Clause prescribed in 41CFR 60-1.4;
- (2) The Affirmative Action Clause prescribed in 41 CFR 60-250.4 regarding veterans and veterans of the Vietnam era;
- (3) The Affirmative Action Clause for handicapped workers prescribed in 41 CFR 60- 741.4;
- (4) The Certification of Compliance with Environmental Laws prescribed in 40 CFR 15.20.

18.0 SPECIAL PROVISIONS

This Contract sets forth the entire agreement between Company and Contractor with respect to its subject matter. All prior negotiations and dealings regarding the subject matter hereof are superseded by and merged into the Contract, including any existing Master Service Contracts between Company and Verdisys, Inc. or any of its subsidiaries or divisions. No modification of this Contract shall be effective unless made in writing and signed by both parties.

19.0 NOTICES

Company: BlueRidge Gas Partners, LLC
4606 FM 1960, Suite 390
Houston, TX 77069

Office: 281-880-8080
Fax: 281-880-6556
Verdisys Inc.
25025 I-45, Suite 525
The Woodlands, Texas 77380
Office: 281-364-6999
Fax: 281-364-8007

Contractor:

11

20.0 ACCEPTANCE OF CONTRACT

IN WITNESS WHEREOF, the parties hereto have executed this Contract upon the date above shown in several counterparts, each of which shall be considered as an original.

COMPANY

By: /s/ T. Pat Harrison

Title: Member

Date: 06-24-04

CONTRACTOR

By: /s/ David M. Adams

Title: President and Co-CEO

Date: 6/28/04

12

INSURANCE

Exhibit A

Contractor shall carry insurance (with reliable insurance companies that are satisfactory to Company) in the minimum amounts set forth below, such insurance to be effective prior to the commencement of any work under this Contract. In each such policy, to the extent of the liabilities agreed to be assumed by Contractor, Contractor shall cause (i) all deductibles to be for Contractor's account, (ii) the insurer to waive all rights of subrogation against Company Group, (iii) Company Group to be listed as additional insureds, and (iv) such policy to be primary as to any other existing valid and collectible insurance of Company Group or otherwise. Before engaging in any work hereunder, Contractor shall furnish Company an executed Certificate of Insurance (in form satisfactory to Company) evidencing the foregoing insurance. Contractor shall cause each insurer to agree to give Company at least thirty days written notice of cancellation or expiration of any such policies or of any other changes that would materially reduce the limits of coverage of such policies. Notwithstanding any provision herein to the contrary, failure to secure the insurance coverage, or the failure to comply fully with any of the insurance provisions of this Contract, or the failure to secure such endorsements on the policy as may be necessary to carry out the terms and provisions of this contract, (x) shall in no way act to relieve Contractor from the obligations of this Contract, and (y) shall constitute grounds for the immediate termination of this Contract by Company (in addition to any other rights or remedies available to the Company).

1. Workers' Compensation insurance to the full extent required by all laws applicable in any jurisdiction in which the Work is to be performed or the contracts of employment for Contractor's employees are made or expressed to be made. The Employer's Liability Insurance shall not be less than \$1,000,000.
2. Comprehensive or Commercial General Liability insurance for any incidents or series of incidents covering the operations of the Contractor in the performance of the contract, in an amount of not less than \$1,000,000.
3. Automobile Bodily Injury and Property Damage Liability Insurance extending to owned, non-owned, and hired automobiles used by Contractor in the performance of this Contract in the amount of not less than \$1,000,000.

RADIAL DRILLING OPTIMIZATION SERVICES

EXHIBIT "B"

Verdisys, Inc. ("Verdisys") to conduct lateral drilling services for BlueRidge Gas Partners, LLC et al ("BlueRidge") in the West Virginia operating area. This work will be performed pursuant to the terms and conditions of that certain Master Service Contract that was entered into by our companies on this 24th day, of June,2004, except as modified herein.

(a)

Work Scope:

1.

A pilot project consisting of a minimum of one to eight-wells with approximately 10 to 15 zones. Verdisys will jet-drill laterals up to 300' each in wells selected by BlueRidge at depths determined by BlueRidge. Well depths will not exceed 6,000' measured depth from the ground surface.

(b)

Commercial Terms:

1.

BlueRidge will pay \$15,000 seven (7) days prior to Verdisys mobilizing the lateral drilling unit to West Virginia. Thereafter, BlueRidge will pay the estimated cost of each well prior to spudding the lateral drilling unit on the well location selected by BlueRidge. The estimated cost per well, based on the information supplied by BlueRidge is: 2 days - \$25,000.

Verdisys to provide:

- Verdisys Lateral Drilling Unit w/ crew
- Verdisys lateral drilling equipment
- Fuel and consumables for Verdisys unit

Esperada to provide:

- Pulling unit
- Wireline/logging unit
- 2 " tubing string set at depth
- Lubricator/BOP (if required)
- Jetting fluid plus specialty additives

Rate schedule:

Day Rate - \$12,500 – Verdisys works or is available

to work a minimum of 8 hours and a maximum of 10 hours per day

o Standby Rate - \$6,250 – Verdisys unable to work due to unsafe weather conditions or if BlueRidge chooses not to work weekends

o Repair Rate - Verdisys shut down due to Verdisys surface equipment repair (Day Rate prorated to 8 hour work day)

Mobilization/demobilization - \$15,000 (Roundtrip)

3rd party equipment/services provided at cost plus 15%

ACCEPTED BY:

BLUERIDGE

By: T. Pat Harrison

Title: Member

Date: 06/24/04

VERDISYS

By: /s/ David M. Adams

Title: President & Co-CEO__

Date: 6/28/04

MASTER SERVICE CONTRACT

THIS AGREEMENT (this "Contract"), made and entered into and shall be effective as of this 21st day of July, 2004, by and between the parties herein designated as "Company" and "Contractor".

Company: VJI Natural Resources, LLC

Address:

2811 Wilshire Blvd.
Suite 570
San Monica, California 90403

Contractor: Verdisys Inc., its subsidiaries, divisions and other affiliates

Address:

The individual, subsidiary, division or affiliate providing services shall be deemed Contractor with respect to such services and shall provide its address for notice purposes before commencing same.

WITNESSETH: THAT,

WHEREAS, Company in the course of such operations regularly and customarily enters into contracts with independent contractors for the performance of service relating thereto; and

WHEREAS, Company desires, as a matter of company policy, to establish and maintain an approved list of Contractors and to offer work or contracts only to those Contractors who are included on such approved list; and

WHEREAS, Contractor represents that it has adequate equipment in good working order and fully trained personnel capable of efficiently operating such equipment and performing services for Company.

NOW THEREFORE IN CONSIDERATION of the mutual promises, conditions and agreements herein contained, the sufficiency of which is hereby acknowledged, and the specifications and special provisions set forth in the exhibits attached hereto and made a part hereof, the parties mutually agree as follows:

1.0 AGREEMENT

Upon execution of this Contract, Company agrees that the name of Contractor shall be added to the Company's approved list of Contractors and this Contract shall remain in force and effect until canceled by either party by giving the other party ten (10) days prior written notice at the respective address of either party. If current work extends past such ten-day period, then cancellation shall not be effective until work is completed. This Contract shall control and govern all work performed by Contractor for Company, under subsequent verbal and/or written work orders. Agreement or stipulations in any such work order, delivery ticket, or other instrument, used by Contractor not in conformity with the terms and provisions hereof shall be null and void. No waiver by Company of any of the terms, provisions or conditions

hereof shall be effective unless said waiver shall be in writing and signed by an authorized officer of Company and specifically referencing this Contract.

2.0 LABOR, WARRANTY, EQUIPMENT, MATERIALS, SUPPLIES AND SERVICES

2.1 When notified by Company by written work order of the services and/or equipment desired and upon acceptance of same, Contractor shall commence furnishing same at the agreed upon time, and continue such operations diligently and without delay, in strict conformity with the specifications and requirements contained herein and such work orders.

2.2 Contractor shall not employ in any work for Company any employee whose employment violates any labor, employment or other applicable laws. Contractor shall not employ in any work for Company any employee who is a minor.

2.3 All work or services rendered or performed by Contractor shall be done with due diligence in a good and workmanlike manner, using skilled, competent and experienced workmen and supervisors, and in accordance with good oilfield servicing practices.

(a)

NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED HEREIN, THE TERMS OF THIS PARAGRAPH APPLY TO ANY SERVICES AND TO ANY EQUIPMENT RENTED OR LEASED WITH OR WITHOUT AN OPERATOR. Contractor uses its best efforts to ensure that all service personnel furnished are competent and rental equipment is in good condition. Contractor personnel will attempt to perform the work requested; however, because of the nature of the work to be accomplished and unpredictable conditions, the results of such services cannot be and are not guaranteed. Contractor warrants the services provided hereunder for a period of thirty (30) days. NO WARRANTY IS GIVEN WITH RESPECT TO ENGINEERING AND TECHNICAL INFORMATION FURNISHED BY CONTRACTOR OR WITH RESPECT TO THE RESULTS OF THE SERVICES PROVIDED BY CONTRACTOR. CONTRACTOR MAKES NO WARRANTY OR REPRESENTATION, EXPRESS OR IMPLIED, AS TO THE DESIGN, OPERATION, OR QUALITY OF THE MATERIAL OR WORKMANSHIP OF RENTAL EQUIPMENT USED TO SUPPLY THE SERVICES PROVIDED TO COMPANY HEREUNDER, AND CONTRACTOR MAKES NO WARRANTY OF MERCHANTABILITY OR FITNESS OF THE EQUIPMENT FOR ANY PARTICULAR PURPOSE OR ANY OTHER REPRESENTATION OR WARRANTY WHATSOEVER.

(b)

Contractor shall have no responsibility for any materials furnished and/or specified-by Company.

(c)

With regard to materials or equipment furnished by third party vendors and/or suppliers, Contractor's liability therefor shall be limited to the assignment of such third party vendor's and/or supplier's warranty to Company, provided such warranties are assignable.

(d)

NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED HEREIN, THE TERMS OF THIS PARAGRAPH APPLY TO THE SALE

OF ANY EQUIPMENT TO COMPANY. Contractor warrants equipment sold pursuant hereto to be free of defects in material and workmanship for a period of one (1) year after the date equipment is delivered. The above warranty does not apply to (i) used equipment that has been repaired or worked over; (ii) equipment that has been modified or subject to improper handling, storage, installation, operation or maintenance by Company, including use of unauthorized replacement parts; (iii) component parts not manufactured by Contractor, whether purchased by Contractor or furnished by Company, such parts being subject to any applicable manufacturer's warranty; (iv) parts requiring replacement because of natural wear and tear; (v) the design on those jobs where Contractor prepared drawings or lists from designs furnished by others; and (vi) models or samples furnished to Company as illustrations only of general properties of equipment. Contractor's liability for breach of this warranty is expressly limited to the repair or replacement, at its sole option, of any equipment or parts of equipment which prove to be defective during the warranty period. THIS LIMITED EXPRESS WARRANTY, AND THE STATED REMEDIES FOR BREACH THEREOF, SHALL BE IN LIEU OF ANY AND ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING WITHOUT LIMITATION, WARRANTIES FOR MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE.

2.4 Contractor agrees to maintain his equipment in good operating condition at all times and shall use all reasonable means to control and prevent fires and blowouts, protect the hole, and protect Company's equipment.

2.5 Notwithstanding anything to the contrary contained herein, except when Contractor's equipment is lost or damaged as a result of the sole negligence of Contractor, Company agrees to defend, indemnify and hold Contractor harmless from the loss of or damage to Contractor's tools or equipment occurring in the hole, or in the drill string below the level of the rotary table. Company will replace such tools/equipment or reimburse Contractor with the current replacement cost new. Should Company decide to replace lost or damaged tools/equipment, the replaced items should be new and purchased or obtained from a reputable manufacturer and should meet all original equipment manufacturer's specifications. Company agrees to reimburse Contractor for the cost of repair to such tools and equipment that are damaged other than from normal wear-and-tear during the rental period. However, before any major repairs are made to damaged equipment, approval for such repairs must be secured from an authorized representative of Company. Company shall not be responsible if Contractor's tools/equipment is damaged as a result of Contractor's negligent acts and/or omissions.

2.6 Notwithstanding anything to the contrary contained herein, it is expressly agreed and understood that in the event Contractor's equipment is leased or rented to Company pursuant to the Contract and is not returned or is damaged beyond repair, Company will replace such equipment or reimburse Contractor with the current replacement cost new of such equipment. Should Company decide to replace lost or damaged assets, the replaced items should be new and purchased or obtained from a reputable manufacturer and

should meet all original equipment manufacturer's specifications.

Company agrees to reimburse Contractor for the cost of repair to such tools and equipment that are damaged other than from normal wear-and-tear during the rental

period. However, before any major repairs are made to damaged equipment, approval for such repairs must be secured from an authorized representative of Company. Company shall not be responsible to the extent that Contractor's equipment is damaged as a result of Contractor's negligent acts and/or omissions.

3.0 PAYMENT

3.1 Once credit is established, normal terms will be net thirty (30) days after receipt of an invoice. The Company shall pay Contractor at the rate stipulated in the Work Agreement provided for herein, subject to same being accepted by Company as fully complying with all the terms, conditions, specifications and requirements of this Contract. Should company not meet Contractor's credit criteria, prepayment may be required.

3.2 Company shall have the right to audit Contractor's books and records relating to all invoices issued pursuant to this agreement. Contractor agrees to maintain such books and records for a period of two (2) years from the date such costs were incurred and to make such books and records available to Company at any time or times within such two (2) year period.

3.3 In the event that Company's account with Contractor becomes delinquent, Contractor has the right to revoke any and all discounts previously applied in arriving at the net invoice price. Upon revocation, the full invoice price without discount will become immediately due and owing and subject to collection. Notwithstanding anything herein to the contrary, Contractor may file liens if Company fails to pay Contractor's valid charges as required by this Contract or any court order.

4.0 REPORTS TO BE FURNISHED BY CONTRACTOR

4.1 The quantity, description and condition of the materials and supplies and/or services furnished shall be verified and checked by Contractor, and all delivery tickets shall be properly certified as to receipt by Contractor's representative. Contractor must obtain approval of Company's representative on the well site of delivery tickets for materials and supplies for which Contractor is to be reimbursed by Company.

4.2 Contractor shall immediately orally report to Company, as soon as practicable followed by an appropriate written report, all accidents or occurrences resulting in death or injuries to Contractor's employees, agents or third parties, or damage to property of Company or third parties arising out of or during the course of work to be performed hereunder. Contractor shall furnish Company with a copy (within ten days) of all records made available by Contractor to Contractor's insurer or governmental authorities or to others of such accidents and occurrences.

5.0 INDEPENDENT COMPANY RELATIONSHIP

In the performance of any work by Contractor for Company, Contractor shall be deemed to be an independent contractor, with the authority and right to direct and control all of the details of the work, Company being interested only in the results obtained. However, all work contemplated shall meet the approval of Company and shall be subjected to the general right of inspection. Company shall have no right or authority to supervise or give instructions to the employees, agents, or representative of Contractor, but such employees, agents or representatives at all times shall be under the direct and sole supervision and control of

Contractor. Any suggestions or directions given by Company or its employees shall be given only to the superintendent or other person in charge of Contractor's crew, provided however, that in the event any employee of Company should give any order or instructions to the employees of Contractor (which employee of Company shall not in any event be authorized to do) and such order is not countermanded by Contractor's superintendent or other person in charge of Contractor's employees or crew, it shall be deemed that such orders or instructions are the orders or instructions of Contractor. It is the understanding and intention of the parties hereto that no relationship of master and servant or principal and agent shall exist between Company and the employees, agents, or representatives of Contractor, and that all work or services covered hereby shall be performed at the sole risk of Contractor.

6.0 INDEMNITY OBLIGATIONS

6.1 Definitions. The following terms shall have the designated definitions.

(a)

Company Group includes, individually or in any combination, Company, its affiliates, contractors (other than Contractor) and entities for whom Company is performing services and each of their respective directors, officers agents, representatives, employees and invitees.

(b)

Contractor Group includes, individually or in any combination, Contractor, and its affiliates and contractors, and each of their respective directors, officers, agents, representatives, employees and invitees.

(c)

Defend – the obligation of the indemnitor (i) to defend the indemnitees at its sole expense, or at the indemnitees' election (ii) to reimburse the indemnitees for the indemnitees' reasonable expenses incurred in defending themselves. Notwithstanding the indemnitee's election of option (i) above, the indemnitee shall be entitled to participate in its defense at its sole cost.

(d)

Losses – claims, demands, causes of action, losses, judgments, liabilities, indemnity obligations, costs, damages or expenses of any kind and character (including attorney's fees and other legal expenses).

6.2 Contractor. Contractor shall release, defend, indemnify, and hold harmless Company

Group from and against any and all Losses arising out of bodily injury or death or property damage or loss (including patent or license infringement resulting from the use of the Contractor Group's property) suffered by any of the Contractor Group in connection with this Contract, **REGARDLESS OF WHETHER CAUSED OR CONTRIBUTED TO BY THE SOLE, JOINT OR CONCURRENT NEGLIGENCE (IN ANY AMOUNT), STRICT LIABILITY OR OTHER FAULT OF ANY MEMBER OF COMPANY GROUP.**

6.3 Company. Company shall release, defend, indemnify, and hold harmless Contractor

Group from and against all Losses arising out of bodily injury or death or property damage or loss (including patent or license infringement resulting from the use of the Company Group's property) suffered by any of the Company Group in connection with this Contract, **REGARDLESS OF WHETHER CAUSED OR CONTRIBUTED TO BY THE SOLE, JOINT OR CONCURRENT NEGLIGENCE (IN ANY AMOUNT), STRICT LIABILITY OR OTHER FAULT OF ANY MEMBER OF CONTRACTOR GROUP.**

5

6.4 Insurance Support/Limitation. The mutual indemnity obligations in Sections 6.2 and

6.3 above shall be supported by insurance provided by the parties hereto in the amounts and the types described in Exhibit A. Notwithstanding anything in this Contract to the contrary, (i) in the event enforcement of Sections 6.2 and/or 6.3 above is governed by the Texas Anti-Indemnity Statute (Tex. Civ. Prac. & Rem. Code Ann. Secs. 127.001-127.007 (1986 & Supp. 1996) as amended) or similar statute in another jurisdiction, and (ii) to the extent the indemnified Losses under such Section 6.2 or 6.3, as applicable, result from the indemnitee's negligence, then the obligations of the indemnitor under such Section 6.2 or 6.3, as applicable, shall be limited to the extent of insurance required to be provided by both parties pursuant to this Section 6.4 (or any such greater amount allowed by law).

6.5 **NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED HEREIN, COMPANY HEREBY AGREES TO ASSUME THE ENTIRE RESPONSIBILITY AND LIABILITY FOR, AND AGREES TO RELEASE,**

DEFEND, INDEMNIFY AND HOLD CONTRACTOR HARMLESS FROM AND AGAINST ALL CLAIMS, LIABILITIES, DAMAGES AND EXPENSES (INCLUDING WITHOUT LIMITATION ATTORNEYS' FEES, COURT COSTS, EXPERT WITNESS FEES AND ANY OTHER COST OF DEFENSE) FOR AND ARISING OUT OF THE FOLLOWING SPECIFIED TYPES OF CLAIMS, LOSSES OR EVENTS:

1. **LOSS OR LIABILITY FOR DAMAGES OR AN EXPENSE ARISING FROM PROPERTY INJURY THAT RESULTS FROM RESERVOIR OR UNDERGROUND DAMAGE, INCLUDING LOSS OF OIL, GAS, OTHER MINERAL SUBSTANCE, OR WATER OR THE WELLBORE ITSELF; OR**
2. **LOSS OR LIABILITY FOR DAMAGES OR ANY EXPENSE ARISING FROM COST OF CONTROL OF WILD WELL, UNDERGROUND OR ABOVE THE SURFACE.**

THIS OBLIGATION TO INDEMNIFY, DEFEND AND RELEASE APPLIES REGARDLESS OF WHETHER OR NOT THE CLAIM OR

LOSS IS OCCASIONED BY OR RESULTS FROM THE ACTUAL OR ALLEGED NEGLIGENCE OF CONTRACTOR OR ANY OTHER PERSON, OR ENTITY, IN WHOLE OR IN PART, WHETHER SOLE, JOINT, ACTIVE OR PASSIVE, EXCEPT TO THE EXTENT THE CLAIM OR LOSS IS DUE TO CONTRACTOR'S SOLE NEGLIGENCE, GROSS NEGLIGENCE OR WILLFUL MISCONDUCT.

6.6. NOTWITHSTANDING THE FOREGOING, CONTRACTOR SHALL HAVE SOLE

RESPONSIBILITY AND LIABILITY FOR THE CONTROL AND REMOVAL OF AND SHALL HOLD COMPANY HARMLESS FROM PROPERTY LOSS OR DAMAGE, FINES AND/OR PENALTIES FROM SUCH POLLUTION OR CONTAMINATION THAT RESULTS FROM SPILLS OF FUELS, LUBRICANT, MOTOR OILS, PIPEDOPE, PAINTS, SOLVENTS, BALLAST, BILGE, METALLIC OBJECTS AND GARBAGE IN CONTRACTOR'S SOLE POSSESSION AND CONTROL, REGARDLESS OF OWNERSHIP, REGARDLESS OF WHETHER OR NOT OCCASIONED BY OR RESULTING FROM THE NEGLIGENCE, STRICT LIABILITY, BREACH OF WARRANTY OR

6

OTHER FAULT OF COMPANY, IN WHOLE OR IN PART, WHETHER SOLE, JOINT, ACTIVE OR PASSIVE. THE INITIATION OF CLEAN-UP OPERATIONS INCLUDING CONTROL, RESPONSE AND REMOVAL, BY EITHER PARTY SHALL NOT BE AN ADMISSION OF ASSUMPTION OF LIABILITY BY THE INITIATING PARTY OR PARTIES.

6.7 Indirect or Consequential Damages. The parties hereto waive and release all claims against the other party for indirect, special, punitive or consequential damages arising out of this Contract, **REGARDLESS OF WHETHER CAUSED OR CONTRIBUTED TO BY THE SOLE, JOINT OR CONCURRENT**

NEGLIGENCE (IN ANY AMOUNT), STRICT LIABILITY OR OTHER FAULT OF ANY OF THE OTHER PARTY. As used herein, "indirect or consequential damages" shall include, but not be limited to, loss of revenue, profit or use of capital, production delays, loss of product, reservoir loss or damage, losses resulting from failure to meet other contractual commitments or deadlines and downtime of facilities or vessels.

6.8 No Limit. Except as otherwise provided herein, the foregoing indemnity obligations shall not be limited to the amount of insurance of the parties.

6.9 The provisions of this Section shall extend to and be enforceable by and for the benefit of Contractor Group and Company Group.

6.10 During the term of this Contract, Contractor and its subcontractors or their officers, directors and employees may have occasion to be upon or about property, platforms, vessels, equipment or other premises belonging to or under the control of or in the possession of or under contract to Company while performing services for another company or while in transit between a vessel and another location. In such event, Contractor's and Company's indemnification rights and obligations under this Contract shall apply to the same extent as if Contractor had been employed at the request of or for the benefit or account of Company.

6.11 Should Louisiana law be applicable to this Contract and the activities performed hereunder, Contractor and Company agree to recognize Company as the statutory employer of employees of Contractor while such employees are performing services to be supplied by Contractor under this agreement. This provision is included for the sole purpose of establishing a statutory employer relationship to gain benefits expressed in La. Rev. Stat. 23:1031 (C-E) and La. Rev. Stat. 23:1061 (A) and is not intended to create an employer/employee relationship for any other purpose.

7.0 INSURANCE

Contractor shall carry insurance (with reliable insurance companies that are satisfactory to Company) in the amounts set forth in Exhibit A, such insurance to be effective prior to the commencement of any work under this Contract. In each such policy, to the extent of the liabilities agreed to be assumed by Contractor, Contractor shall cause (i) all deductibles to be for Contractor's account, (ii) the insurer to waive all rights of subrogation against Company Group, (iii) Company Group to be listed as additional insureds, and (iv) such policy to be primary as to any other existing valid and collectible insurance of Company Group or otherwise. Before engaging in any work hereunder, Contractor shall furnish Company an

7

executed Certificate of Insurance (in form satisfactory to Company) evidencing the foregoing insurance. Contractor shall cause each insurer to agree to give Company at least thirty (30) days written notice of cancellation or expiration of any such policies or of any other changes that would materially reduce the limits of coverage of such policies. Notwithstanding any provision herein to the contrary, failure to secure the insurance coverage, or the failure to comply fully with any of the insurance provisions of this Contract, or the failure to secure such endorsements on the policies as may be necessary to carry out the terms and provisions of this Contract,

(x) shall in no way act to relieve Contractor from the obligations of this Contract, and (y) shall constitute grounds for the immediate termination of this Contract by Company (in addition to any other rights or remedies available to the Company).

8.0 THIRD PARTY BENEFICIARIES

Except as provided in Section 6.9 above with regard to Company Group and Contractor Group, nothing herein shall be construed to confer any benefit on any third party not a party to this Contract nor to provide any rights to such third parties to enforce the provisions hereof.

9.0 TAXES AND CLAIMS

9.1 Contractor agrees to pay all taxes, licenses, and fees levied or assessed on Contractor in connection with or incident to the performance of this Contract by any governmental agency and unemployment compensation insurance, old age benefits, social security, or any other taxes upon the wages of Contractor, its agents, employees, and representatives. Contractor agrees to require the same agreements and be liable for any breach of such agreements by any of its sub-Contractors.

9.2 Contractor agrees to reimburse Company on demand for all such taxes or governmental charges, State or Federal, that Company may be required or deem it necessary to pay on account of employees of Contractor or its sub-Contractors.

Contractors agrees to furnish Company with the information required to enable it to make the necessary reports and pay such taxes or charges. At its election, Company is authorized to deduct all sums so paid for such taxes and governmental charges from such amounts as may be or become due to Contractor hereunder.

9.3 Contractor agrees to pay all claims for labor, materials, services, and supplies furnished to Contractor hereunder and agrees to allow no lien or charge to be fixed upon the rig, the lease, the well, the land on which the well is located, or other property of Company or the party for whom Company is performing services with respect to such claims. Contractor agrees to indemnify, protect, defend, and hold Company harmless from and against all such claims, charges, and liens. If Contractor shall fail or refuse to pay any claims or indebtedness incurred by Contractor in connection with the services provided hereunder, it is agreed that Company shall have the right to pay any such claims or indebtedness out of any money due or to become due to Contractor hereunder.

Notwithstanding the foregoing, Company agrees that it will not pay any such claim or indebtedness as long as same is being actively contested by Contractor and Contractor has taken all actions necessary (including the posting of a bond when appropriate) to protect the property interests of Company or any other party affected by such claim or indebtedness.

9.4 Before payments are made by Company to Contractor, Company may require Contractor to furnish proof that there are no unsatisfied claims for labor, materials,

equipment, and supplies or for injuries to persons or property not covered by insurance.

10.0 LAWS, RULES AND REGULATIONS

10.1 Company and Contractor respectively agree to comply with all laws, rules, and regulations which are now or may become applicable to operations covered by this Contract or arising out of the performance of such operations. If either party is required to pay any fine or penalty resulting from the other party's failure to comply with such laws, rules, or regulations, the party failing to comply shall immediately reimburse the other for any such payment.

10.2 In the event any provision of this Contract is inconsistent with or contrary to any applicable law, rule, or regulation, said provision shall be deemed to be modified to the extent required to comply with said law, rule, or regulation, and this Contract as so modified, shall remain in full force and effect.

10.3 This Contract shall be governed, construed and interpreted in accordance with the laws of Texas.

11.0 FORCE MAJEURE

Except for the duty to make payments hereunder when due, and the indemnification provisions under this Contract, neither Company nor Contractor shall be responsible to the other for any delay, damage or failure caused by or occasioned by a Force Majeure Event. As used in this Contract, "Force Majeure Event" includes, but is not limited to: acts of God, action of the elements, warlike action, insurrection, revolution or civil strife, piracy, civil war or hostile action, strikes, differences with workers, acts of public enemies, federal or state laws, rules and regulations of any governmental authorities having jurisdiction in the premises or of any other group, organization or informal association (whether or not formally recognized as a government); inability to procure material, equipment or necessary labor in the open market, acute and unusual labor or material or equipment shortages, or any other causes (except financial) beyond the control of either party. Delays due to the above causes, or any of them, shall not be deemed to be a breach of or

failure to perform under this Contract. Neither Company nor Contractor shall be required against its will to adjust any labor or similar disputes except in accordance with applicable law.

12.0 PATENTS

In addition to all other indemnity provisions contained herein, Contractor represents and warrants that the use or construction of any and all tools and equipment furnished by Contractor and used in the work provided for herein does not infringe on any license or patent issued or applied for, and Contractor agrees to indemnify and hold Company harmless from any and all claims, demands, and causes of action of every kind and character in favor of or made by an patentee, licensee, or claimant of any rights or priority to such tool or equipment, or the use or construction thereof, that may result from or arise out of furnishing or use of any such tool or equipment by Contractor in connection with the work.

13.0 ASSIGNMENTS

9

Company and Contractor agree that neither will assign or delegate this Contract or any of the work or services required hereunder, except for work normally performed by Contractors, and not to assign any sum that may accrue to Contractor hereunder, without prior written consent of the other party. If any assignment by Company is made that significantly alters Contractor's financial burden, Contractor's compensation shall be adjusted to give effect to any change in Contractor's operating costs.

14.0 TERMINATION OF WORK

14.1 Company may, with 30 days written notification, in its sole discretion, terminate work covered by any work order, oral or written, issued hereunder, in which event Contractor shall be paid at the applicable rates stipulated in Contractor's Rate Schedule or Bid for services rendered up to the date of such termination. In no event shall Contractor be entitled to be paid prospectively for work unperformed by reason of such termination, nor shall Contractor be entitled to any other compensation or damages for loss of anticipated profits or otherwise. On notice of such termination,

Contractor shall promptly remove its personnel, machinery, and equipment from the location and shall further cooperate with Company or its designee to ensure an orderly and expeditious transition and completion of the work.

14.2 The foregoing paragraph shall in no way limit (other than compensation for goods and/or services already provided) Company's right to terminate Contractor without additional compensation in the event of Contractor's breach of this Contract.

15.0 GIFTS AND GRATUITIES

It is considered to be in conflict with the Company's interest for its employees or any member of their immediate family to accept gifts, payments, extravagant entertainment, services, or loans in any form from anyone soliciting business, or who may already have established business relations with the Company. Gifts of nominal value and entertainment, meals, and social invitations that are customary and proper under the circumstances and do not place the recipient under obligation are acceptable. If any employee of the Company should solicit a gift or gratuity from the Contractor, Contractor hereby agrees to notify an officer of the Company of such act. It is agreed that the Company will hold such notification in confidence. It is further understood that failure by the Contractor to comply with the Company's policies regarding gifts and gratuities may, at the Company's option, result in the termination of this Contract and may further preclude any future dealings between the parties.

16.0 ILLEGAL DRUGS, ALCOHOL, AND FIREARMS

16.1 To help insure a safe, productive work environment, Company may establish a program designed to prohibit the use, transportation and possession of firearms, drugs and/or controlled substances, drug paraphernalia and alcoholic beverages on drilling locations, or Company's other premises. Illegal drugs include marijuana, amphetamines, barbiturates, opiates, cocaine, codeine, morphine, hallucinogenic substances (LSD) and any similar drugs and/or chemicals synthetics deemed hazardous by Company.

16.2 Such programs, if established, upon notice shall apply to Contractor's employees, agents, servants and Contractors.

10

16.3 Company specifically reserves the right to carry out reasonable searches of individuals, their personal effects, and vehicles when entering on and leaving Company's premises. The searches will be initiated by Company without prior announcement. Individuals found in violation will be removed from Company's premises immediately. Submission to such a search is strictly voluntary; however, refusal may be cause for not allowing that individual on the wellsite or Company's other premises. It is Contractor's responsibility to notify its employees of this prohibition and its enforcement.

INSURANCE**Exhibit A**

Contractor shall carry insurance (with reliable insurance companies that are satisfactory to Company) in the minimum amounts set forth below, such insurance to be effective prior to the commencement of any work under this Contract. In each such policy, to the extent of the liabilities agreed to be assumed by Contractor, Contractor shall cause (i) all deductibles to be for Contractor's account, (ii) the insurer to waive all rights of subrogation against Company Group, (iii) Company Group to be listed as additional insureds, and (iv) such policy to be primary as to any other existing valid and collectible insurance of Company Group or otherwise. Before engaging in any work hereunder, Contractor shall furnish Company an executed Certificate of Insurance (in form satisfactory to Company) evidencing the foregoing insurance. Contractor shall cause each insurer to agree to give Company at least thirty days written notice of cancellation or expiration of any such policies or of any other changes that would materially reduce the limits of coverage of such policies. Notwithstanding any provision herein to the contrary, failure to secure the insurance coverage, or the failure to comply fully with any of the insurance provisions of this Contract, or the failure to secure such endorsements on the policy as may be necessary to carry out the terms and provisions of this contract, (x) shall in no way act to relieve Contractor from the obligations of this Contract, and (y) shall constitute grounds for the immediate termination of this Contract by Company (in addition to any other rights or remedies available to the Company).

1. Workers' Compensation insurance to the full extent required by all laws applicable in any jurisdiction in which the Work is to be performed or the contracts of employment for Contractor's employees are made or expressed to be made. The Employer's Liability Insurance shall not be less than \$1,000,000.
2. Comprehensive or Commercial General Liability insurance for any incidents or series of incidents covering the operations of the Contractor in the performance of the contract, in an amount of not less than \$1,000,000.
3. Automobile Bodily Injury and Property Damage Liability Insurance extending to owned, non-owned, and hired automobiles used by Contractor in the performance of this Contract in the amount of not less than \$1,000,000.

Excess Liability Insurance over and above the coverages listed above in the amount of not less than \$2,000,000.

Exhibit B**Work Agreement**

Radial Drilling Optimization Services

Verdisys, Inc. ("Verdisys") to conduct lateral drilling services for VJI Natural Resources, LLC ("VJI") in the Holley Field, Kansas. This work will be performed pursuant to the terms and conditions of that certain Master Service Contract ("MSC") that was entered into by our companies on _____, 2004, except as maybe modified herein.

Work Scope:

A pilot project consisting of one to three wells, with a minimum of four (4) laterals at one depth interval per well. Verdisys, following a seven (7) day job notice period, will drill laterals of up to 300' in wells selected by VJI at depths determined by VJI. Well depths will not exceed 5800' measured depth from the ground surface.

(i)

Verdisys to provide:

- o Lateral drilling rig with crew
- o Downhole lateral drilling equipment
- o Fuel and consumables for Verdisys unit

(ii)

VJI to provide:

- o Pulling unit to run work string prior to Verdisys rig up
- o Wireline/logging unit
- o Clean 2 7/8" work string
- o Lubricator and BOP (if required)
- o Jetting fluid plus specialty additives

(b) Commercial Terms:

- Mobilization/Demobilization - \$XXXX
- Lump sum per well drilled with four (4) laterals at one depth interval - \$XXXX
- Laterals requested by VJI above four (4) laterals at one depth - \$XXXX per lateral drilled
- VJI will pay \$XXXX seven (7) days prior to Verdisys mobilizing the lateral drilling unit to the Holley Field, Kansas. Thereafter, VJI will pay the estimated cost of each well prior to spudding the lateral drilling unit on the well location selected by VJI. The estimated cost per well based on the information supplied by VJI is: \$XXXX.
- Work will be performed where Verdisys works, or is available to work a minimum of 8 hours and a maximum of 12 hours per day. A Verdisys work day is defined as daylight operations.
- If VJI requests a Field Engineer then it will be charged at \$XXXX per day plus expenses.

14

-
- A well testing standby rate of \$XXXX per hour will apply if Verdisys is unable to work due to VJI well testing operations. Verdisys costs associated with lodging and meals will be included with the VJI well testing standby if the well testing standby time exceeds eight (8) hours per day.
 - A standby rate of \$XXXX per hour to a maximum of \$XXXX per day will apply if Verdisys is unable to work due to unsafe weather conditions, or if VJI chooses not to work weekends and holidays.
 - Third party equipment/services will be provided to VJI by Verdisys at cost plus 15%.
 - Verdisys shall be responsible for any third party services it incurs for its drilling services, during the period beginning after VJI has run in the work string and immediately prior to Verdisys rigging off location.

(c) Performance criteria:

Performance criteria for the project will be jointly defined and agreed to prior to initiating work with the price for the drilling services adjusted for any material shortfall or material increase in the workscope.

ACCEPTED BY:

VJI

By: /s/ Edward Margolin

Title: CEO

Date: July 26, 2004

VERDISY

By: /s/ David M. Adams

Title: President and Co-CEO

Date: July 26, 2004

15

**SOLICITATION/CONTRACT/ORDER FOR COMMERCIAL ITEMS
OFFEROR TO COMPLETE BLOCKS 12, 17, 23, 24, & 30**

1. REQUISITION NUMBER PAGE 1 OF 3

2. CONTRACT NO.
DE-AP91-D4WR01109

3. AWARD/EFFECTIVE DATE
6/4/04

4. ORDER NUMBER

5. SOLICITATION NUMBER

6. SOLICITATION ISSUE DATE

7. FOR SOLICITATION INFORMATION CALL:

a. NAME

b. TELEPHONE NUMBER (No collect calls)

8. OFFER DUE DATE/ LOCAL TIME

9. ISSUED BY CODE

10. THIS ACQUISITION IS
 UNRESTRICTED
 SET ASIDE: % FOR
 SMALL BUSINESS
 HUBZONE SMALL BUSINESS
 8(A)
 NAICS:
 SIZE STANDARD:

11. DELIVERY FOR FOB DESTINATION UNLESS BLOCK IS MARKED
 SEE SCHEDULE

12. DISCOUNT TERMS
Net 30

U.S. Department of Energy
NPOSR-CUW
907 N. Poplar, Suite 150
Casper WY 82601

13a. THIS CONTRACT IS A RATED ORDER UNDER DPAS (16 CFR 700)

13b. RATING

14. METHOD OF SOLICITATION
 RFQ IFB RFP

15. DELIVER TO CODE
See Block 9

16. ADMINISTERED BY CODE
See Block 9

17a. CONTRACTOR/OFFEROR CODE FACILITY CODE

18a. PAYMENT WILL BE MADE BY CODE

Verdisys
25025 I-45 North, Suite 525
The Woodlands TX 77380
TELEPHONE NO. 281-364-6999

U.S. Department of Energy
Oak Ridge Operations Office
Oak Ridge Financial Services Center
P.O. Box 4937
Oak Ridge TN 37831

17b. CHECK IF REMITTANCE IS DIFFERENT AND PUT SUCH ADDRESS IN OFFER

18b. SUBMIT INVOICES TO ADDRESS SHOWN IN BLOCK 18a UNLESS BLOCK BELOW IS CHECKED SEE ADDENDUM

19. ITEM NO.	20. SCHEDULE OF SUPPLIES/SERVICES	21. QUANTITY	22. UNIT	23. UNIT PRICE	24. AMOUNT
001	Drill 4 lateral @ 2 Shannon Wells, IAW Scope of Work	2	EA	\$70,000.00	\$140,000.00
002	Mobilization/Demobilization	1	EA	\$17,500.00	\$17,500.00

(Use Reverse and/or Attach Additional Sheets as Necessary)

25. ACCOUNTING AND APPROPRIATION DATA

26. TOTAL AWARD AMOUNT (For Govt. Use Only)
\$157,500.00

27a. SOLICITATION INCORPORATES BY REFERENCE FAR 52.212-1, 52.212-4, FAR 52.212-3 AND 52.212-5 ARE ATTACHED. ADDENDA ARE ARE NOT ATTACHED
 27b. CONTRACT/PURCHASE ORDER INCORPORATES BY REFERENCE FAR 52.212-4, FAR 52.212-5 IS ATTACHED. ADDENDA ARE ARE NOT ATTACHED

28. CONTRACTOR IS REQUIRED TO SIGN THIS DOCUMENT AND RETURN 2 COPIES TO ISSUING OFFICE. CONTRACTOR AGREES TO FURNISH AND DELIVER ALL ITEMS SET FORTH OR OTHERWISE IDENTIFIED ABOVE AND ON ANY ADDITIONAL SHEETS SUBJECT TO THE TERMS AND CONDITIONS SPECIFIED HEREIN.

29. AWARD OF CONTRACT: REF. OFFER DATED _____ YOUR OFFER ON SOLICITATION (BLOCK 5), INCLUDING ANY ADDITIONS OR CHANGES WHICH ARE SET FORTH HEREIN, IS ACCEPTED AS TO ITEMS:

30a. SIGNATURE OF OFFEROR/CONTRACTOR
David Adams

31b. UNITED STATES OF AMERICA (SIGNATURE OF CONTRACTING OFFICER)
Neil Haugland

30b. NAME AND TITLE OF SIGNER (Type or print)
DAVID M. ADAMS

30c. DATE SIGNED
6/17/04

31b. NAME OF CONTRACTING OFFICER (Type or print)
Neil Haugland

31c. DATE SIGNED
6/21/04

AUTHORIZED FOR LOCAL REPRODUCTION
PREVIOUS EDITION IS NOT USABLE

STANDARD FORM 1449 (REV. 4/2002)
Prescribed by GSA - FAR (48 CFR) 53.212

RECEIVED JUN 28 2004
CP

March 01, 2004

Mr. Cecil Foote
 Department of Energy
 907 N Poplar, Ste 150
 Casper, WY 82601

Re: **LETTER OF INTENT** - RADIAL DRILLING OPTIMIZATION SERVICES
 Shannon Sandstone

Dear Cecil:

This letter is to confirm your intent to contract with Verdisys, Inc. to provide radial drilling optimization for the following work scope in your field development penetrating the Shannon Sandstone.

Work Scope: Two wells to be determined by the DoE within pilot project commencing in three to six weeks. Verdisys will jet four laterals up to 300' in length per depth interval in two horizons (8 laterals per well) to a measured depth not to exceed 6,000'.

Verdisys to provide:

- Verdisys Lateral Drilling Unit with crew
- Verdisys lateral drilling equipment
- Fuel and consumables for Verdisys unit

DoE to provide:

- Pulling unit
- Wireline/logging unit
- Tubing string set at depth
- Lubricator (if required)
- Jetting fluid plus specialty additives

Rate schedule:

• Per-Well Rate	- \$35,000 (4 laterals @ 1 horizon)
	- \$2,500 per each additional lateral
	- \$1,000 per hour standby (>2 hrs/occur.)
• Mobilization/demobilization	- \$17,500 (roundtrip)
• Field Engineer (if requested)	- \$800 / day plus expenses (at cost)
• 3rd party equipment/services provided at cost plus 15%	

A master service contract is attached for your consideration. We look forward to a mutually successful project that will lead to a continued business relationship between our companies. Should you have any questions, please do not hesitate to contact us.

Sincerely,



David Adams
 President and COO
 Attachment

Accepted By:


Date: 4/14/4

Certification

I, David M. Adams, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Verdisys, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the small business issuer and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: August 10, 2004

/s/ David M. Adams

David M. Adams
Co-Chief Executive Officer
Chief Operating Officer
Principal Executive Officer

Certification

I, John O'Keefe, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Verdisys, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the small business issuer and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: August 10, 2004

/s/ John O'Keefe

John O'Keefe
Co-Chief Executive Officer
Chief Financial Officer
Principal Accounting Officer

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Verdisys, Inc. (the "Company") on Form 10-QSB for the period ending June 30, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David M. Adams, Chief Operating Officer and Principal Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1)

The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2)

The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

\s\ David M. Adams

David M. Adams
Co-Chief Executive Officer
Chief Operating Officer
Principal Executive Officer

August 10, 2004

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Verdisys, Inc. (the "Company") on Form 10-QSB for the period ending June 30, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John O'Keefe, Chief Financial Officer and Principal Accounting Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1)

The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2)

The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

\s\ John O'Keefe

John O'Keefe
Co-Chief Executive Officer
Chief Financial Officer
Principal Accounting Officer

August 10, 2004

Common Stock at \$

per Share With _____% Warrant Coverage at \$

_____per share

SUBSCRIPTION AGREEMENT

1. Subscription:

(a) The undersigned (individually and/or collectively, the "Subscriber") hereby applies to become a Subscriber in the private offering (the "Offering") of shares of common stock (the "Common Shares" or the "Shares") pursuant to the exemption afforded by Rule 506 under Regulation D under the Securities Act of 1933, as amended, of Verdisys, Inc., a California corporation (the "Company"), in accordance with the terms and conditions of this Subscription Agreement.

(b) Before this subscription for participation in the Shares is considered, the Subscriber must complete, execute and deliver to the Company the following:

- (i) This Subscription Agreement; and
 - (ii) The Subscriber's check in the amount provided on the signature page hereto.
-

(c) This subscription is irrevocable by the Subscriber.

(d) This subscription is not transferable or assignable by the Subscriber.

(e) This subscription may be rejected in whole or in part by the Company in its sole discretion. In the event this subscription is rejected by the Company, all funds and documents tendered by the Subscriber shall be returned.

2. Representations by Subscriber. In consideration of the Company's acceptance of participation,

I make the following representations and warranties and agreements to the Company, to its principals, and to participating broker-dealers, if any, jointly and severally, which warranties and representations and agreements shall survive any acceptance of my participation in the Shares:

(a) Subscriber represents and warrants that it is in receipt of and that it has carefully read the following items:

- (i) The Company's Form 10-K for the period ended December 31, 2003 (the "**Form 10-K**");
 - (ii) The Company's Form SB-2 (the "**SB-2**") filed on June 29, 2004 and particularly the Risk Factors contained therein.
-

(iii) All other documents filed by the Company with the SEC subsequent to the Company's Form 10-K and prior to the date of this Agreement, particularly the SB-2.

The documents listed shall be referred to herein as the "Disclosure Documents."

(b) Subscriber has been furnished with and has carefully read the Disclosure Documents including the Risk Factors listed in the SB-2 and is familiar with the terms of the Offering. With respect to individual or partnership tax and other economic considerations involved in this investment, Subscriber is not relying on the Company (or any agent or representative). Subscriber has carefully considered and has, to the extent Subscriber believes such discussion necessary, discussed with Subscriber's legal, tax, accounting and financial advisers the suitability of an investment in the Common Shares for Subscriber's particular tax and financial situation.

(c) Subscriber has had an opportunity to inspect relevant documents relating to the organization and operations of the Company. Subscriber acknowledges that all documents, records and books pertaining to this investment which Subscriber has requested have been made available for inspection by Subscriber and Subscriber's attorney, accountant or other adviser(s).

(d) Subscriber and/or Subscriber's advisor(s) has/have had a reasonable opportunity to ask questions of and receive answers and to request additional relevant information from a person or persons acting on behalf of the Company concerning the Offering.

(e) Subscriber is not subscribing for the Common Shares as a result of or subsequent to any advertisement, article, notice or other communication published in any newspaper, magazine or similar media or broadcast over television or radio or presented at any

seminar.

(f) Subscriber is an “accredited investor,” within the meaning of Rule 501(a) of

Regulation D under the Securities Act (“**Regulation D**”). Subscriber, by reason of Subscriber’s business or financial experience can be reasonably assumed to have the capacity to protect Subscriber’s own interests in connection with the transaction. Subscriber further acknowledges that Subscriber has read the written materials provided by the Company.

(g) Subscriber has adequate means of providing for Subscriber’s current financial needs and contingencies, is able to bear the substantial economic risks of an investment in the Common Shares for an indefinite period of time, has no need for liquidity in such investment and, at the present time, could afford a complete loss of such investment.

(h) Subscriber has such knowledge and experience in financial, tax and business matters so as to enable Subscriber to use the information made available to Subscriber in connection with the Offering to evaluate the merits and risks of an investment in the Common Shares and to make an informed investment decision with respect thereto.

(i) Subscriber acknowledges that the Common Shares herein subscribed for have not been registered under the Securities Act or under any State Act. Subscriber understands further that in absence of an effective Registration Statement, the Common Shares can only be sold pursuant to some exemption from registration, such as Rule 144 of the Act, which requires, among other conditions, that the Common Shares must be held for a minimum of one (1) year.

(j) Subscriber recognizes that investment in the Common Shares involves substantial risks. Subscriber acknowledges that Subscriber has reviewed the risk factors identified within the Disclosure Documents and on Attachment A hereof. Subscriber further recognizes that no Federal or state agencies

have passed upon this offering of the Common Shares or made any finding or determination as to the fairness of this investment.

(k) Subscriber acknowledges that each certificate representing the Common Shares shall contain a legend substantially in the following form:

THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 (THE “SECURITIES ACT”) OR UNDER APPLICABLE STATE SECURITIES LAWS AND MAY NOT BE SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF UNLESS REGISTERED UNDER THE SECURITIES ACT AND ANY APPLICABLE STATE SECURITIES LAWS OR PURSUANT TO AVAILABLE EXEMPTIONS FROM SUCH

REGISTRATION, PROVIDED THAT THE SELLER DELIVERS TO THE COMPANY AN OPINION OF COUNSEL (WHICH OPINION AND COUNSEL ARE REASONABLY SATISFACTORY TO THE COMPANY) CONFIRMING THE AVAILABILITY OF SUCH EXEMPTION. INVESTORS SHOULD BE AWARE THAT THEY MAY BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME.

(l) If this Agreement is executed and delivered on behalf of a partnership, corporation, trust or estate: (i) such partnership, corporation, trust or estate has the full legal right and power and all authority and approval required (a) to execute and deliver, or authorize execution and delivery of, this Agreement and all other instruments executed and delivered by or on behalf of such partnership, corporation, trust or estate in connection with the purchase of the Common Shares, (b) to delegate authority pursuant to a power of attorney and (c) to purchase and hold such Common Shares; (ii) the signature of the party signing on behalf of such partnership, corporation, trust or estate is binding upon such partnership, corporation, trust or estate; and (iii) such partnership, corporation or trust has not been formed for the specific purpose of acquiring the Common Shares, unless each beneficial owner of such entity is qualified as an “accredited investor” within the meaning of Regulation D and has submitted information substantiating such individual qualification.

(m) If Subscriber is a retirement plan or is investing on behalf of a retirement plan, Subscriber acknowledges that investment in the Common Shares poses risks in addition to those associated with other investments, including the inability to use losses generated by an investment in the Common Shares to offset taxable income.

(n) The information furnished by Subscriber in the Subscriber Questionnaire signed by Subscriber is true and accurate as of the date thereof.

3. Understandings of Subscriber.

Subscriber understands, acknowledges and agrees with the Company as follows:

(a) Subscriber hereby acknowledges and agrees that upon notice of acceptance from the Company, the Subscription hereunder is irrevocable by Subscriber, that, except as required by law, Subscriber is not entitled to cancel, terminate or revoke this Agreement or

any agreements of Subscriber hereunder and that this Subscription Agreement and such other agreements shall survive the death or disability of Subscriber and shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, executors, administrators, successors, legal representatives and permitted assigns. If Subscriber is more than one person, the obligations of Subscriber hereunder shall be joint and several and

the agreements, representations, warranties and acknowledgments herein contained shall be deemed to be made by and be binding upon each such person and his or her heirs, executors, administrators, successors, legal representatives and permitted assigns.

(b) No federal or state agency has made any findings or determination as to the fairness of the terms of this Offering for investment purposes; nor any recommendations or endorsements of the Common Shares.

(c) The Offering is intended to be exempt from registration under the Securities Act by virtue of Section 4(2) of the Securities Act and the provisions of Rule 506 of Regulation D thereunder, which is in part dependent upon the truth, completeness and accuracy of the statements made by Subscriber herein.

(d) It is understood that in order not to jeopardize the Offering's exempt status under Section 4(2) of the Securities Act and Regulation D, any transferee may, at a minimum, be required to fulfill the investor suitability requirements thereunder.

(e) No person or entity acting on behalf, or under the authority, of Subscriber is or will be entitled to any broker's, finder's or similar fee or commission in connection with this Subscription.

(f) Subscriber acknowledges that the information furnished in this Agreement by the Company to Subscriber or its advisers in connection with the Offering, is confidential and nonpublic and agrees that all such written information which is material and not yet publicly disseminated by the Company shall be kept in confidence by Subscriber and neither used by Subscriber for Subscriber's personal benefit (other than in connection with this Subscription), nor disclosed to any third party, except Subscriber's legal and other advisers who shall be advised of the confidential nature of such information, for any reason; provided, however, that this obligation shall not apply to any such information that (i) is part of the public knowledge or literature and readily accessible at the date hereof, (ii) becomes a part of the public knowledge or literature and readily accessible by publication (except as a result of a breach of this provision) or (iii) is received from third parties (except third parties who disclose such information in violation of any confidentiality agreements or obligations, including, without limitation, any subscription agreement entered into with the Company). The representations, warranties and agreements of Subscriber and the Company contained herein and in any other writing delivered in connection with the Offering shall be true and correct in all material respects on and as of the Closing Date of such Subscription as if made on and as of the date the Company executes this Agreement and shall survive the execution and delivery of this Agreement and the purchase of the Common Shares.

(g) IN MAKING AN INVESTMENT DECISION, SUBSCRIBER MUST RELY ON ITS OWN EXAMINATION OF THE COMPANY AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THE COMMON SHARES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

3. Agreement to Indemnify Company. I hereby agree to indemnify and hold harmless the

Company, its principals, the Company's officers, directors and attorneys, from any and all damages, costs and expenses (including actual attorneys' fees) which they may incur (i) by reason of my failure to fulfill any of the terms and conditions of participation, (ii) by reason of my breach of any of my representations, warranties or agreements contained herein; (iii) with respect to any and all claims made by or involving any person, other than me personally, claiming any interest, right, title, power or authority in respect to my participation. I further agree and acknowledge that these indemnifications shall survive any sale or transfer, or attempted sale or transfer, of any portion of my participation.

4. Subscription Binding on Heirs, etc. This subscription, upon acceptance by the Company, shall be binding upon the heirs, executors, administrators, successors and assigns of the Subscriber. If the undersigned is more than one person, the obligations of the undersigned shall be joint and several and the representations and warranties shall be deemed to be made by and be binding on each such person and his heirs, executors, administrators, successors, and assigns.

5. Execution Authorized. If this subscription is executed on behalf of a corporation, partnership, trust or other entity, the undersigned has been duly authorized and empowered to legally represent such entity and to execute this subscription and all other instruments in connection with participation in the Shares and the signature of the person is binding upon such entity.

6. Adoption of Terms and Provisions. The Subscriber hereby adopts, accepts and agrees to be bound by all the terms and provisions hereof.

7. Governing Law. This subscription shall be construed in accordance with the laws of the State of

Texas.

8. Investor Information:

(The information below should be consistent with the form of ownership selected below.)

Name (please print):

If entity named above, By:

Its:

Number of Shares

Check enclosed in the amount of \$

Social Security or Taxpayer I.D. Number:

Business Address (including zip code):

Business Phone: ()

Residence Address (including zip code):

Residence Phone: ()

All communications to be sent to: Business or Residence Address Please indicate below the form in which you will hold title to your interest in the Shares.

PLEASE CONSIDER CAREFULLY. ONCE YOUR SUBSCRIPTION IS ACCEPTED, A CHANGE IN THE FORM OF TITLE CONSTITUTES A TRANSFER OF THE INTEREST IN THE SHARES AND MAY THEREFORE BE RESTRICTED BY THE TERMS OF THIS SUBSCRIPTION, THE

MEMORANDUM OR THE SHARES AND MAY RESULT IN ADDITIONAL COSTS TO YOU. Subscribers should seek the advice of their attorneys in deciding in which of the forms they should take ownership of the interest in the Shares, because different forms of ownership can have varying gift tax, estate tax, income tax, and other consequences, depending on the state of the investor's domicile and his or her particular personal circumstances.

JOINT TENANTS WITH RIGHT OF SURVIVORSHIP AND NOT AS TENANTS IN COMMON (both or all parties must sign)

COMMUNITY PROPERTY (one signature required if interest held in one name, i.e., managing spouse; two signatures required if interest held in both names)

TENANTS IN COMMON (both or all parties must sign)

GENERAL PARTNERSHIP (fill out all documents in the name of the PARTNERSHIP, by a PARTNER authorized to sign, and include a copy of the Partnership Agreement)

LIMITED PARTNERSHIP (fill out all documents in the name of the LIMITED PARTNERSHIP, by a GENERAL PARTNER authorized to sign, and include a copy of the Limited Partnership Agreement and any other document showing that the investment is authorized)

LIMITED LIABILITY COMPANY (fill out all documents in the name of the LIMITED LIABILITY COMPANY, by a member authorized to sign, and include a copy of the LIMITED LIABILITY COMPANY's Operating Agreement and any other documents necessary to show the investment is authorized.)

CORPORATION (fill out all documents in the name of the CORPORATION, by the President or other officer authorized to sign, and include a copy of the Corporation's Articles and certified Corporate Resolution authorizing the signature)

TRUST (fill out all documents in the name of the TRUST, by the Trustee, and include a copy of the instrument creating the trust and any other documents necessary to show the investment by the Trustee is authorized. The date of the trust must appear on the Notarial where indicated.)

Subject to acceptance by the Company, the undersigned has completed this Subscription Agreement to evidence his/her subscription for participation in the Shares of the Company, this day of , 2004, at , .

Subscriber

The Company has accepted this subscription this day of , 2004.

Verdisys, Inc., a California Corporation

By

Its

WARRANT AGREEMENT

THIS WARRANT AGREEMENT (this "Agreement") is made and entered into as of July , 2004, between Verdisys, Inça California corporation (the "Company") and

("Holder").

RECITALS

WHEREAS, the Company proposes to issue to Holder

warrants (the "Warrants"), each such Warrant entitling the holder thereof to purchase one share of Common Stock, no par value, of the Company (the "Shares" or the "Common Stock"); and

WHEREAS, the Warrants which are the subject of this Agreement will be issued by the Company to Holder as part of consideration payable to Holder in connection with equity issued by the Company.

NOW, THEREFORE, in consideration of the premises and the mutual agreements herein set forth, the parties hereto agree as follows:

AGREEMENT

1. Warrant Certificates. The warrant certificates to be delivered pursuant to this Agreement

(the "Warrant Certificates") shall be in the form set forth in Exhibit A, attached hereto and made a part hereof, with such appropriate insertions, omissions, substitutions and other variations as are required or permitted by this Warrant Agreement.

2. Right to Exercise Warrants. Each Warrant may be exercised from the date of this Agreement until 11:59 P.M. (Houston time) on the date that is one year after the date of this Agreement (the "Expiration Date"). Each Warrant not exercised on or before the Expiration Date shall expire.

Each Warrant shall entitle its holder to purchase from the Company one share of Common Stock at an exercise price of \$ _____ per share, subject to adjustment as set forth below ("Exercise Price").

The Company shall not be required to issue fractional shares of capital stock upon the exercise of this Warrant or to deliver Warrant Certificates which evidence fractional shares of capital stock. In the event that a fraction of an Exercisable Share would, except for the provisions of this paragraph 2, be issuable upon the exercise of this Warrant, the Company shall pay to the Holder exercising the Warrant an amount in cash equal to such fraction multiplied by the current market value of the Exercise Share. For purposes of this paragraph 2, the current market value shall be determined as follows:

(a) if the Exercise Shares are traded in the over-the-counter market and not on any national securities exchange and not in the NASDAQ Reporting System, the average of the mean between the last bid and asked prices per share, as reported by the National Quotation Bureau, Inc., or an equivalent generally accepted reporting service, for the last business day prior to the date on which this Warrant is exercised, or, if not so reported, the average of the closing bid and asked prices for an Exercise Share as furnished to the Company by any member of the National Association of Securities Dealers, Inc., selected by the Company for that purpose.

(b) if the Exercise Shares are listed or traded on a national securities exchange or in the NASDAQ Reporting System, the closing price on the principal national securities exchange on which they are so listed or traded or in the NASDAQ Reporting System, as the case may be, on the last business day prior to the date of the exercise of this Warrant. The closing price referred to in this Clause (b) shall be the last reported sales price or, in case no such reported sale takes place on such day, the average of the reported closing bid and asked prices, in either case on the national securities exchange on which the Exercise Shares are then listed on in the NASDAQ Reporting System; or

1 of 4

(c) if no such closing price or closing bid and asked prices are available, as determined in any reasonable manner as may be prescribed by the Board of Directors of the Company.

3. Mutilated or Missing Warrant Certificates. In case any of the Warrant Certificates shall be mutilated, lost, stolen or destroyed prior to its expiration date, the Company shall issue and deliver, in exchange and substitution for and upon cancellation of the mutilated Warrant Certificate, or in lieu of and in substitution for the Warrant Certificate lost, stolen or destroyed, a new Warrant Certificate of like tenor and representing an equivalent right or interest.

4. Reservation of Shares. The Company will at all times reserve and keep available, free from preemptive rights, out of the aggregate of its authorized but unissued Shares or its authorized and issued Shares held in its treasury for the purpose of enabling it to satisfy its obligation to issue Shares upon exercise of Warrants, the full number of Shares deliverable upon the exercise of all outstanding Warrants.

The Company covenants that all Shares which may be issued upon exercise of Warrants will be validly issued, fully paid and non-assessable outstanding Shares of the Company.

5. Rights of Holder. The Holder shall not, by virtue of anything contained in this Warrant

Agreement or otherwise, prior to exercise of this Warrant, be entitled to any right whatsoever, either in law or equity, of a stockholder of the Company, including without limitation, the right to receive dividends or to vote or to consent or to receive notice as a shareholder in respect of the meetings of shareholders or the election of directors of the Company of any other matter.

6. Investment Intent. Holder represents and warrants to the Company that Holder is acquiring the Warrants for investment and with no present intention of distributing or reselling any of the Warrants.

7. Certificates to Bear Language. The Warrants and the certificate or certificates therefore shall bear the following legend by which each holder shall be bound:

"THE SECURITIES REPRESENTED BY THIS INSTRUMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND MAY NOT BE SOLD, PLEDGED OR OTHERWISE TRANSFERRED WITHOUT AN EFFECTIVE REGISTRATION THEREOF UNDER SUCH ACT OR PURSUANT TO RULE 144 OR AN OPINION OF COUNSEL, REASONABLY SATISFACTORY TO THE CORPORATION AND ITS COUNSEL, THAT SUCH REGISTRATION IS NOT REQUIRED."

The Shares and the certificate or certificates evidencing any such Shares shall bear the following legend:

"THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933. THE SHARES MAY NOT BE SOLD OR TRANSFERRED IN THE ABSENCE OF SUCH REGISTRATION OR AN OPINION OF COUNSEL THAT AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT IS AVAILABLE."

Certificates for Warrants without such legend shall be issued if such warrants or shares are sold pursuant to an effective registration statement under the Securities Act of 1933 (the "Act") or if the Company has received an opinion from counsel reasonably satisfactory to counsel for the Company, that such legend is no longer required under the Act.

8. Registration Rights. The Company is obligated to register the shares of Common Stock underlying the Warrants in any subsequent registration statement filed by the Company with the

2 of 7

Securities and Exchange Commission, so that holders of such Common Stock shall be entitled to sell the same simultaneously with and upon the terms and conditions as the securities sold for the account of the Company are being sold pursuant to any such registration statement, subject to reasonable and customary lock-up provisions as may be proposed by the underwriter of said registration statement and agreed to by the investors (the "Piggyback Registration Right").

9. Adjustment of Number of Shares and Class of Capital Stock Purchasable The Number of Shares and Class of Capital Stock purchasable under this Warrant Agreement are subject to adjustment from time to time as set forth in this Section.

(a) Adjustment for Change in Capital Stock. If the Company:

- (i) pays a dividend or makes a distribution on its Common Stock, in each case, in shares of its Common Stock;
- (ii) subdivides its outstanding shares of Common Stock into a greater number of shares;
- (iii) combines its outstanding shares of Common Stock into a smaller number of shares;
- (iv) makes a distribution on its Common Stock in shares of its capital stock other than Common Stock; or
- (v) issues by reclassification of its shares of Common Stock any shares of its capital stock;

then the number and classes of shares purchasable upon exercise of each Warrant in effect immediately prior to such action shall be adjusted so that the holder of any Warrant thereafter exercised may receive the number and classes of shares of capital stock of the Company which such holder would have owned immediately following such action if such holder had exercised the Warrant immediately prior to such action.

For a dividend or distribution the adjustment shall become effective immediately after the record date for the dividend or distribution. For a subdivision, combination or reclassification, the adjustment shall become effective immediately after the effective date of the subdivision, combination or reclassification.

If after an adjustment the holder of a Warrant upon exercise of it may receive shares of two or more classes of capital stock of the Company, the Board of Directors of the Company shall in good faith determine the allocation of the adjusted Exercise Price between or among the classes of capital stock. After such allocation, that portion of the Exercise Price applicable to each share of each such class of capital stock shall thereafter be subject to adjustment on terms comparable to those applicable to Common Stock in this Agreement. Notwithstanding the allocation of the Exercise Price between or among shares of capital stock as provided by this Section 9(a), a Warrant may only be exercised in full by payment of the entire Exercise Price currently in effect.

(b) Consolidation, Merger or Sale of the Company. If the Company is a party to a consolidation, merger or transfer of assets which reclassifies or changes its outstanding Common Stock, the successor corporation (or corporation controlling the successor corporation or the Company, as the case may be) shall by operation of law assume the Company's obligations under this Warrant Agreement. Upon consummation of such transaction the Warrants shall automatically become exercisable for the kind and amount of securities, cash or other assets which the holder of a Warrant would have owned immediately after the consolidation, merger or transfer if the holder had exercised the Warrant immediately before the effective date of such transaction. As a condition to the consummation of such

3 of 7

transaction, the Company shall arrange for the person or entity obligated to issue securities or deliver cash or other assets upon exercise of the Warrant to, concurrently with the consummation of such transaction, assume the Company's obligations hereunder by executing an instrument so providing and further providing for adjustments which shall be as nearly equivalent as may be practical to the adjustments provided for in this Section 9.

10. Successors. All the covenants and provisions of this Agreement by or for the benefit of the Company or Holder shall bind and inure to the benefit of their respective successor and assigns hereunder.

11. Counterparts. This Agreement may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and such counterparts shall together constitute by one and the same instrument.

12. Notices. All notices or other communications under this Warrant shall be in writing and shall be deemed to have been given if delivered by hand or mailed by certified mail, postage prepaid, return receipt requested, addressed as follows: if to the Company: Attention: Chief Executive Officer, and to the Holder: at the address of the Holder appearing on the books of the Company or the Company's transfer agent, if any.

Either the Company or the Holder may from time to time change the address to which notices to it are to be mailed hereunder by notice in accordance with the provisions of this Paragraph 12.

13. Supplements and Amendments. The Company may from time to time supplement or amend this Warrant Agreement without the approval of any Holders of Warrants in order to cure any ambiguity or to be correct or supplement any provision contained herein which may be defective or inconsistent with any other provision, or to make any other provisions in regard to matters or questions herein arising hereunder which the Company may deem necessary or desirable and which shall not materially adversely affect the interest of the Holder.

14. Severability. If for any reason any provision, paragraph or term of this Warrant Agreement is held to be invalid or unenforceable, all other valid provisions herein shall remain in full force and effect and all terms, provisions and paragraphs of this Warrant shall be deemed to be severable.

15. Governing Law and Venue. This Warrant shall be deemed to be a contract made under the laws of the State of California and for all purposes shall be governed and construed in accordance with the laws of said State. Any proceeding arising under this Warrant Agreement shall be instituted in Orange County, State of California.

16. Headings. Paragraphs and subparagraph headings, used herein are included herein for convenience of reference only and shall not affect the construction of this Warrant Agreement nor constitute a part of this Warrant Agreement for any other purpose.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed, as of the date and year first above written.

Verdisys, Inc.

By:

HOLDER:

By:

Name:

Tax ID:

Exhibit A

THE SECURITIES REPRESENTED BY THIS INSTRUMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND MAY NOT BE SOLD, PLEDGED OR OTHERWISE TRANSFERRED WITHOUT AN EFFECTIVE REGISTRATION THEREOF UNDER SUCH ACT OR PURSUANT TO RULE 144 OR AN OPINION OF COUNSEL, REASONABLY SATISFACTORY TO THE CORPORATION AND ITS COUNSEL, THAT SUCH REGISTRATION IS NOT REQUIRED.

Void after 11:59 P.M. July , 2005

WARRANT TO PURCHASE SHARES
OF COMMON STOCK OF
VERDISYS, INC

Initial Number of Shares:

Initial Exercise Price:

\$____ per share

Date of Grant:

July , 2004

Expiration Date:

July , 2005

THIS CERTIFIES THAT, for value received, , or any person to whom the interest in this Warrant is lawfully transferred ("Holder") is entitled to purchase the above number (as adjusted pursuant to Section 4 hereof) of fully paid and non-assessable shares of the Common Stock (the "Shares") of Verdisys, Inc., a California corporation (the "Company") having an Initial Exercise Price as set forth above, subject to the provisions and upon the terms and conditions set forth herein. The exercise price, as adjusted from time to time as provided herein, is referred to as the "Exercise Price".

1. Term. The purchase right represented by this Warrant is exercisable, in whole or in part, at any time commencing on the Date of Grant and ending on the Expiration Date, after which time the Warrant shall be void.

2. Method of Exercise; Payment; Issuance of New Warrant. Subject to Section 1 hereof, the right to purchase Shares represented by this Warrant may be exercised by Holder, in whole or in part, for the total number of Shares remaining available for exercise by the surrender of this Warrant (with the notice of exercise form attached hereto as Exhibit A duly executed) at the principal office of the Company and by the payment to the Company, by check made payable to the Company drawn on a United States bank and for United States funds, or by delivery to the Company of evidence of cancellation of indebtedness of the Company to such Holder, of an amount equal to the then applicable Exercise Price per share multiplied by the number of Shares then being purchased. In the event of any exercise of the purchase right represented by this Warrant, certificates for the Shares so purchased shall be promptly delivered to Holder and, unless this Warrant has been fully exercised or has expired, a new Warrant representing the portion of the Shares, if any, with respect to which this Warrant shall not then have been exercised shall also be promptly delivered to Holder.

3. Exercise Price. The Exercise Price at which this Warrant may be exercised shall be the Initial Exercise Price, as adjusted from time to time pursuant to Section 4 hereof.

4. Reclassification, Reorganization, Consolidation or Merger. In the case of any reclassification of the Common Stock of the Company, or any reorganization, consolidation or merger of the Company with or into another corporation (other than a merger or reorganization with respect to which the Company is the continuing corporation and which does not result in any reclassification of the Common Stock), the Company, or such successor corporation, as the case may be, shall execute a new warrant, providing that the Holder shall have the right to exercise such new warrant and upon such exercise to receive, in lieu of each share of Common Stock theretofore issuable upon exercise of this Warrant, the number and kind of securities, money and property receivable upon such reclassification, reorganization, consolidation or merger by a holder of shares of Common Stock of the Company for each share of Common Stock. Such new warrant shall provide for adjustments which shall be as nearly equivalent as may be practicable to the

adjustments provided for in this Section 4 including, without limitation, adjustments to the Exercise Price and to the number of shares issuable upon exercise of this Warrant. The provisions of this Section 4 shall similarly apply to successive reclassifications, reorganizations, consolidations or mergers.

5. Transferability and Non-negotiability of Warrant. This Warrant may not be transferred or assigned in whole or in part without compliance with applicable federal and state securities laws by the transferor and the transferee (including, without limitation, the delivery of investment representation letters and legal opinions reasonably satisfactory to the Company, if reasonably requested by the Company). Subject to the provisions of this Section 5, title to this Warrant may be transferred in the same manner as a negotiable instrument transferable by endorsement and delivery.

6. Miscellaneous. The Company covenants that it will at all times reserve and keep available, solely for the purpose of issue upon the exercise hereof, a sufficient number of shares of Common Stock to permit the exercise hereof in full. Such shares, when issued in compliance with the provisions of this Warrant and the Articles of Incorporation, as amended, will be duly authorized, validly issued, fully paid and non-assessable. No Holder of this Warrant, as such, shall, prior to the exercise of this Warrant, be entitled to vote or receive dividends or be deemed to be a shareholder of the Company for any purpose, nor shall anything contained in this Warrant be construed to confer upon Holder, as such, any rights of a shareholder of the Company or any right to vote, give or withhold consent to any corporate action, receive notice of meetings, receive dividends or subscription rights, or otherwise. Upon receipt of evidence reasonably satisfactory to the Company of the loss, theft, destruction or mutilation of this Warrant and, in the case of any such loss, theft or destruction, upon delivery of an indemnity agreement reasonably satisfactory in form and amount to the Company or, in the case of any such mutilation, upon surrender and cancellation of such Warrant, the Company at its expense will execute and deliver, in lieu thereof, a new Warrant of like date and tenor. No fractional shares shall be issued in connection with any exercise hereunder, but in lieu of such fractional shares the Company shall make a cash payment therefore upon the basis of the Warrant Price then in effect. The terms and provisions of this Warrant shall inure to the benefit of, and be binding upon, the Company and the Holder hereof and their respective successors and assigns. This Warrant shall be governed by and construed under the laws of the State of California.

SIGNATURES ON NEXT PAGE

6 of 7

Holder:

By:

VERDISYS, INC.

A California corporation

By:

7 of 7

PROMISSORY NOTE

I _____, A FULLY ACCREDITED INVESTOR UNDER THE DEFINITION OF THE EXCHANGE ACT OF 1934, AGREE TO LEND VERDISYS, INC. THE SUM OF \$ _____. THE TERM OF THE LOAN IS FOR ONE YEAR FROM THE DATE OF EXECUTION AND THE INTEREST RATE IS 8% SIMPLE INTEREST. THE LOAN ALSO ENTITLES THE LENDER TO A _____% WARRANT COVERAGE, WHICH PROVIDES THEM THE RIGHT TO PURCHASE

COMMON SHARES AT A PRICE OF \$_____ PER SHARE AT ANY TIME WITHIN THE TERM OF THIS NOTE. A SEPARATE WARRANT AGREEMENT WILL BE ISSUED IN CONJUNCTION WITH THE LOAN.

THE NOTE MAY BE REPAID AT ANY TIME PRIOR TO ONE YEAR FROM THE DATE OF EXECUTION AT THE OPTION OF THE COMPANY.

THE PARTIES HERETO EXPRESSLY WAIVE DEMAND, PRESENTMENT FOR PAYMENT, NOTICE OF NONPAYMENT, PROTEST AND NOTICE OF PROTEST. LENDER ASSERTS THAT THEY A FULLY KNOWLEDGABLE OF THE COMPANY'S BUSINESS AND HAVE READ ALL AND ANY ASSOCIATED SEC FILINGS, INCLUDING RISK FACTORS.

SIGNED

SIGNED

LENDER

CFO VERDISYS, INC

DATE

DATE

THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAWS. THEY MAY NOT BE SOLD, OFFERED FOR SALE, TRANSFERRED, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF A REGISTRATION STATEMENT IN EFFECT WITH RESPECT TO THE SECURITIES UNDER SUCH ACT AND ANY APPLICABLE STATE SECURITIES LAW OR PURSUANT TO RULE 144 OR AN OPINION OF COUNSEL SATISFACTORY TO THE PAYOR THAT SUCH REGISTRATION IS NOT REQUIRED.

\$

July 23, 2004

VERDISYS, INC.

CONVERTIBLE PROMISSORY NOTE AGREEMENT WITH 100% WARRANT

COVERAGE

This Convertible Promissory Note Agreement (this "Agreement"), dated as of July 23, 2004, is by and between Verdisys, Inc., a California corporation (the "Payor"), and

, or its assigns ("Holder"). For value received, the Payor promises to pay to Holder the principal sum of

, together with all accrued and unpaid interest thereon as set forth below (the "Note").

Interest on the unpaid principal balance of this Note shall accrue at the rate of eight percent (8.0%) per annum commencing on the date hereof, and shall be payable quarterly. The entire unpaid balance of principal and all accrued and unpaid interest shall be due and payable on or before December 31, 2005 (the "Maturity Date"). Interest will be computed on the basis of a year of 360 days and actual days elapsed (including the first day but excluding the last day). Payment of principal and interest hereunder shall be made by either check or common stock equivalent delivered to the Holder at the address furnished to the Payor for that purpose.

Promissory Note will be convertible into Common Shares, no par value, of Verdisys, Inc. The Conversion Rate shall be equal to one share of Common Stock for every \$2.00 of outstanding principal and accrued and unpaid interest then outstanding with respect to the Note. As of the date of this agreement, the Holder agrees to execute and deliver the Registration Rights Agreement in substantially the form attached hereto as Exhibit B (the "Registration Rights Agreement"). In addition, the Payor will issue a warrant for the equivalent number of underlying common shares that the Holder is entitled to convert the principal of the Note into at a strike price of \$0.001 exercisable until December 31, 2005, in substantially the form attached hereto as Exhibit C (the "Warrant Agreement"). Payor may convert the Note, and associated interest, into shares of registered common stock of the Company when Verdisys, Inc. common stock trades at an average of \$2.00 per share for a period of 20 consecutive trading days, and the Payor has made available registered common shares of the Company for the conversion to take place, in accordance with the registration rights agreement. The Note, the Underlying Shares and the warrants governed by the Warrant Agreement are collectively referred to herein as the "Securities."

All payments of interest and principal shall be in either lawful money of the United States of America or common stock equivalent of Verdisys, Inc. stock at a conversion rate of \$2.00 per share. All payments shall be applied first to costs of collection, if any, then to accrued and unpaid interest, and thereafter to principal. The Payor reserves the right to prepay this Note in whole or in part at any time or from time to time upon five (5) days' prior written notice to Holder (as provided above), without penalty or additional fees.

The Payor hereby waives demand, notice, presentment, protest and notice of dishonor.

The Payor agrees to pay Holder's reasonable costs in collecting and enforcing this Note, including reasonable attorneys' fees.

Placement agents and broker dealers, including Peyton, Chandler & Sullivan, Inc. (an NASD broker-dealer affiliate of Cagan McAfee Capital Partners, LLC), may be paid commissions in an amount up to but not to exceed (i) selling commissions from the Payor up to eight percent (8%) of the aggregate proceeds from the issuance of the Underlying Shares, and (ii) a non-accountable expense allowance up to two percent (2%) of the aggregate proceeds from the issuance of the Underlying Shares.

Until the registration statement contemplated by the Registration Rights Agreement is declared effective, Holder hereby agrees not to, and will cause its affiliates not to, enter into any "put equivalent position" as such term is defined in Rule

16a-1 under the Securities Exchange Act of 1934, as amended, or short sale position with respect to the Common Stock or the Series A Preferred Stock.

Holder makes the following representations and warranties to the Payor, its principals and to participating broker-dealers, if any, jointly and severally:

(a) I have had the opportunity to ask questions and receive any additional information from persons acting on behalf of the Payor to verify my understanding of the terms of the Securities and of the Payor's business and status thereof, and that no oral information furnished to the undersigned or my advisors in connection with my participation in the Securities has been in any way inconsistent with other documentary information provided.

(b) I acknowledge that I have not seen, received, been presented with, or been solicited by any leaflet, public promotional meeting, newspaper or magazine article or advertisement, radio or television advertisement, or any other form of advertising or general solicitation with respect to my participation in the Securities.

(c) The Securities are being purchased for my own account for long-term investment and not with a view to, or for resale in connection with, any distribution or public offering thereof within the meanings of the Securities Act of 1933, as amended (the "Securities Act"), and any applicable state securities laws. No other person or entity will have any direct or indirect beneficial interest in, or right to, the Securities. I or my agents or investment advisors have such knowledge and experience in financial and

2

business matters relating to an investment of this type that will enable me to utilize the information made available to me in connection with the participation in the Securities to evaluate the merits and risks of participation and to make an informed investment decision.

(d) I understand that (A) the Securities (1) have not been registered under the Securities Act or any state securities laws, (2) will be issued in reliance upon exemptions from the registration and prospectus delivery requirements of the Securities Act pursuant to Section 4(2) and/or Regulation D thereof and (3) will be issued in reliance upon exemptions from the registration and prospectus delivery requirements of state securities laws which relate to private offerings, and (B) I must therefore bear the economic risk of such investment indefinitely unless a subsequent disposition thereof is registered under the Securities Act and applicable state securities laws or is exempt therefrom. I further understand that such exemptions depend upon, among other things, the bona fide nature of my investment intent as expressed herein. Pursuant to the foregoing, I acknowledge that the certificates representing the Securities acquired pursuant to this Note (except with respect to the shares of Common Stock issuable upon conversion of the Underlying Shares upon the registration of such shares of Common Stock under the Securities Act in accordance with the Registration Rights Agreement) shall bear a restrictive legend substantially as follows:

"THE SECURITIES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO RESTRICTIONS ON TRANSFER UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND STATE SECURITIES LAWS, AND MAY NOT BE OFFERED FOR SALE, SOLD, ASSIGNED, TRANSFERRED, PLEDGED OR OTHERWISE DISPOSED OF UNLESS (I) REGISTERED UNDER THE APPLICABLE SECURITIES LAWS OR (II) AN OPINION OF COUNSEL, WHICH OPINION AND COUNSEL ARE BOTH REASONABLY SATISFACTORY TO THE PAYOR, HAS BEEN DELIVERED TO THE PAYOR AND SUCH OPINION STATES THAT THE SECURITIES MAY BE TRANSFERRED WITHOUT SUCH REGISTRATION."

(e) I acknowledge that I have been advised that:

(i) The Securities offered hereby have not been approved or disapproved by the Securities and Exchange Commission ("SEC") or any state securities commission nor has the SEC or any state securities commission passed upon the accuracy or adequacy of any representations by the Payor. Any representation to the contrary is a criminal offense.

(ii) In making an investment decision, I must rely on my own examination of the Payor and the terms of the offering of the Securities, including the merits and risks involved. The Securities have not been recommended by any federal or state securities commission or regulatory authority. Furthermore, the foregoing authorities have not confirmed the accuracy or determined the adequacy of any representation. Any representation to the contrary is a criminal offense.

3

(iii) The Securities are "Restricted Securities" within the meaning of Rule 144 under the Securities Act, are subject to

restrictions on transferability and resale and may not be transferred or resold except as permitted under the Securities Act and applicable state securities laws, pursuant to registration or exemption therefrom.

(f) Other than the rights specifically set forth in the Registration Rights Agreement, I represent, warrant and agree that the Payor and the officers of the Payor (the "Payor's Officers") are under no obligation to register or qualify the participation in the Securities under the Securities Act or under any state securities law, or to assist the undersigned in complying with any exemption from registration and qualification.

(g) I represent that I am an "accredited investor" within the meaning of Rule 501 of Regulation D under the Securities Act and I have executed the Certificate of Accredited Investor Status, attached hereto as Exhibit D.

(h) I understand that the participation in the Securities is illiquid, cannot be readily sold as there will not be a public market for them and that I may not be able to sell or dispose of my participation in the Securities, or to utilize the Securities as collateral for a loan. I understand that the purchase of the Securities is a speculative investment and involves substantial risks and that I could lose my entire investment in the Securities. I must not purchase participation in the Securities unless I have liquid assets sufficient to assure myself that such purchase will cause me no undue financial difficulties and that I can still provide for my current and possible personal contingencies, and that the commitment herein for participation in the Securities, combined with other investments of mine, is reasonable in relation to my net worth.

(i) I understand that my right to transfer my participation in the Securities will be restricted against transfers unless the transfer is not in violation of the Securities Act, the Delaware Securities Law, and any other applicable state securities laws (including investment suitability standards), that the Payor will not consent to a transfer of participation in the Securities unless the transferee represents that such transferee meets the financial suitability standards required of an initial participant and that the Payor has the right, in its absolute discretion, to refuse to consent to such transfer.

(j) I have been advised to consult with my own attorney or attorneys regarding all legal matters concerning an investment in the Payor and the tax consequences of participation in the Securities, and have done so, to the extent I consider necessary.

(k) I acknowledge that the tax consequences to me of investing in the Payor will depend on my particular circumstances, and neither the Payor, the Payor's officers, any other investors, nor the partners, shareholders, members, managers, agents, officers, directors, employees, affiliates or consultants of any of them, will be responsible or liable for the tax consequences to me of an investment in the Payor. I will look solely

4

to and rely upon my own advisers with respect to the tax consequences of this investment.

(l) All information which I have provided to the Payor concerning myself, my financial position and my knowledge of financial and business matters is truthful, accurate, correct and complete as of the date set forth herein. I agree to furnish the Payor such other information as the Payor may reasonably request in order to verify the accuracy of the information contained herein.

(m) I and my affiliates do not have, and during the 30 day period prior to the date of this Agreement, I and my affiliates have not entered into, any "put equivalent position" or short sale positions with respect to the Common Stock.

I hereby agree to indemnify and hold harmless the Payor, its principals, the Payor's officers, directors and attorneys, from any and all damages, costs and expenses (including actual attorneys' fees) which they may incur (i) by reason of my failure to fulfill any of the terms and conditions of participation, (ii) by reason of my breach of any of my representations, warranties or agreements contained herein; (iii) with respect to any and all claims made by or involving any person, other than me personally, claiming any interest, right, title, power or authority in respect to my participation. I further agree and acknowledge that these indemnifications shall survive any sale or transfer, or attempted sale or transfer, of any portion of my participation.

This Agreement shall be binding upon the heirs, executors, administrators, successors and assigns of the Holder. If the undersigned is more than one person, the obligations of the undersigned shall be joint and several and the representations and warranties shall be deemed to be made by and be binding on each such person and his heirs, executors, administrators, successors, and assigns.

The terms of this Agreement shall be construed in accordance with the laws of the State of Delaware. The terms of this Agreement (including, without limitation, the Maturity Date, and the rate of interest) may be waived or modified only in writing, signed by the Payor.

IN WITNESS WHEREOF, the parties have executed this Agreement the day and year first above written.

VERDISYS, INC.

By:

Name:

Title:

HOLDER:

By:

Name:

Title:

6

Exhibit A

Certificate of Designation of Series A Convertible Preferred Stock

A-1

Exhibit B

Form of Registration Rights Agreement

C-1

Exhibit C

Form of Warrant Agreement

C-1

Exhibit D

Certificate of Accredited Investor Status

Except as may be indicated by the undersigned below, the undersigned is an "accredited investor," as that term is defined in Regulation D under the Securities Act of 1933, as amended (the "Securities Act"). The undersigned has checked the box below indicating the basis on which he is representing his status as an "accredited investor":

- a bank as defined in Section 3(a)(2) of the Securities Act, or any savings and loan association or other institution as defined in Section 3(a)(5)(A) of the Securities Act whether acting in its individual or fiduciary capacity; a broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934, as amended (the "Securities Exchange Act"); an insurance company as defined in Section 2(13) of the Securities Act; an investment company registered under the Investment Company Act of 1940 or a business development company as defined in Section 2(a)(48) of that Act; a small business investment

company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958; a plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, and such plan has total assets in excess of \$5,000,000; an employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974, if the investment decision is made by a plan fiduciary, as defined in Section 3(21) of such Act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of \$5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are "accredited investors";

- a private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940;
- an organization described in Section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5,000,000;
- a natural person whose individual net worth, or joint net worth with the undersigned's spouse, at the time of this purchase exceeds \$1,000,000;
- a natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with the undersigned's spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;
- a trust with total assets in excess of \$5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a person who has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment; or
- an entity in which all of the equity holders are "accredited investors" by virtue of their meeting one or more of the above standards.
- an individual who is a director or executive officer of Particle Drilling Technologies, Inc.

D-1

IN WITNESS WHEREOF, the undersigned has executed this Certificate of Accredited Investor Status effective as of June 24, 2004.

Name of Holder

By:

Name:

Title:

Investor Information Page

(Please complete and Return to Payor)

(The information below should be consistent with the form of ownership selected below.)

Name (please print):

If entity named above By:

Its:

Social Security or Taxpayer I.D. Number:

Business Address (including zip code): _

Business Phone: ____

Business Fax: _____

Residence Address (including zip code):

Residence Phone:

All communications to be sent to:

Business or

Residence Address

Please indicate below the form in which you will hold title to your interest in the Underlying Shares. PLEASE CONSIDER CAREFULLY. ONCE YOU SELECT THE FORM OF TITLE, A CHANGE IN THE FORM OF TITLE CONSTITUTES A TRANSFER OF THE INTEREST IN THE UNDERLYING SHARES AND MAY THEREFORE BE RESTRICTED BY THE TERMS OF THIS NOTE, AND MAY RESULT IN ADDITIONAL COSTS TO YOU. Holders should seek the advice of their attorneys in deciding in which of the forms they should take ownership of the interest in the Underlying Shares, because different forms of ownership can have varying gift tax, estate tax, income tax, and other consequences, depending on the state of the investor's domicile and his or her particular personal circumstances.

INDIVIDUAL OWNERSHIP (one signature required)

JOINT TENANTS WITH RIGHT OF SURVIVORSHIP AND NOT AS TENANTS IN COMMON (both or all parties must sign)

COMMUNITY PROPERTY (one signature required if interest held in one name, i.e., managing spouse; two signatures required if interest held in both names)

TENANTS IN COMMON (both or all parties must sign)

GENERAL PARTNERSHIP (fill out all documents in the name of the PARTNERSHIP, by a PARTNER authorized to sign, and include a copy of the Partnership Agreement)

LIMITED PARTNERSHIP (fill out all documents in the name of the LIMITED PARTNERSHIP, by a GENERAL PARTNER authorized to sign, and include a copy of the Limited Partnership Agreement and any other document showing that the investment is authorized)

LIMITED LIABILITY COMPANY (fill out all documents in the name of the LIMITED LIABILITY COMPANY, by a member authorized to sign, and include a copy of the LIMITED LIABILITY COMPANY's Operating Agreement and any other documents necessary to show the investment is authorized.)

CORPORATION (fill out all documents in the name of the CORPORATION, by the President or other officer authorized to sign, and include a copy of the Corporation's Articles and certified Corporate Resolution authorizing the signature)

TRUST (fill out all documents in the name of the TRUST, by the Trustee, and include a copy of the instrument creating the trust and any other documents necessary to show the investment by the Trustee is authorized. The date of the trust must appear on the Notarial where indicated.)

REGISTRATION RIGHTS AGREEMENT

THIS REGISTRATION RIGHTS AGREEMENT ("Agreement") is made and entered into as of July ____, 2004 by and between (i) Verdisys, Inc., a California corporation (the "Company"), and (ii) those certain Participants under that certain Subscription Agreement of even date herewith between each Participant and the Company, each of whose signatures shall be included on Exhibit A hereto upon consummation of their respective portion of the private offering of the Company's common stock on the date hereof (the "Transaction") (each such Participant a "Stockholder").

Agreements:

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth and for other good and valuable consideration, the receipt, adequacy and sufficiency of which are hereby acknowledged by each of the Company and Stockholder, each of the Company and Stockholder hereby agrees as follows:

- (a) While acting in a commercially reasonable fashion, the Company shall prepare and file a Registration Statement on Form SB-2 (the "Registration Statement") with the Securities and Exchange Commission (the "SEC") registering the resale of the shares of Common Stock issued to the Participants in connection with the offering on or before thirty (30) business days following the final closing of the transaction (the "Filing Deadline") and shall use its commercially reasonable best efforts to have such Registration Statement declared effective by the SEC within 150 days following the final closing of the Transaction.
- (b) In connection with the registration provided for hereunder, Stockholder shall use reasonable efforts to cooperate with the Company and shall furnish to the Company in writing such information with respect to it and its proposed distribution as shall be reasonably necessary in order to assure compliance with federal and applicable state securities laws.
- (c) The Company shall pay all expenses incurred by the Company in complying with its registration obligations pursuant to this Agreement, including, without limitation, all registration, qualification, and filing fees, blue sky fees and expenses, printing expenses, fees and disbursements of counsel and independent public accountants for the Company, all expenses of the underwriter customarily paid by issuers or sellers of securities (including fees of the National Association of Securities Dealers, Inc.), transfer taxes, escrow fees, fees of transfer agents and registrars, and costs of insurance. Stockholder shall pay all underwriting discounts and selling commissions applicable to the sale of the Registrable Shares being registered.
- (d) (i) The Company shall protect, indemnify and hold Stockholder, and its officers, directors, stockholders, attorneys, accountants, employees, affiliates, successors and assigns, harmless from any and all demands, claims, actions, causes of actions, lawsuits, proceedings, investigations, judgments, losses, damages, injuries, liabilities, obligations, expenses and costs (including costs of litigation and attorneys' fees), arising

out of or based upon (aa) any untrue statement or alleged untrue statement of any material fact contained in or incorporated by reference into the Registration Statement, any preliminary prospectus or final prospectus contained therein, or any amendment or supplement thereto, (bb) the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, or (cc) any material violation by the Company of any rule or regulation promulgated under Act applicable to the Company and relating to action or inaction by the Company in connection with any such registration; provided, however, that the Company shall not be liable in the case of (aa) and (bb) above if and to the extent that the event otherwise giving rise to indemnification arises out of or is based upon an untrue statement or alleged untrue statement or omission or alleged omission made in conformity with information furnished by a person otherwise entitled to indemnification in writing specifically for use in the Registration Statement or prospectus or information contained in a writing that has been expressly approved or deemed approved by a person otherwise entitled to indemnification.

(ii) Stockholder shall protect, indemnify and hold the Company and its officers, directors, stockholders, attorneys, accountants, employees, affiliates, successors and assigns, harmless from any and all demands, claims, actions, causes of actions, lawsuits, proceedings, investigations, judgments, losses, damages, injuries, liabilities, obligations, expenses and costs (including costs of litigation and attorneys' fees), arising out of or based upon (aa) any untrue statement or alleged untrue statement of any material fact contained in or incorporated by reference into the Registration Statement, any preliminary prospectus or final prospectus contained therein, or any amendment or supplement thereto, (bb) the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, or (cc) any material violation by Stockholder of any rule or regulation promulgated under the Act applicable to Stockholder and relating to action or inaction by Stockholder in connection with any such registration; provided, however, that Stockholder shall be liable in the case of (aa) and (bb) above only if and to the extent that the event giving rise to indemnification arises out of or is based upon an untrue statement or alleged untrue statement or omission or alleged omission made in conformity with information furnished by Stockholder in writing specifically for use in the

Registration Statement or prospectus or information contained in a writing that has been expressly approved or deemed approved by Stockholder.

(iii) Promptly after receipt by an indemnified party under this Section (d) of notice of the threat or commencement of any action, such indemnified party shall, if a claim in respect thereof is to be made against an indemnifying party hereunder, notify each such indemnifying party in writing thereof, but the omission so to notify an indemnifying party shall not relieve it from any liability which it may have to any indemnified party to the extent that the indemnifying party is not prejudice as a result thereof. In case any such action shall be brought against any indemnified party and it shall notify an indemnifying party of the commencement thereof, the indemnifying party shall be entitled to participate in and, to the extent it shall wish, to assume and undertake the defense thereof with

2

counsel reasonably satisfactory to such indemnified party, and, after notice from the indemnifying party to such indemnified party of its election so to assume and undertake the defense thereof, the indemnifying party shall not be liable to such indemnified party under this Section (d) for any legal expenses subsequently incurred by such indemnified party in connection with the defense thereof other than reasonable costs of investigation and of liaison with counsel so elected; provided, however, that, if the defendants in any such action include both an indemnified party and an indemnifying party and the related indemnified party shall have reasonably concluded that there may be reasonable defenses available to it which are different from or additional to those available to the indemnifying party or if the interests of the indemnified party reasonably may be believed to conflict with the interests of the indemnifying party, the indemnified party shall have the right to select separate counsel and to assume such legal defenses and otherwise to participate in the defense of such action, with the expenses and fees of such separate counsel and other expenses related to such participation to be reimbursed by the indemnifying party as incurred. No indemnifying party shall be subject to any liability for any settlement made without consent which shall not be unreasonably withheld. No indemnifying party shall consent to the entry of any judgment or enter into any settlement which does not include as an unconditional term thereof the giving by the claimant or plaintiff to such indemnified party of a release from all liability with respect to such claim or litigation.

(e) Any notice or request herein required or permitted to be given to any party hereunder shall be given in writing and shall be personally delivered or sent to such party by prepaid mail at the address set forth below the signature of such party hereto or at such other address as such party may designate by written communication to the other party to this Agreement. Each notice given in accordance with this paragraph shall be deemed to have been given, if personally delivered, on the date personally delivered, or, if mailed, on the third day following the day on which it is deposited in the United States mail, certified or registered mail, return receipt requested, with postage prepaid.

(f) This Agreement embodies the entire agreement and understanding between the parties hereto with respect to the subject matter hereof and supersede all prior agreements and understandings, whether written or oral, relating to the subject matter hereof. This Agreement may not be amended, supplemented, waived, or terminated except by written instrument executed by the Company and Stockholder. No waiver of any provision of this Agreement shall constitute a waiver of any other provision of this Agreement, nor shall such waiver constitute a waiver of any subsequent breach of such provision. This Agreement shall be binding upon and shall inure to the benefit of each party hereto and his or its respective successors, heirs, assigns, and legal representatives, but neither this Agreement nor any rights hereunder may be assigned by any party hereto without the consent in writing of the other party. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together constitute one and the same instrument. A party may execute this Agreement and transmit its signature by facsimile, which shall be fully binding, and the party taking such actions shall deliver a manually signed original as soon as is practicable.

3

IN WITNESS WHEREOF, the undersigned have set their hands hereunto as of the first date written above.

"COMPANY"

VERDISYS, INC.

By:

John O'Keefe
Chief Financial Officer

Address: 25025 I-45N, Suite 525

EXHIBIT A

Stockholder's Signature Page to Registration Rights Agreement

"Stockholder"

Signature

Printed Name

Street Address

City, State, Zip Code

Date:

, 2004

Number of Registrable Shares:

Number of Registrable Shares Underlying Warrants: