

HOLLAND & HART <sup>LLP</sup>



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2004 OCT 12 PM 4 01

October 12, 2004

**HAND-DELIVERED**

Mark E. Fesmire, P. E.  
Director  
Oil Conservation Division  
New Mexico Department of Energy,  
Minerals and Natural Resources  
2040 South Pacheco Street  
Santa Fe, New Mexico 87505

*Case 13370*

Re: Application of McQuadrangle, LC for statutory unitization, Eddy County, New Mexico.

Dear Mr. Fesmire:

Enclosed is the application of McQuadrangle, LC for statutory unitization of the South RedLake II Unit and a draft of a legal advertisement for this case. McQuadrangle requests that this application be placed on the Division Examiner Hearing docket scheduled for November 4, 2004.

Very truly yours,

William F. Carr

Enclosures

cc: Mr. Delbert McDougal  
Mr. Jim Pierce  
David R. Vandiver, Esq.

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STATE OF NEW MEXICO  
DEPARTMENT OF ENERGY, MINERALS AND NATURAL RESOURCES  
OIL CONSERVATION DIVISION

2009 OCT 12 PM 4:33:01

IN THE MATTER OF THE APPLICATION OF  
MCQUADRANGLE, LC FOR  
STATUTORY UNITIZATION OF THE  
SOUTH REDLAKE II UNIT AREA,  
EDDY COUNTY, NEW MEXICO.

CASE NO. 13370

APPLICATION

MCQUADRANGLE, LC ("McQuadrangle"), pursuant to the provisions of the New Mexico Statutory Unitization Act (NMSA 1978, §§ 70-7-1 through 70-7-21, NMSA, 2004) hereby applies to the Oil Conservation Division for an order unitizing the South RedLake II Unit Area, Eddy County, New Mexico, and in support of its application states:

1. McQuadrangle, LC is a Texas Limited Liability Company that is authorized to transact business in the State of New Mexico and is engaged in the business of, among other things, producing and selling oil and natural gas.
2. McQuadrangle seeks an order pursuant to the Statutory Unitization Act providing for unitized management, operation and further development of a portion of the Grayburg formation, Red Lake Queen-Grayburg-San Andres Pool which consists of 961.61 acres, more or less, of Federal and State lands located in Eddy County, New Mexico, and is more particularly described as follows:

TOWNSHIP 17 SOUTH, RANGE 27 EAST, NMPM

Section 35: E/2, E/2 SW/4, SE/4 NW/4,  
Section 36: W/2, SW/4 NE/4

TOWNSHIP 18 SOUTH, RANGE 27 EAST, NMPM

Section 1: Lot 4  
Section 2: Lots 1, 2, 3

A map of the proposed Unit Area is attached to this application as Exhibit A.

3. The vertical limits of the unitized formation to be included within the proposed Unit Area extends from an upper limit described as 100 feet below mean sea level of at the top of the Grayburg formation, whichever is higher, to a lower limit at the base of the San Andres formation; the geologic markers having been previously found to occur at 1,430 feet and the base of which is found at 1,762 feet in the Carper-Sivley Joint Account Magruder Well No. 13, located 330 feet from the South line and 480 feet from the East line of Section 35, Township 17 South, Range 27 East, NMPM, Eddy County, New Mexico, as recorded on Welex Electric log taken on March 28, 1960, said log being measured from a kelly bushing elevation of 3,654 feet above sea level.

4. The portions of the Grayburg reservoir involved in this application have been reasonably defined by development.

5. The type of operations to be conducted in this Unit include secondary recovery by means of waterflooding.

6. Attached to this application as Exhibit "B" and incorporated herein is a copy of the proposed plan of unitization that McQuadrangle considers fair, reasonable and equitable.

7. Attached to this application as Exhibit "C" and incorporated herein is a copy of the proposed operating plan covering the manner in which the unit will be supervised and managed and costs allocated and paid.

8. McQuadrangle further states:

A. Unitized management, operating and further development of the portion of the Grayburg formation, Red Lake Queen-Grayburg-San Andres Pool, which is the subject of this application, is reasonably necessary in order to effectively carry on secondary recovery operations and, at a later date, tertiary recovery operations, and to substantially increase the ultimate recovery of oil from the unitized portion of the pool.

- B. The proposed unitized methods of operations to be applied to this portion of the Red Lake Queen-Grayburg-San Andres Pool are feasible, will prevent waste and will result with reasonable probability in the increased recovery of substantially more oil and/or gas from the pool, or unitized portions thereof, than would otherwise be recovered.
- C. The estimated additional costs, if any, of conducting such operations will not exceed the estimated value of additional oil recovered plus reasonable profit.
- D. Unitization and adoption of unitized methods of operation will benefit the working interest owners and the royalty owners of the oil and gas rights within this portion of the pool.
- E. McQuadrangle, LC, as operator, has made a good faith effort to secure voluntary unitization within the portion of the Red Lake Queen-Grayburg-San Andres Pool affected by this application.
- F. The participation formula contained in the unitization agreement allocates the produced and saved unitized hydrocarbons to the separately owned tracts in the Unit Area on a fair, reasonable and equitable basis.

9. McQuadrangle requests that any order issued in this case include each matter set forth in NMSA 1978, § 70-7-7 (2004) and that it specifically provide for carrying any working interest owner on a limited, carried net profits basis, payable out of production, and include a non-consent penalty for risk to be charged against carried working interests within the unit area upon such terms and conditions to be determined by the Division as just and reasonable.

10. Statutory unitization of the South RedLake II Unit Area, Red Lake Queen-Grayburg-San Andres Pool, is in the best interest of conservation, the prevention of waste and the protection of correlative rights.

WHEREFORE, McQuadrangle, LC, respectfully requests that this application be set for hearing before a duly appointed Examiner of the Oil Conservation Division on November 4, 2004, and, that after notice and hearing as required by law and the rules of the Division, the Division enter its order granting this application statutorily unitizing the subject portions of the Red Lake Queen-Grayburg-San Andres Pool, Eddy County, New Mexico.

Respectfully submitted,

HOLLAND & HART LLP

By:  \_\_\_\_\_

William F. Carr  
Post Office Box 2208  
Santa Fe, New Mexico 87504-2208

ATTORNEYS FOR MCQUADRANGLE, LC



STATE/FEDERAL/FEE  
WATERFLOOD UNIT

UNIT AGREEMENT  
FOR THE DEVELOPMENT AND OPERATION  
OF THE

SOUTH REDLAKE II UNIT AREA

EDDY COUNTY, NEW MEXICO

NO. \_\_\_\_\_

UNIT AGREEMENT  
FOR THE DEVELOPMENT AND OPERATION  
OF THE  
SOUTH REDLAKE II UNIT  
EDDY COUNTY, NEW MEXICO

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UNIT AGREEMENT  
FOR THE DEVELOPMENT AND OPERATION  
OF THE  
SOUTH REDLAKE II UNIT  
EDDY COUNTY, NEW MEXICO

THIS AGREEMENT, entered into as of the 1st day of March, 20 03, by and between the parties subscribing, ratifying, or consenting hereto, and herein referred to as the "parties hereto,"

WITNESSETH:

WHEREAS, the parties hereto are the owners of working, royalty or other oil and gas interests in the Unit Area subject to this Agreement;  
and

WHEREAS, the Mineral Leasing Act of February 25, 1920, 41 Stat. 437, as amended, 30 U.S.C. Sec. 181 et seq., authorizes Federal lessees and their representatives to unite with each other, or jointly or separately with others, in collectively adopting and operating a cooperative or unit plan of development or operation of any oil or gas pool, field, or like area, or any part thereof for the purpose of more properly conserving the natural resources thereof whenever determined and certified by the Secretary of the Interior to be necessary or advisable in the public interest; and

WHEREAS, the Commissioner of Public Lands of the State of New Mexico is authorized by an Act of the Legislature (Section 1, Chapter 88, Laws 1943, as amended by Section 1 of Chapter 176, Laws of 1961) (Chapter 19, Article 10, Section 45, New Mexico Statutes 1978 Annotated), to consent to and approve the development or operation of State lands under agreements made by lessees of State land jointly or severally with other lessees where such agreements provide for the unit operation or development of part of or all of any oil or gas pool, field or area; and

WHEREAS, the Commissioner of Public Lands of the State of New Mexico is authorized by an Act of the Legislature (Section 1, Chapter 88, Laws 1943, as amended by Section 1, Chapter 162, Laws of 1951) (Chapter 19, Article 10, Section 47, New Mexico Statutes 1978 Annotated) to amend with the approval of lessee, evidenced by the lessee's execution of such agreement or otherwise, any oil and gas lease embracing State lands so that the length of the term of said lease may coincide with the term of such agreements for the unit operation and development of part or all of any oil or gas pool, field or area; and

WHEREAS, the Oil Conservation Division of the State of New Mexico (hereinafter referred to as the "Division") is authorized by an Act of the Legislature (Chapter 72, Laws of 1935 as amended) (Chapter 70, Article 2, Section 2 et seq., New Mexico Statutes 1978 Annotated) to approve this Agreement and the conservation provisions hereof; and

WHEREAS, the Oil Conservation Division of the Energy and Minerals Department of the State of New Mexico is authorized by law (Chapter 65, Article 3 and Article 14, N.M.S. 1953 Annotated) to approve this Agreement and the conservation provisions hereof; and

WHEREAS, the parties hereto hold sufficient interest in the Unit Area covering the land hereinafter described to give reasonably effective control of operations therein; and

WHEREAS, it is the purpose of the parties hereto to conserve natural resources, prevent waste, and secure other benefits obtainable through development and operation of the area subject to this Agreement under the terms, conditions, and limitations herein set forth;

NOW THEREFORE, in consideration of the premises and the promises herein contained, the parties hereto commit to this Agreement their respective interest in the below-defined Unit Area, and agree severally among themselves as follows:

SECTION 1. ENABLING ACT AND REGULATIONS. The Mineral Leasing Act of February 25, 1920, as amended, supra, and all valid pertinent regulations, including operating and unit plan regulations, heretofore issued thereunder or valid, pertinent, and reasonable regulations hereafter issued thereunder are accepted and made a part of this Agreement as to Federal lands, provided such regulations are not inconsistent with the terms of this Agreement; and as to non-Federal lands, the oil and gas operating regulations in effect as of the Effective Date hereof governing drilling and producing operations, not inconsistent with the terms hereof or the laws of the state in which the non-Federal land is located, are hereby accepted and made a part of this Agreement.

SECTION 2. UNIT AREA AND DEFINITIONS. For the purpose of this Agreement, the following terms and expressions as used herein shall mean:

- (a) "Unit Area" is defined as those lands described in Exhibit "B" and depicted on Exhibit "A" hereof, and such land is hereby designated and recognized as constituting the Unit Area, containing 961.61 acres, more or less, in Eddy County, New Mexico.

- (b) "Land Commissioner" is defined as the Commissioner of Public Lands of the State of New Mexico.
- (c) "Division" is defined as the Oil Conservation Division of the Department of Energy and Minerals of the State of New Mexico.
- (d) "Authorized Officer" or "A.O." is any employee of the Bureau of Land Management who has been delegated the required authority to act on behalf of the BLM.
- (e) "Secretary" is defined as the Secretary of the Interior of the United States of America, or his duly authorized delegate.
- (f) "Department" is defined as the Department of the Interior of the United States of America.
- (g) "Proper BLM Office" is defined as the Bureau of Land Management office having jurisdiction over the federal lands included in the Unit Area.
- (h) "Unitized Formation" shall mean that interval underlying the Unit Area, the vertical limits of which extended from an upper limit described as 100 feet below mean sea level or at the top of the Grayburg Formation, whichever is higher, to a lower limit at the base of the San Andres formation; the geologic markers having been previously found to occur at 1,430' and the base of which is found@ 1,762' in the Carper-Sivley Joint Account Magruder #13 (330' FSL, 480' FEL of Section 35, T17S, R27E, Eddy County, NM) as recorded on Welex Electric Log taken March 28, 1960, said log being measured from kelly bushing elevation of 3,654' above sea level.
- (i) "Unitized Substances" are all oil, gas, gaseous substances, sulphur contained in gas, condensate, distillate and all associated and constituent liquid or liquefiable hydrocarbons, other than outside substances, within and produced from the Unitized Formation.
- (j) "Tract" is each parcel of land described as such and given a Tract number in Exhibit "B".
- (k) "Tract Participation" is defined as the percentage of participation shown on Exhibit "B" for allocating Unitized Substances to a Tract under this agreement.
- (l) "Unit Participation" is the sum of the percentages obtained by multiplying the Working Interest of a Working Interest Owner in each Tract by the Tract Participation of such Tract.
- (m) "Working Interest" is the right to search for, produce and acquire Unitized Substances whether held as an incident of ownership of mineral fee simple title, under an oil and gas lease, operating agreement, or otherwise held, which interest is chargeable with and obligated to pay or bear, either in cash or out of production, or otherwise, all or a portion of the cost of drilling, developing and producing the Unitized Substances from the Unitized Formation and operations thereof hereunder. Provided that any royalty interest created out of a working interest subsequent to the execution of this Agreement by the owner of the working interest shall continue to be subject to such working interest burdens and obligations.
- (n) "Working Interest Owner" is any party hereto owning a Working Interest, including a carried working interest owner, holding an interest in Unitized Substances by virtue of a lease, operating agreement, fee title or otherwise. The owner of oil and gas rights that are free of lease or other instrument creating a Working Interest in another shall be regarded as a Working Interest Owner to the extent of seven-eighths (7/8) of his interest in Unitized Substances, and as a Royalty Owner with respect to his remaining one-eighth (1/8) interest therein.
- (o) "Royalty Interest" or "Royalty" is an interest other than a Working Interest in or right to receive a portion of the Unitized Substances or the proceeds thereof and includes the royalty interest reserved by the lessor or by an oil and gas lease and any overriding royalty interest, oil payment interest, net profit contracts, or any other payment or burden which does not carry with it the right to search for and produce unitized substances.
- (p) "Royalty Owner" is the owner of a Royalty Interest.
- (q) "Unit Operating Agreement" is the agreement entered into by and between the Unit Operator and the Working Interest Owners as provided in Section 9, infra, and shall be styled "Unit Operating Agreement, Unit, Eddy County, South Redlake II New Mexico".
- (r) "Oil and Gas Rights" is the right to explore, develop and operate lands within the Unit Area for the production of Unitized Substances, or to share in the production so obtained or the proceeds thereof.
- (s) "Outside Substances" is any substance obtained from any source other than the Unitized Formation and injected into the Unitized

Formation.

(t) "Unit Manager" is any person or corporation appointed by Working Interest Owners to perform the duties of Unit Operator until the selection and qualification of a successor Unit Operator as provided for in Section 7 hereof.

(u) "Unit Operator" is the party designated by Working Interest Owners under the Unit Operating Agreement to conduct Unit Operations.

(v) "Unit Operations" is any operation conducted pursuant to this Agreement and the Unit Operating Agreement.

(w) "Unit Equipment" is all personal property, lease and well equipment, plants, and other facilities and equipment taken over or otherwise acquired for the joint account for use in Unit Operations.

(x) "Unit Expense" is all cost, expense, or indebtedness incurred by Working Interest Owners or Unit Operator pursuant to this Agreement and the Unit Operating Agreement for or on account of Unit Operations.

(y) "Effective Date" is the date determined in accordance with Section 24, or as re-determined in accordance with Section 39.

**SECTION 3. EXHIBITS.** The following exhibits are incorporated herein by reference: Exhibit "A" attached hereto is a map showing the Unit Area and the boundaries and identity of tracts and leases in said Unit Area to the extent known to the Unit Operator. Exhibit "B" attached hereto is a schedule showing, to the extent known to the Unit Operator, the acreage comprising each Tract, percentages and kind of ownership of oil and gas interests in all land in the Unit Area, and Tract Participation of each Tract. However, nothing herein or in said schedule or map shall be construed as a representation by any party hereto as to the ownership of any interest other than such interest or interests as are shown in said map or schedule as owned by such party. The shapes and descriptions of the respective Tracts have been established by using the best information available. Each Working Interest Owner is responsible for supplying Unit Operator with accurate information relating to each Working Interest Owner's interest. If it subsequently appears that any Tract, because of diverse royalty or working interest ownership on the Effective Date hereof, should be divided into more than one Tract, or when any revision is requested by the A.O., or any correction of any error other than mechanical miscalculations or clerical is needed, then the Unit Operator, with the approval of the Working Interest Owners, may correct the mistake by revising the exhibits to conform to the facts. The revision shall not include any reevaluation of engineering or geological interpretations used in determining Tract Participation. Each such revision of an exhibit made prior to thirty (30) days after the Effective Date shall be effective as of the Effective Date. Each other such revision of an exhibit shall be effective at 7:00 a.m. on the first day of the calendar month next following the filing for record of the revised exhibit or on such other date as may be determined by Working Interest Owners and set forth in the revised exhibit. Copies of such revision shall be filed with the Land Commissioner, and not less than four copies shall be filed with the A.O. In any such revision, there shall be no retroactive allocation or adjustment of Unit Expense or of interests in the Unitized Substances produced, or proceeds thereof.

**SECTION 4. EXPANSION.** The above described Unit Area may, with the approval of the A.O. and Land Commissioner, when practicable be expanded to include therein any additional Tract or Tracts regarded as reasonably necessary or advisable for the purposes of this Agreement provided, however, in such expansion there shall be no retroactive allocation or adjustment of Unit Expense or of interests in the Unitized Substances produced, or proceeds thereof. Pursuant to Subsection (b), the Working Interest Owners may agree upon an adjustment of investment by reason of the expansion. Such expansion shall be effected in the following manner:

(a) The Working Interest Owner or Owners of a Tract or Tracts desiring to bring such Tract or Tracts into this unit, shall file an application therefor with Unit Operator requesting such admission.

(b) Unit Operator shall circulate a notice of the proposed expansion to each Working Interest Owner in the Unit Area and in the Tract proposed to be included in the unit, setting out the basis for admission, the Tract Participation to be assigned to each Tract in the enlarged Unit Area and other pertinent data. After negotiation (at Working Interest Owners' meeting or otherwise) if at least three Working Interest Owners having in the aggregate seventy-five percent (75%) of the Unit Participation then in effect have agreed to inclusion of such Tract or Tracts in the Unit Area, then Unit Operator shall:

1. After obtaining preliminary concurrence by the A.O. and Land Commissioner, prepare a notice of proposed expansion describing the contemplated changes in the boundaries of the Unit Area, the reason therefor, the basis for admission of the additional Tract or Tracts, the Tract Participation to be assigned thereto and the proposed effective date thereof; and

2. Deliver copies of said notice to Land Commissioner, the A.O. at the proper BLM Office, each Working Interest Owner and to the last known address of each lessee and lessor whose interests are affected, advising such parties that thirty (30) days will be allowed for submission to the Unit Operator of any objection to such proposed expansion; and

3. File, upon the expiration of said thirty (30) day period as set out in (2) immediately above with the Land Commissioner and A.O. the following: (a) evidence of mailing or delivering copies of said notice of expansion; (b) an application for approval of such expansion; (c) an instrument containing the appropriate joinders in compliance with the participation requirements of Section 14, and

Section 34, infra; and (d) a copy of all objections received along with the Unit Operator's response thereto.

The expansion shall, after due consideration of all pertinent information and approval by the Land Commissioner and the A.O., become effective as of the date prescribed in the notice thereof, preferably the first day of the month subsequent to the date of notice. The revised Tract Participation of the respective Tracts included within the Unit Area prior to such enlargement shall remain the same ratio one to another.

SECTION 5. UNITIZED LAND. All land committed to this Agreement as to the Unitized Formation shall constitute land referred to herein as "Unitized Land" or "Land subject to this Agreement". Nothing herein shall be construed to unitize, pool, or in any way affect the oil, gas and other minerals contained in or that may be produced from any formation other than the Unitized Formation as defined in Section 2 (h) of this Agreement.

SECTION 6. UNIT OPERATOR. McQuadrangle, LC is hereby designated the Unit Operator, and by signing this instrument as Unit Operator, agrees and consents to accept the duties and obligations of Unit Operator for the operation, development, and production of Unitized Substances as herein provided. Whenever reference is made herein to the Unit Operator, such reference means the Unit Operator acting in that capacity and not as an owner of interests in Unitized Substances, when such interest are owned by it and the term "Working Interest Owner" when used herein shall include or refer to the Unit Operator as the owner of a Working Interest when such an interest is owned by it.

Unit Operator shall have a lien upon interests of Working Owners in the Unit Area to the extent provided in the Unit Operating Agreement.

SECTION 7. RESIGNATION OR REMOVAL OF UNIT OPERATOR. Unit Operator shall have the right to resign at any time, but such resignation shall not become effective so as to release Unit Operator from the duties and obligations of Unit Operator and terminate Unit Operator's rights as such for a period of six (6) months after written notice of intention to resign has been given by Unit Operator to all Working Interest Owners, the Land Commissioner and the A.O. unless a new Unit Operator shall have taken over and assumed the duties and obligations of Unit Operator prior to the expiration of said period.

The Unit Operator shall, upon default or failure in the performance of its duties and obligations hereunder, be subject to removal by Working Interest Owners having in the aggregate eighty percent (80%) or more of the Unit Participation then in effect exclusive of the Working Interest Owner who is the Unit Operator. Such removal shall be effective upon notice thereof to the Land Commissioner and the A.O.

In all such instances of effective resignation or removal, until a successor to Unit Operator is selected and approved as hereinafter provided, the Working Interest Owners shall be jointly responsible for the performance of the duties of the Unit Operator and shall, not later than thirty (30) days before such resignation or removal becomes effective, appoint a Unit Manager to represent them in any action to be taken hereunder.

The resignation or removal of Unit Operator under this Agreement shall not terminate its right, title or interest as the owner of a Working Interest or other interest in Unitized Substances, but upon the resignation or removal of Unit Operator becoming effective, such Unit Operator shall deliver possession of all wells, equipment, books and records, materials, appurtenances and any other assets used in connection with the Unit Operations to the new duly qualified successor Unit Operator or to the Unit Manager if no such new Unit Operator is elected. Nothing herein shall be construed as authorizing the removal of any material, equipment or appurtenances needed for the preservation of any wells. Nothing herein contained shall be construed to relieve or discharge any Unit Operator or Unit Manager who resigns or is removed hereunder from any liability or duties accruing or performable by it prior to the effective date of such resignation or removal.

SECTION 8. SUCCESSOR UNIT OPERATOR. Whenever the Unit Operator shall tender its resignation as Unit Operator or shall be removed as hereinabove provided, the Working Interest Owners shall select a successor Unit Operator as herein provided. Such selection shall not become effective until (a) a Unit Operator so selected shall accept in writing the duties and responsibilities of Unit Operator, and (b) the selection shall have been approved by the Land Commissioner and the A.O. If no successor Unit Operator or Unit Manager is selected and qualified as herein provided, the Land Commissioner and/or the A.O., at their election, may declare this Agreement terminated.

In selecting a successor Unit Operator, the affirmative vote of three or more Working Interest Owners having a total of sixty-five percent (65%) or more of the total Unit Participation shall prevail; provided that if any one Working Interest Owner has a Unit Participation of more than thirty-five percent (35%), its negative vote or failure to vote shall not be regarded as sufficient unless supported by the vote of one or more other Working Interest Owners having a total Unit Participation of at least five percent (5%). If the Unit Operator who is removed votes only to succeed itself or fails to vote, the successor Unit Operator may be selected by the affirmative vote of the owners of at least seventy-five percent (75%) of the Unit Participation remaining after excluding the Unit Participation of Unit Operator so removed.

SECTION 9. ACCOUNTING PROVISIONS AND UNIT OPERATING AGREEMENT. Costs and expenses incurred by Unit Operator in conducting Unit Operations hereunder shall be paid, apportioned among and borne by the Working Interest Owners in accordance with the Unit Operating Agreement. Such Unit Operating Agreement shall also provide the manner in which the Working Interest Owners shall be entitled to receive their respective proportionate and allocated share of the benefits accruing hereto in conformity with their underlying operating agreements, leases or other contracts and such other rights and obligations as between Unit Operator and the Working Interest Owners as may be agreed upon by the Unit Operator and the Working Interest Owners; however, no such Unit Operating Agreement shall be

deemed either to modify any of the terms and conditions of this Agreement or to relieve the Unit Operator of any right or obligation established under this Agreement, and in case of any inconsistency or conflict between this Agreement and the Unit Operating Agreement, this Agreement shall prevail. Copies of any Unit Operating Agreement executed pursuant to this Section shall be filed with the Land Commissioner and with the A.O. at the Proper BLM Office as required prior to approval of this Agreement.

**SECTION 10. RIGHTS AND OBLIGATIONS OF UNIT OPERATOR.** Except as otherwise specifically provided herein, the exclusive right, privilege and duty of exercising any and all rights of the parties hereto including surface rights which are necessary or convenient for prospecting for, producing, storing, allocating and distributing the Unitized Substances are hereby delegated to and shall be exercised by the Unit Operator as herein provided. Upon request, acceptable evidence of title to said rights shall be deposited with said Unit Operator, and together with this Agreement, shall constitute and define the rights, privileges and obligations of Unit Operator. Nothing herein, however, shall be construed to transfer title to any land or to any lease or operating agreement, it being understood that under this Agreement the Unit Operator, in its capacity as Unit Operator, shall exercise the rights of possession and use vested in the parties hereto only for the purposes herein specified.

**SECTION 11. PLAN OF OPERATIONS.** It is recognized and agreed by the parties hereto that all of the land subject to this Agreement is reasonably proved to be productive of Unitized Substances and that the object and purpose of this Agreement is to formulate and to put into effect an improved recovery project in order to effect additional recovery of Unitized Substances, prevent waste and conserve natural resources. Unit Operator shall have the right to inject into the Unitized Formation any substances for secondary recovery or enhanced recovery purposes in accordance with a plan of operation approved by the Working Interest Owners, the A.O., the Land Commissioner and the Division, including the right to drill and maintain injection wells on the Unitized Land and completed in the Unitized Formation, and to use abandoned well or wells producing from the Unitized Formation for said purpose. Subject to like approval, the Plan of Operation may be revised as conditions may warrant.

The initial Plan of Operation shall be filed with the A.O., the Land Commissioner and the Division concurrently with the filing of the Unit Agreement for final approval. Said initial plan of operations and all revisions thereof shall be as complete and adequate as the A.O., the Land Commissioner and the Division may determine to be necessary for timely operation consistent herewith. Upon approval of this Agreement and the initial plan by the A.O. and Commissioner, said plan, and all subsequently approved plans, shall constitute the operating obligations of the Unit Operator under this Agreement for the period specified therein. Thereafter, from time to time before the expiration of any existing plan, the Unit Operator shall submit for like approval a plan for an additional specified period of operations. After such operations are commenced, reasonable diligence shall be exercised by the Unit Operator in complying with the obligations of the approved Plan of Operation.

Notwithstanding anything to the contrary herein contained, should the Unit Operator fail to commence Unit Operations for the secondary recovery of Unitized Substances from the Unit Area within eighteen (18) months after the effective date of this Agreement, or any extension thereof approved by the A.O., this Agreement shall terminate automatically as of the date of default.

**SECTION 12. USE OF SURFACE AND USE OF WATER.** The parties to the extent of their rights and interests, hereby grant to Unit Operator the right to use as much of the surface, including the water thereunder, of the Unitized Land as may reasonably be necessary for Unit Operations.

Unit Operator's free use of water or brine or both for Unit Operations, shall not include any water from any well, lake, pond or irrigation ditch of a surface owner, unless approval for such use is granted by the surface owner.

Unit Operator shall pay the surface owner for damages to growing crops, fences, improvements and structures on the Unitized Land that result from Unit Operations, and such payments shall be considered as items of unit expense to be borne by all the Working Interest Owners of lands subject hereto.

**SECTION 13. TRACT PARTICIPATION.** In Exhibit "B" attached hereto there are listed and numbered the various Tracts within the Unit Area, and set forth opposite each Tract are figures which represent the Tract Participation, during Unit Operations if all Tracts in the Unit Area qualify as provided herein. The Tract Participation of each Tract as shown in Exhibit "B" was determined in accordance with the following formula:

$$\text{Tract Participation} = 50\% \text{ A/B} + 40\% \text{ C/D} + 10\% \text{ E/F}$$

- A = the Tract Cumulative Oil Production from the Unitized Formation as of September 30, 1982.
- B = the Unit Total Cumulative Oil Production from the Unitized Formation as of September 30, 1982.
- C = the Remaining Primary Oil Reserves from the Unitized Formation for the Tract, beginning October 1, 1982, as determined by the Technical Committee on February 25, 1983.
- D = the Remaining Primary Oil Reserves from the Unitized Formation for all Unit Tracts, beginning October 1, 1982, as determined by the Technical Committee on February 25, 1983.

E = the amount of oil produced from the Unitized Formation by the Tract from January 1, 1982, through September 30, 1982.

F = the amount of oil produced from the Unitized Formation by all Unit Tracts from January 1, 1982, through September 30, 1982.

In the event less than all Tracts are qualified on the Effective Date hereof, the Tract Participation shall be calculated on the basis of all such qualified Tracts rather than all Tracts in the Unit Area.

**SECTION 14. TRACTS QUALIFIED FOR PARTICIPATION.** On and after the Effective Date hereof, the Tracts within the Unit Area which shall be entitled to participation in the production of Unitized Substances shall be those Tracts more particularly described in Exhibit "B" that corner or have a common boundary (Tracts separated only by a public road or a railroad right-of-way shall be considered to have a common boundary), and that otherwise qualify as follows:

(a) Each Tract as to which Working Interest Owners owning one hundred percent (100%) of the Working Interest have become parties to this Agreement and as to which Royalty Owners owning seventy-five percent (75%) or more of the Royalty Interest have become parties to this Agreement.

(b) Each Tract as to which Working Interest Owners owning one hundred percent (100%) of the Working Interest have become parties to this Agreement, and as to which Royalty Owners owning less than seventy-five percent (75%) of the Royalty Interest have become parties to this Agreement, and as to which (1) the Working Interest Owner who operates the Tract and Working Interest Owners owning at least seventy-five percent (75%) of the remaining Working Interest in such Tract have joined in a request for the inclusion of such Tract, and as to which (2) Working Interest Owners owning at least seventy-five percent (75%) of the combined Unit Participation in all Tracts that meet the requirements of Section 14 (a) above have voted in favor of the inclusion of such tract.

(c) Each Tract as to which Working Interest Owners owning less than one hundred percent (100%) of the Working Interest have become parties to this Agreement, regardless of the percentage of Royalty Interest therein that is committed hereto; and as to which (1) the Working Interest Owner who operates the Tract and Working Interest Owner owning at least seventy-five percent (75%) of the remaining Working Interest in such Tract who have become parties to this Agreement have joined in a request for inclusion of such Tract, and have executed and delivered, or obligated themselves to execute and deliver an indemnity agreement indemnifying and agreeing to hold harmless the other owners of committed Working Interests, their successors and assigns, against all claims and demands that may be made by the owners of Working Interest in such Tract who are not parties to this Agreement, and which arise out of the inclusion of the Tract; and as to which (2) Working Interest Owners owning at least seventy-five percent (75%) of the Unit Participation in all Tracts that meet the requirements of Section 14 (a) and 14 (b) have voted in favor of the inclusion of such Tract and to accept the indemnity agreement. Upon the inclusion of such a Tract, the Tract Participation which would have been attributed to the non-subscribing owners of Working Interest in such Tract, had they become parties to this Agreement and the Unit Operating Agreement, shall be attributed to the Working Interest Owners in such Tract who have become parties to such agreements, and joined in the indemnity agreement, in proportion to their respective Working Interests in the Tract.

If on the Effective Date of this Agreement there is any Tract or Tracts which have not been effectively committed to or made subject to this Agreement by qualifying as above provided, then such Tract or Tracts shall not be entitled to participate hereunder. Unit Operator shall, when submitting this Agreement for final approval by the Land Commissioner and the A.O., file therewith a schedule of those tracts which have been committed and made subject to this Agreement and are entitled to participate in Unitized Substances. Said schedule shall set forth opposite each such committed Tract the lease number or assignment number, the owner of record of the lease, and the percentage participation of such tract which shall be computed according to the participation formula set forth in Section 13 (Tract Participation) above. This schedule of participation shall be revised Exhibit "B" and upon approval thereof by the Land Commissioner and the A.O., shall become a part of this Agreement and shall govern the allocation of production of Unitized Substances until a new schedule is approved by the Land Commissioner and A.O.

**SECTION 15.A. ALLOCATION OF UNITIZED SUBSTANCES.** All Unitized Substances produced and saved (less, save and except any part of such Unitized Substances used in conformity with good operating practices on unitized land for drilling, operating, camp and other production or development purposes and for injection or unavoidable loss in accordance with a Plan of Operation approved by the A.O. and Land Commissioner) shall be apportioned among and allocated to the qualified Tracts in accordance with the respective Tract Participations effective hereunder during the respective periods such Unitized Substances were produced, as set forth in the schedule of participation in Exhibit "B". The amount of Unitized Substances so allocated to each Tract, and only that amount (regardless of whether it be more or less than the amount of the actual production of Unitized Substances from the well or wells, if any, on such Tract) shall, for all intents, uses and purposes, be deemed to have been produced from such Tract.

The Unitized Substances allocated to each Tract shall be distributed among, or accounted for, to the parties entitled to share in the production from such Tract in the same manner, in the same proportions, and upon the same conditions, as they would have participated and shared in the production from such Tracts, or in the proceeds thereof, had this Agreement not been entered into; and with the same legal force and effect.

No Tract committed to this Agreement and qualified for participation as above provided shall be subsequently excluded from participation hereunder on account of depletion of Unitized Substances.

If the Working Interest and/or the Royalty Interest in any Tract are divided with respect to separate parcels or portions of such Tract and owned now or hereafter in severalty by different persons, the Tract Participation shall in the absence of a recordable instrument executed by all owners in such Tract and furnished to Unit Operator fixing the divisions of ownership, be divided among such parcels or portions in proportion to the number of surface acres in each.

**SECTION 15.B. EXCESS IMPUTED NEWLY DISCOVERED CRUDE OIL.** Each Tract shall be allocated any excess imputed newly discovered crude oil in the proportion that its Tract Participation bears to the total of the Tract Participations of all Tracts not previously allocated the total number of barrels of crude oil allocable to these Tracts out of unit production in accordance with the Tract Participations of such Tracts; provided, however, that excess imputed newly discovered crude oil allocated to each such Tract, when added to the total number of barrels of imputed newly discovered crude oil previously allocated to it, shall not exceed, in any month, the total number of barrels of oil allocable to it out of unit production in accordance with its Tract Participation.

**SECTION 15.C. EXCESS IMPUTED STRIPPER CRUDE OIL.** Each Tract shall be allocated any excess imputed stripper crude oil in the proportion that its Tract Participation bears to the total of the Tract Participations of all Tracts not previously allocated the total number of crude oil barrels allocable to these Tracts out of unit production in accordance with the Tract Participations of such Tracts; provided, however, that excess imputed stripper crude oil allocated to each such Tract, when added to the total number of barrels of imputed stripper crude oil previously allocated to it, shall not exceed, in any month, the total number of barrels of oil allocable to it out of unit production in accordance with its Tract Participation.

**SECTION 15.D. TAKING UNITIZED SUBSTANCES IN KIND.** The Unitized Substances allocated to each Tract shall be delivered in kind to the respective parties entitled thereto by virtue of the ownership of oil and gas rights therein. Each such party shall have the right to construct, maintain and operate all necessary facilities for that purpose within the Unitized Area, provided the same are so constructed, maintained and operated as not to interfere with Unit Operations. Subject to Section 17 hereof, any extra expenditure incurred by Unit Operator by reason of the delivery in kind of any portion of the Unitized Substances shall be borne by the party taking delivery. In the event any Working Interest Owner shall fail to take or otherwise adequately dispose of its proportionate share of the production from the Unitized Formation then so long as such condition continues, Unit Operator, for the account and at the expense of the Working Interest Owner of the Tract or Tracts concerned, and in order to avoid curtailing the operation of the Unit Area, may, but shall not be required to, sell or otherwise dispose of such production to itself or to others, provided that all contracts of sale by Unit Operator of any other party's share of Unitized Substances shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the circumstances, but in no event shall any such contract be for a period in excess of one year, and at not less than the prevailing market price in the area for like production, and the account of such Working Interest Owner shall be charged therewith as having received such production. The net proceeds, if any, of the Unitized Substances so disposed of by Unit Operator shall be paid to the Working Interest Owner of the Tract or Tracts concerned. Notwithstanding the foregoing, Unit Operator shall not make a sale into interstate commerce of any Working Interest Owner's share of gas production without first giving such Working Interest Owner sixty (60) days' notice of such intended sale.

Any Working Interest Owner receiving in kind or separately disposing of all or any part of the Unitized Substances allocated to any Tract, or receiving the proceeds therefrom if the same is sold or purchased by Unit Operator, shall be responsible for the payment of all royalty, overriding royalty and production payments due thereon, and each such party shall hold each other Working Interest Owner harmless against all claims, demands and causes of action by owners of such royalty, overriding royalty and production payments.

If, after the Effective Date of this Agreement, there is any Tract or Tracts that are subsequently committed hereto, as provided in Section 4 (Expansion) hereof, or any Tract or Tracts within the Unit Area not committed hereto as of the Effective Date hereof but which are subsequently committed hereto under the provisions of Section 14 (Tracts Qualified for Participation) and Section 32 (Non-joinder and Subsequent Joinder); or if

any Tract is excluded from this Agreement as provided for in Section 21 (Loss of Title), the schedule of participation as shown in Exhibit "B" shall be revised by the Unit Operator, and the revised Exhibit "B", upon approval by the Land Commissioner and the A.O., shall govern the allocation of production on and after the effective date thereof until a revised schedule is approved as hereinabove provided.

**SECTION 16. OUTSIDE SUBSTANCES.** If gas obtained from formations not subject to this Agreement is introduced into the Unitized Formation for use in repressuring, stimulating of production or increasing ultimate recovery which shall be in conformity with a Plan of Operation first approved by the Land Commissioner and the A.O., a like amount of gas with appropriate deduction for loss or depletion from any cause may be withdrawn from unit wells completed in the Unitized Formation royalty free as to dry gas, but not royalty free as to the products extracted therefrom; provided that such withdrawal shall be at such time as may be provided in the approved Plan of Operation or as otherwise may be consented to or prescribed by the Land Commissioner and the A.O. as conforming to good petroleum engineering practices and provided further that such right of withdrawal shall terminate on the termination date of this Agreement.

**SECTION 17. ROYALTY SETTLEMENT.** The State of New Mexico and United States of America and all Royalty Owners who, under an existing contract, are entitled to take in kind a share of the substances produced from any Tract unitized hereunder, shall continue to be

entitled to such right to take in kind their share of the Unitized Substances allocated to such Tract, and Unit Operator shall make deliveries of such Royalty share taken in kind in conformity with the applicable contracts, laws and regulations. Settlement for Royalty not taken in kind shall be made by Working Interest Owners responsible therefor under existing contracts, laws and regulations on or before the last day of each month for Unitized Substances produced during the preceding calendar month; provided, however, that nothing herein contained shall operate to relieve the lessees of any land from their respective lease obligations for the payment of any Royalty due under the leases, except that such Royalty shall be computed on Unitized Substances as allocated to each Tract in accordance with the terms of this Agreement. With respect to Federal leases committed hereto on which the royalty rate depends upon the daily average production per well, such average production shall be determined in accordance with the operating regulations pertaining to Federal leases as though the committed Tracts were included in a single consolidated lease.

If the amount of production or the proceeds thereof accruing to any Royalty Owner (except the United States of America) in a Tract depends upon the average production per well or the average pipeline runs per well from such Tract during any period of time, then such production shall be determined from and after the effective date hereof by dividing the quantity of Unitized Substances allocated hereunder to such Tract during such period of time by the number of wells located thereon capable of producing Unitized Substances as of the Effective Date hereof, provided that any Tract not having any well so capable of producing Unitized Substances on the Effective Date hereof shall be considered as having one such well for the purpose of this provision.

All Royalty due the State of New Mexico and the United States of America and the other Royalty Owners hereunder shall be computed and paid on the basis of all Unitized Substances allocated to the respective Tract or Tracts committed hereto, in lieu of actual production from such Tract or Tracts.

With the exception of Federal and State requirements to the contrary, Working Interest Owners may use or consume Unitized Substances for Unit Operations and no Royalty, overriding royalty, production or other payments shall be payable on account of Unitized Substances used, lost, or consumed in Unit Operations.

Each Royalty Owner (other than the State of New Mexico and the United States of America) that executes this Agreement represents and warrants that it is the owner of a Royalty Interest in a Tract or Tracts within the Unit Area as its interest appears in Exhibit "B" attached hereto. If any Royalty Interest in a Tract or Tracts should be lost by title failure or otherwise in whole or in part, during the term of this Agreement, then the Royalty Interest of the party representing himself to be the owner thereof shall be reduced proportionately and the interest of all parties shall be adjusted accordingly.

**SECTION 18. RENTAL SETTLEMENT.** Rentals or minimum Royalties due on the leases committed hereto shall be paid by Working Interest Owners responsible therefor under existing contracts, laws and regulations provided that nothing herein contained shall operate to relieve the lessees of any land from their respective lease obligations for the payment of any rental or minimum Royalty in lieu thereof, due under their leases. Rental for lands of the State of New Mexico subject to this Agreement shall be paid at the rate specified in the respective leases from the State of New Mexico. Rental or minimum Royalty for lands of the United States of America subject to this Agreement shall be paid at the rate specified in the respective leases from the United States of America, unless such rental or minimum Royalty is waived, suspended or reduced by law or by approval of the Secretary or his duly authorized representative.

**SECTION 19. CONSERVATION.** Operations hereunder and production of Unitized Substances shall be conducted to provide for the most economical and efficient recovery of said substances without waste, as defined by or pursuant to Federal and State laws and regulations.

**SECTION 20. DRAINAGE.** The Unit Operator shall take all reasonable and prudent measures to prevent drainage of Unitized Substances from unitized land by wells on land not subject to this Agreement.

The Unit Operator, upon approval by the Working Interest Owners, the A.O. and the Land Commissioner, is hereby empowered to enter into a borderline agreement or agreements with working interest owners of adjoining lands not subject to this Agreement with respect to operation in the border area for the maximum economic recovery, conservation purposes and proper protection of the parties and interest affected.

**SECTION 21. LOSS OF TITLE.** In the event title to any Tract of unitized land shall fail and the true owner cannot be induced to join in this Agreement, such Tract shall be automatically regarded as not committed hereto, and there shall be such readjustment of future costs and benefits as may be required on account of the loss of such title. In the event of a dispute as to title to any Royalty, Working Interest, or other interests subject thereto, payment or delivery on account thereof may be withheld without liability for interest until the dispute is finally settled; provided, that, as to State or Federal lands or leases, no payments of funds due the United States or the State of New Mexico shall be withheld, but such funds shall be deposited as directed by the A.O. or Land Commissioner (as the case may be) to be held as unearned money pending final settlement of the title dispute, and then applied as earned or returned in accordance with such final settlement.

If the title or right of any party claiming the right to receive in kind all or any portion of the Unitized Substances allocated to a Tract is in dispute, Unit Operator at the direction of Working Interest Owners shall either:

- (a) require that the party to whom such Unitized Substance are delivered or to whom the proceeds thereof are paid furnish security for the

proper accounting therefor to the rightful owner if the title or right of such party fails in whole or in part, or

(b) withhold and market the portion of Unitized Substances with respect to which title or right is in dispute, and impound the proceeds thereof until such time as the title or right thereto is established by a final judgement of a court of competent jurisdiction or otherwise to the satisfaction of Working Interest Owners, whereupon the proceeds so impounded shall be paid to the party rightfully entitled thereto.

Each Working Interest Owner shall indemnify, hold harmless, and defend all other Working Interest Owners against any and all claims by any party against the interest attributed to such Working Interest Owner on Exhibit "B".

Unit Operator as such is relieved from any responsibility for any defect or failure of any title hereunder.

**SECTION 22. LEASES AND CONTRACTS CONFORMED AND EXTENDED.** The terms, conditions and provisions of all leases, subleases and other contracts relating to exploration, drilling, development or operation for oil or gas on lands committed to this Agreement are hereby expressly modified and amended to the extent necessary to make the same conform to the provisions hereof, but otherwise to remain in full force and effect, and the parties hereto hereby consent that the Secretary and the Land Commissioner, respectively, shall and by their approval hereof, or by the approval hereof by their duly authorized representatives, do hereby establish, alter, change or revoke the drilling, producing, rental, minimum Royalty and Royalty requirements of Federal and State leases committed hereto and the regulations in respect thereto to conform said requirements to the provisions of this Agreement.

Without limiting the generality of the foregoing, all leases, subleases and contracts are particularly modified in accordance with the following:

(a) The development and operation of lands subject to this Agreement under the terms hereof shall be deemed full performance of all obligations for development and operation with respect to each Tract subject to this Agreement, regardless of whether there is any development of any Tract of the Unit Area, notwithstanding anything to the contrary in any lease, operating agreement or other contract by and between the parties hereto, or their respective predecessors in interest, or any of them.

(b) Drilling, producing or improved recovery operations performed hereunder shall be deemed to be performed upon and for the benefit of each Tract, and no lease shall be deemed to expire by reason of failure to drill or produce wells situated on the land therein embraced.

(c) Suspension of drilling or producing operations within the Unit Area pursuant to direction or consent of the Land Commissioner and the A.C., or their duly authorized representatives, shall be deemed to constitute such suspension pursuant to such direction or consent as to each Tract within the Unitized Area.

(d) Each lease, sublease, or contract relating to the exploration, drilling, development, or operation for oil and gas which by its terms might expire prior to the termination of this Agreement, is hereby extended beyond any such term so provided therein, so that it shall be continued in full force and effect for and during the term of this Agreement.

(e) Any lease embracing lands of the State of New Mexico which is made subject to this Agreement shall continue in force beyond the term provided therein as to the lands committed hereto until the termination hereof.

(f) Any lease embracing lands of the State of New Mexico having only a portion of its land committed hereto shall be segregated as to that portion committed and that not committed, and the terms of such lease shall apply separately to such segregated portions commencing as of the Effective Date hereof. Provided, however, that notwithstanding any of the provisions of this Agreement to the contrary, such lease (including both segregated portions) shall continue in full force and effect beyond the term provided therein as to all lands embraced in such lease if oil or gas is, or has heretofore been discovered in paying quantities on some part of the lands embraced in such lease committed to this Agreement or, so long as a portion of the Unitized Substances produced from the Unit Area is, under the terms of this Agreement, allocated to the portion of the lands covered by such lease committed to this Agreement, or, at any time during the term hereof, as to any lease that is then valid and subsisting and upon which the lessee or the Unit Operator is then engaged in bona fide drilling, reworking, or improved recovery operations on any part of the lands embraced in such lease, then the same as to all lands embraced therein shall remain in full force and effect so long as such operations are diligently prosecuted, and if they result in the production of oil or gas, said lease shall continue in full force and effect as to all of the lands embraced therein, so long thereafter as oil or gas in paying quantities is being produced from any portion of said lands.

(g) The segregation of any Federal lease committed to this Agreement is governed by the following provision in the fourth paragraph of Section 17 (j) of the Mineral Leasing Act, as amended by the Act of September 2, 1960 (74 Stat. 781-784): "Any (Federal) lease heretofore or hereafter committed to any such (unit) plan embracing lands that are in part within and in part outside of the area covered by any such plan shall be segregated into separate leases as to the lands committed and the lands not committed as of the effective date of unitization; provided, however, that any such lease as to the non-unitized portion shall continue in force and effect for the term thereof but for not less than two years from the date of such segregation and so long thereafter as oil or gas is produced in paying quantities."

SECTION 23. COVENANTS RUN WITH LAND. The covenants herein shall be construed to be covenants running with the land with respect to the interest of the parties hereto and their successors in interest until this Agreement terminates, and any grant, transfer or conveyance of interest in land or leases subject hereto shall be and hereby is conditioned upon the assumption of all privileges and obligations hereunder by the grantee, transferee or other successor in interest. No assignment or transfer of any Working Interest subject hereto shall be binding upon Unit Operator until the first day of the calendar month after Unit Operator is furnished with the original, or acceptable photostatic or certified copy, of the recorded instrument or transfer; and no assignment or transfer of any Royalty Interest subject hereto shall be binding upon the Working Interest Owner responsible therefor until the first day of the calendar month after said Working Interest Owner is furnished with the original, or acceptable photostatic or certified copy, of the recorded instrument or transfer.

SECTION 24. EFFECTIVE DATE AND TERM. This Agreement shall become binding upon each party who executes or ratifies it as of the date of execution or ratification by such party and shall become effective on the first day of the calendar month next following the approval of this Agreement by the A.O., the Land Commissioner and the Commission.

If this Agreement does not become effective on or before August 31, 2003, it shall ipso facto expire on said date (hereinafter call "Expiration Date") and thereafter be of no further force or effect, unless prior thereto this Agreement has been executed or ratified by Working Interest Owners owning a combined Participation of at least seventy-five percent (75%); and at least seventy-five percent (75%) of such Working Interest Owners committed to this Agreement have decided to extend Expiration Date for a period not to exceed one (1) year (hereinafter called "Extended Expiration Date"). If Expiration Date is so extended and this Agreement does not become effective on or before the Extended Expiration Date, it shall ipso facto expire on Extended Expiration Date and thereafter be of no further force and effect.

Unit Operator shall file for record within thirty (30) days after the Effective Date of this Agreement, in the office of the County Clerk of \_\_\_\_\_ County, New Mexico, where a counterpart of this Agreement has become effective according to its terms and stating further the effective date.

The terms of this Agreement shall be for and during the time that Unitized Substances are produced from the unitized land and so long thereafter as drilling, reworking or other operations (including improved recovery operations) are prosecuted thereon without cessation of more than ninety (90) consecutive days unless sooner terminated as herein provided.

This Agreement may be terminated with the approval of the Land Commissioner and the A.O. by Working Interest Owners owning eighty percent (80%) of the Unit Participation then in effect whenever such Working Interest Owners determine that Unit Operations are no longer profitable, or in the interest of conservation. Upon approval, such termination shall be effective as of the first day of the month after said Working Interest Owners' determination. Notice of any such termination shall be filed by Unit Operator in the office of the County Clerk of Eddy County, New Mexico, within thirty (30) days of the effective date of termination.

Upon termination of this Agreement, the parties hereto shall be governed by the terms and provisions of the leases and contracts affecting the separate Tracts just as if this Agreement had never been entered into.

Notwithstanding any other provisions in the leases unitized under this Agreement, Royalty Owners hereby grant Working Interest Owners a period of six months after termination of this Agreement in which to salvage, sell, distribute or otherwise dispose of the personal property and facilities used in connection with Unit Operations.

SECTION 25. RATE OF PROSPECTING, DEVELOPMENT & PRODUCTION. All production and the disposal thereof shall be in conformity with allocations and quotas made or fixed by any duly authorized person or regulatory body under any Federal or State Statute. The A.O. is hereby vested with authority to alter or modify from time to time, in his discretion, the rate of prospecting and development and within the limits made or fixed by the Division to alter or modify the quantity and rate of production under this Agreement, such authority being hereby limited to alteration or modification in the public interest, the purpose thereof and the public interest to be served thereby to be stated in the order of alteration or modification; provided, further, that no such alteration or modification shall be effective as to any land of the State of New Mexico as to the rate of prospecting and development in the absence of the specific written approval thereof by the Land Commissioner and as to any lands in the State of New Mexico or privately-owned lands subject to this Agreement or to the quantity and rate of production from such lands in the absence of specific written approval thereof by the Division.

Powers in this Section vested in the A.O. shall only be exercised after notice to Unit Operator and opportunity for hearing to be held not less than fifteen (15) days from notice, and thereafter subject to administrative appeal before becoming final.

SECTION 26. NONDISCRIMINATION. Unit Operator in connection with the performance of work under this Agreement relating to leases of the United States, agrees to comply with all of the provisions of Section 202 (1) to (7) inclusive of Executive Order 11246, (30 F.R. 12319), which are hereby incorporated by reference in this Agreement.

SECTION 27. APPEARANCES. Unit Operator shall have the right to appear for or on behalf of any interests affected hereby

before the Land Commissioner, the Department, and the Division, and to appeal from any order issued under the rules and regulations of the Land Commissioner, the Department or the Division, or to apply for relief from any of said rules and regulations or in any proceedings relative to operations before the Land Commissioner, the Department or the Division or any other legally constituted authority; provided, however, that any other interested party shall also have the right at his or its own expense to be heard in any such proceeding.

SECTION 28. NOTICES. All notices, demands, objections or statements required hereunder to be given or rendered to the parties hereto shall be deemed fully given if made in writing and personally delivered to the party or parties or sent by postpaid certified or registered mail, addressed to such party or parties at their last known address set forth in connection with the signatures hereto or to the ratification or consent hereof or to such other address as any such party or parties may have furnished in writing to the party sending the notice, demand or statement.

SECTION 29. NO WAIVER OF CERTAIN RIGHT. Nothing in this Agreement contained shall be construed as a waiver by any party hereto of the right to assert any legal or constitutional right or defense as to the validity or invalidity of any law of the State wherein said Unitized Lands are located, or regulations issued thereunder in any way affecting such party, or as a waiver by any such party of any right beyond his or its authority to waive; provided, however, each party hereto covenants that it will not resort to any action to partition the unitized land or the Unit Equipment.

SECTION 30. EQUIPMENT AND FACILITIES NOT FIXTURES ATTACHED TO REALTY. Each Working Interest Owner has heretofore placed and used on its Tract or Tracts committed to this Agreement various well and lease equipment and other property, equipment and facilities. It is also recognized that additional equipment and facilities may hereafter be placed and used upon the Unitized Land as now or hereafter constituted. Therefore, for all purposes of this Agreement, any such equipment shall be considered to be personal property and not fixtures attached to realty. Accordingly, said well and lease equipment and personal property is hereby severed from the mineral estates affected by this Agreement, and it is agreed that any such equipment and personal property shall be and remain personal property of the Working Interest Owners for all purposes.

SECTION 31. UNAVOIDABLE DELAY. All obligations under this Agreement requiring the Unit Operator to commence or continue improved recovery operations or to operate on or produce Unitized Substances from any of the lands covered by this Agreement shall be suspended while, but only so long as, the Unit Operator, despite the exercise of due care and diligence, is prevented from complying with such obligations, in whole or in part, by strikes, acts of God, Federal, State or municipal law or agency, unavoidable accident, uncontrollable delays in transportation, inability to obtain necessary materials or equipment in open market, or other matters beyond the reasonable control of the Unit Operator whether similar to matters herein enumerated or not.

SECTION 32. NONJOINER AND SUBSEQUENT JOINER. Joinder by any Royalty Owner, at any time, must be accompanied by appropriate joinder of the corresponding Working Interest Owner in order for the interest of such Royalty Owner to be regarded as effectively committed. Joinder to this Agreement by a Working Interest Owner, at any time, must be accompanied by appropriate joinder to the Unit Operating Agreement in order for such interest to be regarded as effectively committed to this Agreement.

Any oil or gas interest in the Unitized Formations not committed hereto prior to submission of this Agreement to the Land Commissioner and the A.O. for final approval may thereafter be committed hereto upon compliance with the applicable provisions of this Section and of Section 14 (Tracts Qualified for Participation) hereof, at any time up to the Effective Date hereof on the same basis of Tract Participation as provided in Section 13, by the owner or owners thereof subscribing, ratifying, or consenting in writing to this Agreement and, if the interest is a Working Interest, by the owner of such interest subscribing also to the Unit Operating Agreement.

It is understood and agreed, however, that from and after the Effective Date hereof the right of subsequent joinder as provided in this Section shall be subject to such requirements or approvals and on such basis as may be agreed upon by Working Interest Owners owning not less than sixty-five percent (65%) of the Unit Participation then in effect, and approved by the Land Commissioner and A.O. Such subsequent joinder by a proposed Working Interest Owner must be evidenced by his execution or ratification of this Agreement and the Unit Operating Agreement and, where State or Federal land is involved, such joinder must be approved by the Land Commissioner or A.O. Such joinder by a proposed Royalty Owner must be evidenced by his execution, ratification or consent of this Agreement and must be consented to in writing by the Working Interest Owner responsible for the payment of any benefits that may accrue hereunder in behalf of such proposed Royalty Owner. Except as may be otherwise herein provided, subsequent joinder to this Agreement shall be effective as of the first day of the month following the filing with the Land Commissioner and A.O. of duly executed counterparts of any and all documents necessary to establish effective commitment of any Tract or interest to this Agreement, unless objection to such joinder by the Land Commissioner or the A.O., is duly made sixty (60) days after such filing.

SECTION 33. COUNTERPARTS. This Agreement may be executed in any number of counterparts, no one of which needs to be executed by all parties and may be ratified or consented to by separate instrument in writing, specifically referring hereto, and shall be binding upon all those parties who have executed such a counterpart, ratification or consent hereto with the same force and effect as if all parties had signed the same document, and regardless of whether or not it is executed by all other parties owning or claiming an interest in the land within the described Unit Area. Furthermore, this Agreement shall extend to and be binding on the parties hereto, their successors, heirs and assigns.

SECTION 34. JOINER IN DUAL CAPACITY. Execution as herein provided by any party as either a Working Interest Owner or a Royalty Owner shall commit all interests owned or controlled by such party; provided, that if the party is the owner of a Working Interest, he must

also execute the Unit Operating Agreement.

SECTION 35. TAXES. Each party hereto shall, for its own account, render and pay its share of any taxes levied against or measured by the amount or value of the Unitized Substances produced from the unitized land; provided, however, that if it is required or if it be determined that the Unit Operator or the several Working Interest Owners must pay or advance said taxes for the account of the parties hereto, it is hereby expressly agreed that the parties so paying or advancing said taxes shall be reimbursed therefor by the parties hereto, including Royalty Owners, who may be responsible for the taxes on their respective allocated share of said Unitized Substances. No taxes shall be charged to the United States or to the State of New Mexico, nor to any lessor who has a contract with a lessee which requires his lessee to pay such taxes.

SECTION 36. NO PARTNERSHIP. The duties, obligations and liabilities of the parties hereto are intended to be several and not joint or collective. This Agreement is not intended to create, and shall not be construed to create, an association or trust, or to impose a partnership duty, obligation or liability with regard to any one or more of the parties hereto. Each party hereto shall be individually responsible for its own obligation as herein provided.

SECTION 37. PRODUCTION AS OF THE EFFECTIVE DATE. Unit Operator shall make a proper and timely gauge of all leases and other tanks within the Unit Area in order to ascertain the amount of merchantable oil above the pipeline connection, in such tanks as of 7:00 a.m. on the Effective Date hereof. All such oil which has been produced in accordance with established allowables shall be and remain the property of the Working Interest Owner entitled thereto, the same as if the unit had not been formed; and the responsible Working Interest Owner shall promptly remove said oil from the unitized land. Any such oil not so removed shall be sold by Unit Operator for the account of such Working Interest Owners, subject to the payment of all Royalty to Royalty Owners under the terms hereof. The oil that is in excess of the prior allowable of the wells from which it was produced shall be regarded as Unitized Substances produced after Effective Date hereof.

If, as of the Effective Date hereof, any Tract is overproduced with respect to the allowable of the wells on that Tract and the amount of over-production has been sold or otherwise disposed of, such over-production shall be regarded as a part of the Unitized Substances produced after the Effective Date hereof and shall be charged to such Tract as having been delivered to the parties entitled to Unitized Substances allocated to such Tract.

SECTION 38. NO SHARING OF MARKET. This Agreement is not intended to provide and shall not be construed to provide, directly or indirectly, for any cooperative refining, joint sale or marketing of Unitized Substances.

SECTION 39. STATUTORY UNITIZATION. If and when Working Interest Owners owning at least seventy-five percent (75%) Unit Participation and Royalty Owners owning at least seventy-five percent (75%) Royalty Interest have become parties to this Agreement or have approved this Agreement in writing and such Working Interest Owners have also become parties to the Unit Operating Agreement, Unit Operator may make application to the Division for statutory unitization of the uncommitted interests pursuant to the Statutory Unitization Act (Chapter 65, Article 14, N.M.S. 1953 Annotated). If such application is made and statutory unitization is approved by the Division, then effective as of the date of the Division's order approving statutory unitization, this Agreement and/or the Unit Operating Agreement shall automatically be revised and/or amended in accordance with the following:

- (1) Section 14 of this Agreement shall be revised by substituting for the entire said section the following:

"SECTION 14. TRACTS QUALIFIED FOR PARTICIPATION. On and after the Effective Date hereof, all Tracts within the Unit Area shall be entitled to participation in the production of Unitized Substances."

- (2) Section 24 of this Agreement shall be revised by substituting for the first three paragraphs of said section the following:

"SECTION 24. EFFECTIVE DATE AND TERM. This Agreement shall become effective on the first day of the calendar month next following the effective date of the Division's order approving statutory unitization upon the terms and conditions of this Agreement, as amended (if any amendment is necessary) to conform to the Division's order; approval of this Agreement, as so amended, by the Land Commissioner, and the A.O. and the filing by Unit Operator of this Agreement or notice thereof for record in the office of the County Clerk of Eddy County, New Mexico. Unit Operator shall not file this Agreement or notice thereof for record, and hence this Agreement shall not become effective, unless within ninety (90) days after the date all other prerequisites for effectiveness of this Agreement have been satisfied, such filing is approved by Working Interest Owners owning a combined Unit Participation of at least sixty-five percent (65%) as to all Tracts within the Unit Area.

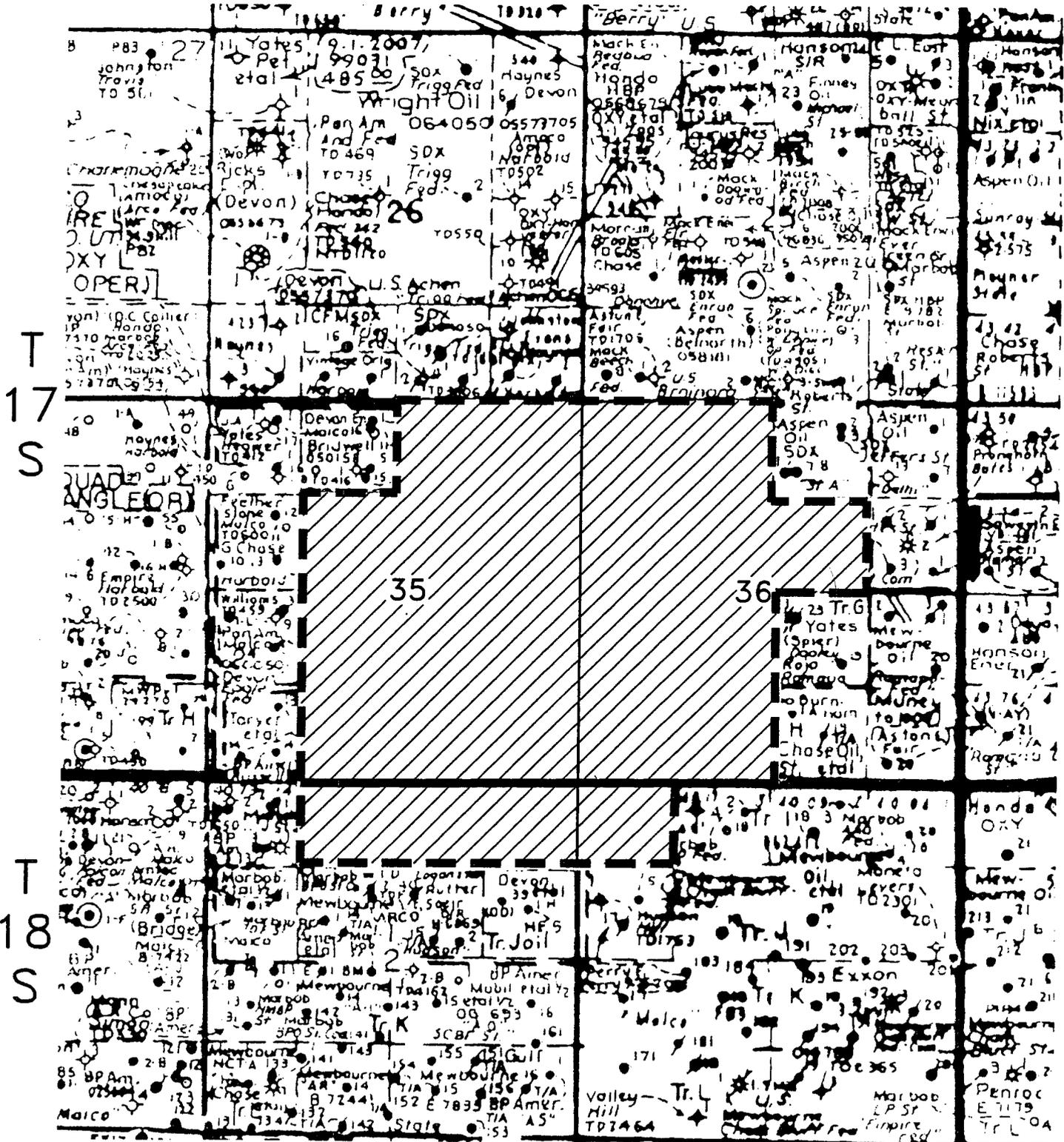
"Unit Operator shall, within thirty (30) days after the Effective Date of this Agreement, file for record in the office of the County Clerk of Eddy County, New Mexico, a certificate to the effect that this Agreement has become effective in accordance with its terms, therein identifying the Division's order approving statutory unitization and stating the Effective Date."

- (3) This Agreement and/or the Unit Operating Agreement shall be amended in any and all respects necessary to conform to the Division's order approving statutory unitization.

Any and all amendments of this Agreement and/or the Unit Operating Agreement that are necessary to conform said agreements to the



R 27 E



**OWNERSHIP MAP**  
**SOUTH RED LAKE II UNIT**  
**EDDY COUNTY, NEW MEXICO**

LEGEND

- PRODUCING WELL
- \* GAS WELL
- ◇ DRY HOLE
- PLUGGED & ABANDONED
- ▨ PRESENT UNIT AREA

JULY, 2004  
 BY: JIM PIERCE  
 DRAWING BY: HTDS

**AMENDED EXHIBIT "B". SCHEDULE OF OWNERSHIP**

Schedule Showing All Lands and Leases Within the  
SOUTH REDLAKE II UNIT, EDDY COUNTY, NEW MEXICO

Tract Number	Description of Lands	Acres	Serial Number and Expiration	Basic Royalty and Percentage	Lessee of Record	Overriding Royalty and Percentage	Working Interest and Percentage
1.	Section 35: SW/4SE/4, SE/4SW/4 T17S, R27E	80	LC-028755-A HBP	USA/All Sliding Scale	OXY USA WTP, LP	Losee, et al 5.00%	McQuadrangle, LC 100%
2.	Section 35: SE/4NW/4, SE/4NE/4 T17S, R27E	80	LC-050158 HBP	USA/All Sliding Scale	BP America Production Co.	Trigg, et al 5.00%	McQuadrangle, LC 100%
2A.	Section 35: NE/4NE/4 T17S, R27E	40	LC-050158 HBP	USA/All Sliding Scale	BP America Production Co.	Trigg, et al 5.00%	McQuadrangle, LC 100%
3.	Section 35: W/2NE/4 T17S, R27E	80	LC-055561 HBP	USA/All Sliding Scale	Occidental Permian, LTD.	Cockburn, et al 5.00%	McQuadrangle, LC 100%
4.	Section 35: SE/4SE/4, NE/4SW/4, N/2SE/4 T17S, R27E	160	LC-057798 HBP	USA/All Sliding Scale	OXY USA WTP, LP	Donohue, et al 5.00%	McQuadrangle, LC 100%
5.	Section 1: Lot 4 (NWNW) T18S, R27E	40.22	LC-0624121 HBP	USA/All Sliding Scale	BP America Production Co.	Paul Slayton, et al 5.00%	McQuadrangle, LC 100%
<b>6 Federal Tracts totaling 480.22 Acres or 49.94% of the Unit Area.</b>							
6.	Section 2: Lot 3 (NENW) T18S, R27E	40.60	2029-75 HBP	State of NM 12.5%	OXY USA WTP, LP	Paton, et al 12.5%	McQuadrangle, LC 100%
7.	Section 36: E/2SW/4 T17S, R27E	80	B-752-2 HBP	State of NM 12.5%	Wm. P. Dooley	Wm. P. Dooley, et al 16.25%	McQuadrangle, LC 100%
8.	Section 2: Lot 2 (NWNE) T18S, R27E	40.46	B-1483-26 HBP	State of NM 12.5%	OXY USA WTP, L.P.	Laura Kaempf, et al 12.5%	McQuadrangle, LC 100%

9.	Section 36: SE/4NW/4 T17S, R27E	40	B-8318-134 HBP	State of NM 12.5%	BP America Production Co.	Harlan Steed, et al 16.25%	McQuadrangle, LC 100%
10.	Section 2: Lot 1 (NENE) T18S, R27E	40.33	B-9299-4 HBP	State of NM 12.5%	BP America Production Co.	Hudson, et al 15.00%	McQuadrangle, LC 100%
11.	Section 36: NW/4SW/4 T17S, R27E	40	B-11538-14 HBP	State of NM 12.5%	Conoco Inc.; Pure Energy Group, Inc.; Bellwether Exploration Co.	Manix Energy LLC, et al 16.25%	McQuadrangle, LC 100%
12.	Section 36: NE/4NW/4 T17S, R27E	40	B-11538-14 HBP	State of NM 12.5%	“	“	McQuadrangle, LC 100%
13.	Section 36: SW/4SW/4 T17S, R27E	40	E-379-5 HBP	State of NM 12.5%	Occidental Permian, LP	McQuadrangle, LC, et al 10.00%	McQuadrangle, LC 100%
14.	Section 36: SW/4NE/4 T17S, R27E	40	E-1059-2 HBP	State of NM 12.5%	BP America Production Co.	“	McQuadrangle, LC 100%
15.	Section 36: W/2NW/4 T17S, R27E	80	V-5512 HBP	State of NM 16.67%	Southwestern Energy Prod. Company	Southwestern Energy Prod. Company	Southwestern Energy Production Company 100%

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10 State Tracts Totaling 481.39 Acres or 50.06% of Unit Area

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Total Federal Acreage:	480.22 Acres or 49.94%
Total State Acreage:	481.39 Acres or 50.06%
Total Acreage in Unit Area:	961.61 Acres or 100.000000%

**EXHIBIT "C". SCHEDULE OF TRACT PARTICIPATION (production)**

1.	7.99535%	Section 35: SW/4SE/4, SE/4SW/4. T17S, R27E	Federal Lease #LC-028755-A Sliding Scale Royalty Reduced to 2.1% effective 7/1/00
2.	6.41114%	Section 35: SE/4NW/4, SE/4NE/4 T17S, R27E	Federal Lease #LC-050158 Sliding Scale Royalty Reduced to 1.3% effective 7/1/00
2A.	6.41114%	Section 35: NE/4NE/4 T17S, R27E	Federal Lease #LC-050158 Sliding Scale Royalty Reduced to 1.3% effective 7/1/00
3.	4.82955%	Section 35: W/2NE/4 T17S, R27E	Federal Lease #LC-055561 Sliding Scale Royalty Reduced to 2.9% effective 7/1/00
4.	8.82591%	Section 35: SE/4SE/4, NE/4SW/4, N/2SE/4 T17S, R27E	Federal Lease #LC-057798 Sliding Scale Royalty Reduced to 0.5% effective 7/1/00
5.	0	Section 1: Lot 4 (NWNW) T18S, R27E	Federal Lease #LC-062412 Sliding Scale Royalty Reduced to 0.5% effective 7/1/00
6.	1.99737%	Section 2: Lot 3 (NENW) T18S, R27E	State Lease #2029-75 12.5%
7.	12.90584%	Section 36: E/2SW/4 T17S, R27E	State Lease #B-752-2 12.5%
8.	2.99767%	Section 2: Lot 2 (NWNE) T18S, R27E	State Lease # B-1483-26 12.5%
9.	4.99586%	Section 36: SE/4NW/4 T17S, R27E	State Lease #B-8318-134 12.5%
10.	1.99818%	Section 2: Lot 1 (NENE) T18S, R27E	State Lease #B-9299-4 12.5%

MODEL FORM OPERATING AGREEMENT



OPERATING AGREEMENT

DATED

October 31, 192003,

OPERATOR McQuadrangle, L.L.C.

CONTRACT AREA Section 35: E/2, SE/4NW/4, E/2SW/4;  
Section 36: NW/4, SW/4NE/4, SW/4, T-17-S, R-27-E; Section 1: Lot 4;  
Section 2: N/2NE/4, NE/4NW/4 being Lots 1, 2 and 3, T-18-S, R-27-E, NMPM,  
Eddy County, New Mexico

COUNTY OR PARISH OF Eddy, STATE OF New Mexico

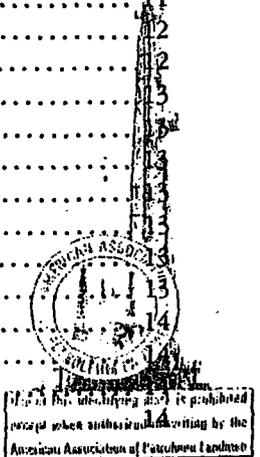
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 AMERICAN ASSOCIATION OF PETROLEUM  
 LANDMEN, 4100 FOSSIL CREEK BLVD.  
 FORT WORTH, TEXAS, 76137, APPROVED FORM.  
 A.A.P.L. NO. 610 - 1989

EXHIBIT C

11.	2.99767%	Section 36: NW/4NW/4 T17S, R27E	State Lease #B-11538-14 12.5%
12.	2.99767%	Section 36: NE/4NW/4 T17S, R27E	State Lease #B-11538-14 12.5%
13.	16.81945%	Section 36: SW/4SW/4 T17S, R27E	State Lease #E-379-5 12.5%
14.	2.99767%	Section 36: SW/4NE/4 T17S, R27E	State Lease #E-1059-2 12.5%
15.	14.82127%	Section 36: W/2NW/4 T17S, R27E	State Lease #V-5512

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Use of this operating agreement is published  
except when authorized in writing by the  
American Association of Petroleum Landmen

OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between ... Triangle, LLC hereinafter designated and referred to as "Operator," and the signatory party or parties other than Operator, sometimes hereinafter referred to individually as "Non-Operator," and collectively as "Non-Operators."

WITNESSETH:

WHEREAS, the parties to this agreement are owners of Oil and Gas Leases and/or Oil and Gas Interests in the land identified in Exhibit "A," and the parties hereto have reached an agreement to explore and develop these Leases and/or Oil and Gas Interests for the production of Oil and Gas to the extent and as hereinafter provided,

NOW, THEREFORE, it is agreed as follows:

ARTICLE I. DEFINITIONS

As used in this agreement, the following words and terms shall have the meanings here ascribed to them:

A. The term "AFE" shall mean an Authority for Expenditure prepared by a party to this agreement for the purpose of estimating the costs to be incurred in conducting an operation hereunder.

B. The term "Completion" or "Complete" shall mean a single operation intended to complete a well as a producer of Oil and Gas in one or more Zones, including, but not limited to, the setting of production casing, perforating, well stimulation and production testing conducted in such operation.

C. The term "Contract Area" shall mean all of the lands, Oil and Gas Leases and/or Oil and Gas Interests intended to be developed and operated for Oil and Gas purposes under this agreement. Such lands, Oil and Gas Leases and Oil and Gas Interests are described in Exhibit "A."

D. The term "Deepen" shall mean a single operation whereby a well is drilled to an objective Zone below the deepest Zone in which the well was previously drilled, or below the Deepest Zone proposed in the associated AFE, whichever is the lesser.

E. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.

F. The term "Drilling Unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a Drilling Unit is not fixed by any such rule or order, a Drilling Unit shall be the drilling unit as established by the pattern of drilling in the Contract Area unless fixed by express agreement of the Drilling Parties.

G. The term "Drillsite" shall mean the Oil and Gas Lease or Oil and Gas Interest on which a proposed well is to be located.

H. The term "Initial Well" shall mean the well required to be drilled by the parties hereto as provided in Article VI.A.

I. The term "Non-Consent Well" shall mean a well in which less than all parties have conducted an operation as provided in Article VI.B.2.

J. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

K. The term "Oil and Gas" shall mean oil, gas, casinghead gas, gas condensate, and/or all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.

L. The term "Oil and Gas Interests" or "Interests" shall mean unleased fee and mineral interests in Oil and Gas in tracts of land lying within the Contract Area which are owned by parties to this agreement.

M. The terms "Oil and Gas Lease," "Lease" and "Leasehold" shall mean the oil and gas leases or interests therein covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

N. The term "Plug Back" shall mean a single operation whereby a deeper Zone is abandoned in order to attempt a Completion in a shallower Zone.

O. The term "Recompletion" or "Recomplete" shall mean an operation whereby a Completion in one Zone is abandoned in order to attempt a Completion in a different Zone within the existing wellbore.

P. The term "Rework" shall mean an operation conducted in the wellbore of a well after it is Completed to secure, restore, or improve production in a Zone which is currently open to production in the wellbore. Such operations include, but are not limited to, well stimulation operations but exclude any routine repair or maintenance work or drilling, Sidetracking, Deepening, Completing, Recompleting, or Plugging Back of a well.

Q. The term "Sidetrack" shall mean the directional control and intentional deviation of a well from vertical so as to change the bottom hole location unless done to straighten the hole or to drill around junk in the hole to overcome other mechanical difficulties.

R. The term "Zone" shall mean a stratum of earth containing or thought to contain a common accumulation of Oil and Gas separately producible from any other common accumulation of Oil and Gas.

Unless the context otherwise clearly indicates, words used in the singular include the plural, the word "person" includes natural and artificial persons, the plural includes the singular, and any gender includes the masculine, feminine, and neuter.

ARTICLE II. EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

- X A. Exhibit "A," shall include the following information: (1) Description of lands subject to this agreement, (2) Restrictions, if any, as to depths, formations, or substances, (3) Parties to agreement with addresses and telephone numbers for notice purposes, (4) Percentages or fractional interests of parties to this agreement, (5) Oil and Gas Leases and/or Oil and Gas Interests subject to this agreement, (6) Burdens on production.
Y B. Exhibit "B," Form of Lease. All State and Federal/various forms
X C. Exhibit "C," Accounting Procedure.
X D. Exhibit "D," Insurance.
E. Exhibit "E," Gas Balancing Agreement.
X F. Exhibit "F," Non-Discrimination and Certification of Non-Segregated Facilities.
C. Exhibit "G," Tax Partnership.
H. Other:



1 If any provision of any exhibit, except Exhibits "E," "F" and "G," is inconsistent with any provision contained in  
2 the body of this agreement, the provisions in the body of this agreement shall prevail.

3 **ARTICLE III.**  
4 **INTERESTS OF PARTIES**

5 **A. Oil and Gas Interests:**

6 If any party owns an Oil and Gas Interest in the Contract Area, that Interest shall be treated for all purposes of this  
7 agreement and during the term hereof as if it were covered by the form of Oil and Gas Lease attached hereto as Exhibit "B,"  
8 and the owner thereof shall be deemed to own both royalty interest in such lease and the interest of the lessee thereunder.

9 **B. Interests of Parties in Costs and Production:**

10 Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne  
11 and paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties as their  
12 interests are set forth in Exhibit "A." In the same manner, the parties shall also own all production of Oil and Gas from the  
13 Contract Area subject, however, to the payment of royalties and other burdens on production as described hereafter.

14 Regardless of which party has contributed any Oil and Gas Lease or Oil and Gas Interest on which royalty or other  
15 burdens may be payable and except as otherwise expressly provided in this agreement, each party shall pay or deliver, or  
16 cause to be paid or delivered, all burdens on its share of the production from the Contract Area up to, but not in excess of,  
17 20% and shall indemnify, defend and hold the other parties free from any liability therefor.

18 Except as otherwise expressly provided in this agreement, if any party has contributed hereto any Lease or Interest which is  
19 burdened with any royalty, overriding royalty, production payment or other burden on production in excess of the amounts  
20 stipulated above, such party so burdened shall assume and alone bear all such excess obligations and shall indemnify, defend  
21 and hold the other parties hereto harmless from any and all claims attributable to such excess burden. However, so long as  
22 the Drilling Unit for the productive Zone(s) is identical with the Contract Area, each party shall pay or deliver, or cause to  
23 be paid or delivered, all burdens on production from the Contract Area due under the terms of the Oil and Gas Lease(s)  
24 which such party has contributed to this agreement, and shall indemnify, defend and hold the other parties free from any  
25 liability therefor.

26 No party shall ever be responsible, on a price basis higher than the price received by such party, to any other party's  
27 lessor or royalty owner, and if such other party's lessor or royalty owner should demand and receive settlement on a higher  
28 price basis, the party contributing the affected Lease shall bear the additional royalty burden attributable to such higher price.

29 Nothing contained in this Article III.B. shall be deemed an assignment or cross-assignment of interests covered hereby,  
30 and in the event two or more parties contribute to this agreement jointly owned Leases, the parties' undivided interests in  
31 said Leaseholds shall be deemed separate leasehold interests for the purposes of this agreement.

32 **C. Subsequently Created Interests:**

33 If any party has contributed hereto a Lease or Interest that is burdened with an assignment of production given as security  
34 for the payment of money, or if, after the date of this agreement, any party creates an overriding royalty, production  
35 payment, net profits interest, assignment of production or other burden payable out of production attributable to its working  
36 interest hereunder, such burden shall be deemed a "Subsequently Created Interest." Further, if any party has contributed  
37 hereto a Lease or Interest burdened with an overriding royalty, production payment, net profits interest, or other burden  
38 payable out of production created prior to the date of this agreement, and such burden is not shown on Exhibit "A," such  
39 burden also shall be deemed a Subsequently Created Interest to the extent such burden causes the burdens on such party's  
40 Lease or Interest to exceed the amount stipulated in Article III.B. above.

41 The party whose interest is burdened with the Subsequently Created Interest (the "Burdened Party") shall assume and  
42 alone bear, pay and discharge the Subsequently Created Interest and shall indemnify, defend and hold harmless the other  
43 parties from and against any liability therefor. Further, if the Burdened Party fails to pay, when due, its share of expenses  
44 chargeable hereunder, all provisions of Article VII.B. shall be enforceable against the Subsequently Created Interest in the  
45 same manner as they are enforceable against the working interest of the Burdened Party. If the Burdened Party is required  
46 under this agreement to assign or relinquish to any other party, or parties, all or a portion of its working interest and/or  
47 the production attributable thereto, said other party, or parties, shall receive said assignment and/or production free and clear of  
48 said Subsequently Created Interest, and the Burdened Party shall indemnify, defend and hold harmless said other party, or  
49 parties, from any and all claims and demands for payment asserted by owners of the Subsequently Created Interest.

50 **ARTICLE IV.**  
51 **TITLES**

52 **A. Title Examination:**

53 Title examination shall be made on the Drillsite of any proposed well prior to commencement of drilling operations and,  
54 if a majority in interest of the Drilling Parties so request or Operator so elects, title examination shall be made on the entire  
55 Drilling Unit, or maximum anticipated Drilling Unit, of the well. The opinion will include the ownership of the working  
56 interest, minerals, royalty, overriding royalty and production payments under the applicable Leases. Each party contributing  
57 Leases and/or Oil and Gas Interests to be included in the Drillsite or Drilling Unit, if appropriate, shall furnish to Operator  
58 all abstracts (including federal lease status reports), title opinions, title papers and curative material in its possession free of  
59 charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the  
60 examination of the title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or  
61 by outside attorneys. Copies of all title opinions shall be furnished to each Drilling Party. Costs incurred by Operator in  
62 procuring abstracts, fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in royalty  
63 opinions and division order title opinions) and other direct charges as provided in Exhibit "C" shall be borne by the Drilling  
64 Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such  
65 interests appear in Exhibit "A." Operator shall make no charge for services rendered by its staff attorneys or other personnel  
66 in the performance of the above functions.

67 Each party shall be responsible for securing curative matter and pooling amendments or agreements required in  
68 connection with Leases or Oil and Gas Interests contributed by such party. Operator shall be responsible for the preparation  
69 and recording of pooling designations or declarations and communitization agreements as well as the conduct of hearings  
70 before governmental agencies for the securing of spacing or pooling orders or any other orders necessary or appropriate to  
71 the conduct of operations hereunder. This shall not prevent any party from appearing on its own behalf at such hearings.  
72 Costs incurred by Operator, including fees paid to outside attorneys, which are associated with hearings before governmental  
73 agencies, and which costs are necessary and proper for the activities contemplated under this agreement, shall be direct  
74 charges to the joint account and shall not be covered by the administrative overhead charges as provided in Exhibit "C."

1 Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above  
2 functions.

3 No well shall be drilled on the Contract Area until after: (1) the title to the Drillsite or Drilling Unit, if appropriate, has  
4 been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by  
5 all of the Drilling Parties in such well.

6 **B. Loss or Failure of Title:**

7 ~~**Failure of Title:** Should any Oil and Gas Interest or Oil and Gas Lease be lost through failure of title, which results in a  
8 reduction of interest from that shown on Exhibit "A," the party credited with contributing the affected Lease or Interest  
9 (including, if applicable, a successor in interest to such party) shall have ninety (90) days from final determination of title  
10 failure to acquire a new lease or other instrument curing the entirety of the title failure, which acquisition will not be subject  
11 to Article VIII.B., and failing to do so, this agreement, nevertheless, shall continue in force as to all remaining Oil and Gas  
12 Leases and Interests; and,~~

13 (a) The party credited with contributing the Oil and Gas Lease or Interest affected by the title failure (including, if  
14 applicable, a successor in interest to such party) shall bear alone the entire loss and it shall not be entitled to recover from  
15 Operator or the other parties any development or operating costs which it may have previously paid or incurred, but there  
16 shall be no additional liability on its part to the other parties hereto by reason of such title failure;

17 (b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the  
18 Lease or Interest which has failed, but the interests of the parties contained on Exhibit "A" shall be revised on an acreage  
19 basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose Lease or  
20 Interest is affected by the title failure will thereafter be reduced in the Contract Area by the amount of the Lease or Interest failed;

21 (c) If the proportionate interest of the other parties hereto in any producing well previously drilled on the Contract  
22 Area is increased by reason of the title failure, the party who bore the costs incurred in connection with such well attributable  
23 to the Lease or Interest which has failed shall receive the proceeds attributable to the increase in such interest (less costs and  
24 burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well  
25 attributable to such failed Lease or Interest;

26 (d) Should any person not a party to this agreement, who is determined to be the owner of any Lease or Interest  
27 which has failed, pay in any manner any part of the cost of operation, development, or equipment, such amount shall be paid  
28 to the party or parties who bore the costs which are so refunded;

29 (e) Any liability to account to a person not a party to this agreement for prior production of Oil and Gas which arises  
30 by reason of title failure shall be borne severally by each party (including a predecessor to a current party) who received  
31 production for which such accounting is required based on the amount of such production received, and each such party shall  
32 severally indemnify, defend and hold harmless all other parties hereto for any such liability to account;

33 (f) No charge shall be made to the joint account for legal expenses, fees or salaries in connection with the defense of  
34 the Lease or Interest claimed to have failed, but if the party contributing such Lease or Interest hereto elects to defend its title  
35 it shall bear all expenses in connection therewith; and

36 (g) If any party is given credit on Exhibit "A" to a Lease or Interest which is limited solely to ownership of an  
37 interest in the wellbore of any well or wells and the production therefrom, such party's absence of interest in the remainder  
38 of the Contract Area shall be considered a Failure of Title as to such remaining Contract Area unless that absence of interest  
39 is reflected on Exhibit "A."

40 **2. Loss by Non-Payment or Erroneous Payment of Amount Due:** If, through mistake or oversight, any rental, shut-in well  
41 payment, minimum royalty or royalty payment, or other payment necessary to maintain all or a portion of an Oil and Gas  
42 Lease or Interest is not paid or is erroneously paid, and as a result a Lease or Interest terminates, there shall be no monetary  
43 liability against the party who failed to make such payment. Unless the party who failed to make the required payment  
44 secures a new Lease or Interest covering the same interest within ninety (90) days from the discovery of the failure to make  
45 proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties reflected on Exhibit "A"  
46 shall be revised on an acreage basis, effective as of the date of termination of the Lease or Interest involved, and the party  
47 who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership  
48 of the Lease or Interest which has terminated. If the party who failed to make the required payment shall not have been fully  
49 reimbursed, at the time of the loss, from the proceeds of the sale of Oil and Gas attributable to the lost Lease or Interest,  
50 calculated on an acreage basis, for the development and operating costs previously paid on account of such Lease or Interest,  
51 it shall be reimbursed for unrecovered actual costs previously paid by it (but not for its share of the cost of any dry hole  
52 previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

53 (a) Proceeds of Oil and Gas produced prior to termination of the Lease or Interest, less operating expenses and lease  
54 burdens chargeable hereunder to the person who failed to make payment, previously accrued to the credit of the lost Lease or  
55 Interest on an acreage basis, up to the amount of unrecovered costs;

56 (b) Proceeds of Oil and Gas, less operating expenses and lease burdens chargeable hereunder to the person who failed  
57 to make payment, up to the amount of unrecovered costs attributable to that portion of Oil and Gas thereafter produced and  
58 marketed (excluding production from any wells thereafter drilled) which, in the absence of such Lease or Interest termination,  
59 would be attributable to the lost Lease or Interest on an acreage basis and which as a result of such Lease or Interest  
60 termination is credited to other parties, the proceeds of said portion of the Oil and Gas to be contributed by the other parties  
61 in proportion to their respective interests reflected on Exhibit "A"; and,

62 (c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner  
63 of the Lease or Interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

64 **3. Other Losses:** All losses of Leases or Interests committed to this agreement, other than those set forth in Articles  
65 IV.B.1. and IV.B.2. above, shall be joint losses and shall be borne by all parties in proportion to their interests shown on  
66 Exhibit "A." This shall include but not be limited to the loss of any Lease or Interest through failure to develop or because  
67 express or implied covenants have not been performed (other than performance which requires only the payment of money),  
68 and the loss of any Lease by expiration at the end of its primary term if it is not renewed or extended. There shall be no  
69 readjustment of interests in the remaining portion of the Contract Area on account of any joint loss.

70 **4. Curing Title:** In the event of a Failure of Title under Article IV.B.1. or a loss of title under Article IV.B.2. above, any  
71 Lease or Interest acquired by any party hereto (other than the party whose interest has failed or was lost) during the ninety  
72 (90) day period provided by Article IV.B.1. and Article IV.B.2. above covering all or a portion of the interest that failed  
73 or was lost shall be offered at cost to the party whose interest has failed or was lost, and the provisions of Article VIII.B.  
74 shall not apply to such acquisition.

## ARTICLE V.

## OPERATOR

## A. Designation and Responsibilities of Operator:

McQuadrangle, LLC shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of this agreement. In its performance of services hereunder for the Non-Operators, Operator shall be an independent contractor not subject to the control or direction of the Non-Operators except as to the type of operation to be undertaken in accordance with the election procedures contained in this agreement. Operator shall not be deemed, or hold itself out as, the agent of the Non-Operators with authority to bind them to any obligation or liability assumed or incurred by Operator as to any third party. Operator shall conduct its activities under this agreement as a reasonable prudent operator, in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and regulation, but in no event shall it have any liability as Operator to the other parties for losses sustained or liabilities incurred except such as may result from gross negligence or willful misconduct.

## B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest hereunder in the Contract Area, or is no longer capable of serving as Operator, Operator shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor. Operator may be removed only for good cause by the affirmative vote of Non-Operators owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator; such vote shall not be deemed effective until a written notice has been delivered to the Operator by a Non-Operator detailing the alleged default and Operator has failed to cure the default within thirty (30) days from its receipt of the notice or, if the default concerns an operation then being conducted, within forty-eight (48) hours of its receipt of the notice. For purposes hereof, "good cause" shall mean not only gross negligence or willful misconduct but also the material breach of or inability to meet the standards of operation contained in Article V.A. or material failure or inability to perform its obligations under this agreement.

Subject to Article VII.D.1., such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator under any provision of this agreement, a successor Operator shall be selected by the parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. The successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A"; provided, however, if an Operator which has been removed or is deemed to have resigned fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of the party or parties owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of the Operator that was removed or resigned. The former Operator shall promptly deliver to the successor Operator all records and data relating to the operations conducted by the former Operator to the extent such records and data are not already in the possession of the successor operator. Any cost of obtaining or copying the former Operator's records and data shall be charged to the joint account.

3. Effect of Bankruptcy: If Operator becomes insolvent, bankrupt or is placed in receivership, it shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor. If a petition for relief under the federal bankruptcy laws is filed by or against Operator, and the removal of Operator is prevented by the federal bankruptcy court, all Non-Operators and Operator shall comprise an interim operating committee to serve until Operator has elected to reject or assume this agreement pursuant to the Bankruptcy Code, and an election to reject this agreement by Operator as a debtor in possession, or by a trustee in bankruptcy, shall be deemed a resignation as Operator without any action by Non-Operators, except the selection of a successor. During the period of time the operating committee controls operations, all actions shall require the approval of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A." In the event there are only two (2) parties to this agreement, during the period of time the operating committee controls operations, a third party acceptable to Operator, Non-Operator and the federal bankruptcy court shall be selected as a member of the operating committee, and all actions shall require the approval of two (2) members of the operating committee without regard for their interest in the Contract Area based on Exhibit "A."

## C. Employees and Contractors:

The number of employees or contractors used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed shall be determined by Operator, and all such employees or contractors shall be the employees or contractors of Operator.

## D. Rights and Duties of Operator:

1. Competitive Rates and Use of Affiliates: All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature. All work performed or materials supplied by affiliates or related parties of Operator shall be performed or supplied at competitive rates, pursuant to written agreement, and in accordance with customs and standards prevailing in the industry.

2. Discharge of Joint Account Obligations: Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in Exhibit "C." Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

3. Protection from Liens: Operator shall pay, or cause to be paid, as and when they become due and payable, all accounts of contractors and suppliers and wages and salaries for services rendered or performed, and for materials supplied on, to or in respect of the Contract Area or any operations for the joint account thereof, and shall keep the Contract Area free from

1 liens and encumbrances resulting therefrom except for those resulting from a bona fide dispute as to services rendered or  
2 materials supplied.

3 4. Custody of Funds: Operator shall hold for the account of the Non-Operators any funds of the Non-Operators advanced  
4 or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the  
5 Contract Area, and such funds shall remain the funds of the Non-Operators on whose account they are advanced or paid until  
6 used for their intended purpose or otherwise delivered to the Non-Operators or applied toward the payment of debts as  
7 provided in Article VII.B. Nothing in this paragraph shall be construed to establish a fiduciary relationship between Operator  
8 and Non-Operators for any purpose other than to account for Non-Operator funds as herein specifically provided. Nothing in  
9 this paragraph shall require the maintenance by Operator of separate accounts for the funds of Non-Operators unless the  
10 parties otherwise specifically agree.

11 5. Access to Contract Area and Records: Operator shall, except as otherwise provided herein, permit each Non-Operator  
12 or its duly authorized representative, at the Non-Operator's sole risk and cost, full and free access at all reasonable times to  
13 all operations of every kind and character being conducted for the joint account on the Contract Area and to the records of  
14 operations conducted thereon or production therefrom, including Operator's books and records relating thereto. Such access  
15 rights shall not be exercised in a manner interfering with Operator's conduct of an operation hereunder and shall not obligate  
16 Operator to furnish any geologic or geophysical data of an interpretive nature unless the cost of preparation of such  
17 interpretive data was charged to the joint account. Operator will furnish to each Non-Operator upon request copies of any  
18 and all reports and information obtained by Operator in connection with production and related items, including, without  
19 limitation, meter and chart reports, production purchaser statements, run tickets and monthly gauge reports, but excluding  
20 purchase contracts and pricing information to the extent not applicable to the production of the Non-Operator seeking the  
21 information. Any audit of Operator's records relating to amounts expended and the appropriateness of such expenditures  
22 shall be conducted in accordance with the audit protocol specified in Exhibit "C."

23 6. Filing and Furnishing Governmental Reports: Operator will file, and upon written request promptly furnish copies to  
24 each requesting Non-Operator not in default of its payment obligations, all operational notices, reports or applications  
25 required to be filed by local, State, Federal or Indian agencies or authorities having jurisdiction over operations hereunder.  
26 Each Non-Operator shall provide to Operator on a timely basis all information necessary to Operator to make such filings.

27 7. Drilling and Testing Operations: The following provisions shall apply to each well drilled hereunder, including but not  
28 limited to the Initial Well:

29 (a) Operator will promptly advise Non-Operators of the date on which the well is spudded, or the date on which  
30 drilling operations are commenced.

31 (b) Operator will send to Non-Operators such reports, test results and notices regarding the progress of operations on the well  
32 as the Non-Operators shall reasonably request, including, but not limited to, daily drilling reports, completion reports, and well logs.

33 (c) Operator shall adequately test all Zones encountered which may reasonably be expected to be capable of producing  
34 Oil and Gas in paying quantities as a result of examination of the electric log or any other logs or cores or tests conducted  
35 hereunder.

36 8. Cost Estimates. Upon request of any Consenting Party, Operator shall furnish estimates of current and cumulative costs  
37 incurred for the joint account at reasonable intervals during the conduct of any operation pursuant to this agreement.  
38 Operator shall not be held liable for errors in such estimates so long as the estimates are made in good faith.

39 9. Insurance: At all times while operations are conducted hereunder, Operator shall comply with the workers  
40 compensation law of the state where the operations are being conducted; provided, however, that Operator may be a self-  
41 insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall  
42 be as provided in Exhibit "C." Operator shall also carry or provide insurance for the benefit of the joint account of the parties  
43 as outlined in Exhibit "D" attached hereto and made a part hereof. Operator shall require all contractors engaged in work on  
44 or for the Contract Area to comply with the workers compensation law of the state where the operations are being conducted  
45 and to maintain such other insurance as Operator may require.

46 In the event automobile liability insurance is specified in said Exhibit "D," or subsequently receives the approval of the  
47 parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's automotive  
48 equipment.

49 **ARTICLE VI.**  
50 **DRILLING AND DEVELOPMENT**

51 **A. Initial Well:**

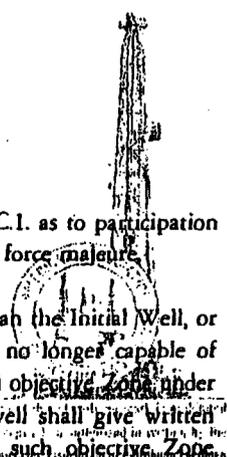
52 On or before the \_\_\_\_\_ day of \_\_\_\_\_, 19 \_\_\_\_\_, Operator shall commence the drilling of the Initial  
53 Well at the following location:

54  
55  
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57  
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59  
60 and shall thereafter continue the drilling of the well with due diligence to

61  
62  
63  
64  
65  
66  
67 The drilling of the Initial Well and the participation therein by all parties is obligatory, subject to Article VI.C.1. as to participation  
68 in Completion operations and Article VI.F. as to termination of operations and Article XI as to occurrence of force majeure.

69 **B. Subsequent Operations:**

70 1. Proposed Operations: If any party hereto should desire to drill any well on the Contract Area other than the Initial Well, or  
71 if any party should desire to Rework, Sidetrack, Deepen, Recomplete or Plug Back a dry hole or a well no longer capable of  
72 producing in paying quantities in which such party has not otherwise relinquished its interest in the proposed objective zone under  
73 this agreement, the party desiring to drill, Rework, Sidetrack, Deepen, Recomplete or Plug Back such a well shall give written  
74 notice of the proposed operation to the parties who have not otherwise relinquished their interest in such objective zone.



1 under this agreement and to all other parties in the case of a proposal for Sidetracking or Deepening, specifying the work to be  
 2 performed, the location, proposed depth, objective Zone and the estimated cost of the operation. The parties to whom such a  
 3 notice is delivered shall have thirty (30) days after receipt of the notice within which to notify the party proposing to do the work  
 4 whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of a proposal to  
 5 Rework, Sidetrack, Recomplete, Plug Back or Deepen may be given by telephone and the response period shall be limited to forty-  
 6 eight (48) hours, exclusive of Saturday, Sunday and legal holidays. Failure of a party to whom such notice is delivered to reply  
 7 within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation.  
 8 Any proposal by a party to conduct an operation conflicting with the operation initially proposed shall be delivered to all parties  
 9 within the time and in the manner provided in Article VI.B.6.

10 If all parties to whom such notice is delivered elect to participate in such a proposed operation, the parties shall be  
 11 contractually committed to participate therein provided such operations are commenced within the time period hereafter set  
 12 forth, and Operator shall, no later than ninety (90) days after expiration of the notice period of thirty (30) days (or as  
 13 promptly as practicable after the expiration of the forty-eight (48) hour period when a drilling rig is on location, as the case  
 14 may be), actually commence the proposed operation and thereafter complete it with due diligence at the risk and expense of  
 15 the parties participating therein; provided, however, said commencement date may be extended upon written notice of same  
 16 by Operator to the other parties, for a period of up to thirty (30) additional days if, in the sole opinion of Operator, such  
 17 additional time is reasonably necessary to obtain permits from governmental authorities, surface rights (including rights-of-  
 18 way) or appropriate drilling equipment, or to complete title examination or curative matter required for title approval or  
 19 acceptance. If the actual operation has not been commenced within the time provided (including any extension thereof as  
 20 specifically permitted herein or in the force majeure provisions of Article XI) and if any party hereto still desires to conduct  
 21 said operation, written notice proposing same must be resubmitted to the other parties in accordance herewith as if no prior  
 22 proposal had been made. Those parties that did not participate in the drilling of a well for which a proposal to Deepen or  
 23 Sidetrack is made hereunder shall, if such parties desire to participate in the proposed Deepening or Sidetracking operation,  
 24 reimburse the Drilling Parties in accordance with Article VI.B.4. in the event of a Deepening operation and in accordance  
 25 with Article VI.B.5. in the event of a Sidetracking operation.

## 26 2. Operations by Less Than All Parties:

27 (a) Determination of Participation. If any party to whom such notice is delivered as provided in Article VI.B.1. or  
 28 VI.C.1. (Option No. 2) elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this  
 29 Article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, no  
 30 later than ninety (90) days after the expiration of the notice period of thirty (30) days (or as promptly as practicable after the  
 31 expiration of the forty-eight (48) hour period when a drilling rig is on location, as the case may be) actually commence the  
 32 proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting  
 33 Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party,  
 34 the Consenting Parties shall either: (i) request Operator to perform the work required by such proposed operation for the  
 35 account of the Consenting Parties, or (ii) designate one of the Consenting Parties as Operator to perform such work. The  
 36 rights and duties granted to and imposed upon the Operator under this agreement are granted to and imposed upon the party  
 37 designated as Operator for an operation in which the original Operator is a Non-Consenting Party. Consenting Parties, when  
 38 conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this  
 39 agreement.

40 If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the  
 41 applicable notice period, shall advise all Parties of the total interest of the parties approving such operation and its  
 42 recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party,  
 43 within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after delivery of such notice, shall advise the  
 44 proposing party of its desire to (i) limit participation to such party's interest as shown on Exhibit "A" or (ii) carry only its  
 45 proportionate part (determined by dividing such party's interest in the Contract Area by the interests of all Consenting Parties in  
 46 the Contract Area) of Non-Consenting Parties' interests, or (iii) carry its proportionate part (determined as provided in (ii)) of  
 47 Non-Consenting Parties' interests together with all or a portion of its proportionate part of any Non-Consenting Parties'  
 48 interests that any Consenting Party did not elect to take. Any interest of Non-Consenting Parties that is not carried by a  
 49 Consenting Party shall be deemed to be carried by the party proposing the operation if such party does not withdraw its  
 50 proposal. Failure to advise the proposing party within the time required shall be deemed an election under (i). In the event a  
 51 drilling rig is on location, notice may be given by telephone, and the time permitted for such a response shall not exceed a  
 52 total of forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays). The proposing party, at its election, may  
 53 withdraw such proposal if there is less than 100% participation and shall notify all parties of such decision within ten (10)  
 54 days, or within twenty-four (24) hours if a drilling rig is on location, following expiration of the applicable response period.  
 55 If 100% subscription to the proposed operation is obtained, the proposing party shall promptly notify the Consenting Parties  
 56 of their proportionate interests in the operation and the party serving as Operator shall commence such operation within the  
 57 period provided in Article VI.B.1., subject to the same extension right as provided therein.

58 (b) Relinquishment of Interest for Non-Participation. The entire cost and risk of conducting such operations shall be  
 59 borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding  
 60 paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and  
 61 encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results  
 62 in a dry hole, then subject to Articles VI.B.6. and VI.E.3., the Consenting Parties shall plug and abandon the well and restore  
 63 the surface location at their sole cost, risk and expense; provided, however, that those Non-Consenting Parties that  
 64 participated in the drilling, Deepening or Sidetracking of the well shall remain liable for, and shall pay, their proportionate  
 65 shares of the cost of plugging and abandoning the well and restoring the surface location insofar only as those costs were not  
 66 increased by the subsequent operations of the Consenting Parties. If any well drilled, Reworked, Sidetracked, Deepened,  
 67 Recompleted or Plugged Back under the provisions of this Article results in a well capable of producing Oil and/or Gas in  
 68 paying quantities, the Consenting Parties shall Complete and equip the well to produce at their sole cost and risk, and the  
 69 well shall then be turned over to Operator (if the Operator did not conduct the operation) and shall be operated by it at the  
 70 expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, Reworking,  
 71 Sidetracking, ReCompleting, Deepening or Plugging Back of any such well by Consenting Parties in accordance with the  
 72 provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties and the  
 73 Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-  
 74 Consenting Party's interest in the well and share of production therefrom or, in the case of a Reworking, Sidetracking,

1 Deepening, Recompleting or Plugging Back, or a Completion pursuant to Article VI.C.1. Option No. 2, all of such Non-  
 2 Consenting Party's interest in the production obtained from the operation in which the Non-Consenting Party did not elect  
 3 to participate. Such relinquishment shall be effective until the proceeds of the sale of such share, calculated at the well, or  
 4 market value thereof if such share is not sold (after deducting applicable ad valorem, production, severance, and excise taxes,  
 5 royalty, overriding royalty and other interests not excepted by Article III.C. payable out of or measured by the production  
 6 from such well accruing with respect to such interest until it reverts), shall equal the total of the following:

7 (i) \_\_\_\_\_ % of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment  
 8 beyond the wellhead connections (including but not limited to stock tanks, separators, treaters, pumping equipment and  
 9 piping), plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first  
 10 production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other  
 11 provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that  
 12 interest which would have been chargeable to such Non-Consenting Party had it participated in the well from the beginning  
 13 of the operations; and

14 (ii) \_\_\_\_\_ % of (a) that portion of the costs and expenses of drilling, Reworking, Sidetracking, Deepening,  
 15 Plugging Back, testing, Completing, and Recompleting, after deducting any cash contributions received under Article VIII.C.,  
 16 and of (b) that portion of the cost of newly acquired equipment in the well (to and including the wellhead connections),  
 17 which would have been chargeable to such Non-Consenting Party if it had participated therein.

18 Notwithstanding anything to the contrary in this Article VI.B., if the well does not reach the deepest objective Zone  
 19 described in the notice proposing the well for reasons other than the encountering of granite or practically impenetrable  
 20 substance or other condition in the hole rendering further operations impracticable, Operator shall give notice thereof to each  
 21 Non-Consenting Party who submitted or voted for an alternative proposal under Article VI.B.6. to drill the well to a  
 22 shallower Zone than the deepest objective Zone proposed in the notice under which the well was drilled, and each such Non-  
 23 Consenting Party shall have the option to participate in the initial proposed Completion of the well by paying its share of the  
 24 cost of drilling the well to its actual depth, calculated in the manner provided in Article VI.B.4. (a). If any such Non-  
 25 Consenting Party does not elect to participate in the first Completion proposed for such well, the relinquishment provisions  
 26 of this Article VI.B.2. (b) shall apply to such party's interest.

27 (c) Reworking, Recompleting or Plugging Back. An election not to participate in the drilling, Sidetracking or  
 28 Deepening of a well shall be deemed an election not to participate in any Reworking or Plugging Back operation proposed in  
 29 such a well, or portion thereof, to which the initial non-consent election applied that is conducted at any time prior to full  
 30 recovery by the Consenting Parties of the Non-Consenting Party's recoupment amount. Similarly, an election not to  
 31 participate in the Completing or Recompleting of a well shall be deemed an election not to participate in any Reworking  
 32 operation proposed in such a well, or portion thereof, to which the initial non-consent election applied that is conducted at  
 33 any time prior to full recovery by the Consenting Parties of the Non-Consenting Party's recoupment amount. Any such  
 34 Reworking, Recompleting or Plugging Back operation conducted during the recoupment period shall be deemed part of the  
 35 cost of operation of said well and there shall be added to the sums to be recouped by the Consenting Parties \_\_\_\_\_ % of  
 36 that portion of the costs of the Reworking, Recompleting or Plugging Back operation which would have been chargeable to  
 37 such Non-Consenting Party had it participated therein. If such a Reworking, Recompleting or Plugging Back operation is  
 38 proposed during such recoupment period, the provisions of this Article VI.B. shall be applicable as between said Consenting  
 39 Parties in said well.

40 (d) Recoupment Matters. During the period of time Consenting Parties are entitled to receive Non-Consenting Party's  
 41 share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all ad valorem,  
 42 production, severance, excise, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to  
 43 Non-Consenting Party's share of production not excepted by Article III.C.

44 In the case of any Reworking, Sidetracking, Plugging Back, Recompleting or Deepening operation, the Consenting  
 45 Parties shall be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of all  
 46 such equipment shall remain unchanged; and upon abandonment of a well after such Reworking, Sidetracking, Plugging Back,  
 47 Recompleting or Deepening, the Consenting Parties shall account for all such equipment to the owners thereof, with each  
 48 party receiving its proportionate part in kind or in value, less cost of salvage.

49 Within ninety (90) days after the completion of any operation under this Article, the party conducting the operations  
 50 for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to  
 51 the well, and an itemized statement of the cost of drilling, Sidetracking, Deepening, Plugging Back, testing, Completing,  
 52 Recompleting, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement  
 53 of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the  
 54 Consenting Parties are being reimbursed as provided above, the party conducting the operations for the Consenting Parties  
 55 shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the operation of  
 56 the well, together with a statement of the quantity of Oil and Gas produced from it and the amount of proceeds realized from  
 57 the sale of the well's working interest production during the preceding month. In determining the quantity of Oil and Gas  
 58 produced during any month, Consenting Parties shall use industry accepted methods such as but not limited to metering or  
 59 periodic well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with  
 60 any such operation which would have been owned by a Non-Consenting Party had it participated therein shall be credited  
 61 against the total unreturned costs of the work done and of the equipment purchased in determining when the interest of such  
 62 Non-Consenting Party shall revert to it as above provided; and if there is a credit balance, it shall be paid to such Non-  
 63 Consenting Party.

64 If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided  
 65 for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it as of 7:00 a.m. of the day  
 66 following the day on which such recoupment occurs, and, from and after such reversion, such Non-Consenting Party shall  
 67 own the same interest in such well, the material and equipment in or pertaining thereto, and the production therefrom as  
 68 such Non-Consenting Party would have been entitled to had it participated in the drilling, Sidetracking, Reworking,  
 69 Deepening, Recompleting or Plugging Back of said well. Thereafter, such Non-Consenting Party shall be charged with and  
 70 shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this  
 71 agreement and Exhibit "C" attached hereto.

72 3. Stand-By Costs: When a well which has been drilled or Deepened has reached its authorized depth and all tests have  
 73 been completed and the results thereof furnished to the parties, or when operations on the well have been otherwise  
 74 terminated pursuant to Article VI.F., stand-by costs incurred pending response to a party's notice proposing a Reworking

1 Sidetracking, Deepening, Recompleting, Plugging Back or Completing operation in such a well (including the period required  
2 under Article VI.B.6. to resolve competing proposals) shall be charged and borne as part of the drilling or Deepening  
3 operation just completed. Stand-by costs subsequent to all parties responding, or expiration of the response time permitted,  
4 whichever first occurs, and prior to agreement as to the participating interests of all Consenting Parties pursuant to the terms  
5 of the second grammatical paragraph of Article VI.B.2. (a) shall be charged to and borne as part of the proposed operation,  
6 but if the proposal is subsequently withdrawn because of insufficient participation, such stand-by costs shall be allocated  
7 between the Consenting Parties in the proportion each Consenting Party's interest as shown on Exhibit "A" bears to the total  
8 interest as shown on Exhibit "A" of all Consenting Parties.

9 In the event that notice for a Sidetracking operation is given while the drilling rig to be utilized is on location, any party  
10 may request and receive up to five (5) additional days after expiration of the forty-eight hour response period specified in  
11 Article VI.B.1. within which to respond by paying for all stand-by costs and other costs incurred during such extended  
12 response period; Operator may require such party to pay the estimated stand-by time in advance as a condition to extending  
13 the response period. If more than one party elects to take such additional time to respond to the notice, standby costs shall be  
14 allocated between the parties taking additional time to respond on a day-to-day basis in the proportion each electing party's  
15 interest as shown on Exhibit "A" bears to the total interest as shown on Exhibit "A" of all the electing parties.

16 4. Deepening: If less than all the parties elect to participate in a drilling, Sidetracking, or Deepening operation proposed  
17 pursuant to Article VI.B.1., the interest relinquished by the Non-Consenting Parties to the Consenting Parties under Article  
18 VI.B.2. shall relate only and be limited to the lesser of (i) the total depth actually drilled or (ii) the objective depth or Zone  
19 of which the parties were given notice under Article VI.B.1. ("Initial Objective"). Such well shall not be Deepened beyond the  
20 Initial Objective without first complying with this Article to afford the Non-Consenting Parties the opportunity to participate  
21 in the Deepening operation.

22 In the event any Consenting Party desires to drill or Deepen a Non-Consent Well to a depth below the Initial Objective,  
23 such party shall give notice thereof, complying with the requirements of Article VI.B.1., to all parties (including Non-  
24 Consenting Parties). Thereupon, Articles VI.B.1. and 2. shall apply and all parties receiving such notice shall have the right to  
25 participate or not participate in the Deepening of such well pursuant to said Articles VI.B.1. and 2. If a Deepening operation  
26 is approved pursuant to such provisions, and if any Non-Consenting Party elects to participate in the Deepening operation,  
27 such Non-Consenting party shall pay or make reimbursement (as the case may be) of the following costs and expenses:

28 (a) If the proposal to Deepen is made prior to the Completion of such well as a well capable of producing in paying  
29 quantities, such Non-Consenting Party shall pay (or reimburse Consenting Parties for, as the case may be) that share of costs  
30 and expenses incurred in connection with the drilling of said well from the surface to the Initial Objective which Non-  
31 Consenting Party would have paid had such Non-Consenting Party agreed to participate therein, plus the Non-Consenting  
32 Party's share of the cost of Deepening and of participating in any further operations on the well in accordance with the other  
33 provisions of this Agreement; provided, however, all costs for testing and Completion or attempted Completion of the well  
34 incurred by Consenting Parties prior to the point of actual operations to Deepen beyond the Initial Objective shall be for the  
35 sole account of Consenting Parties.

36 (b) If the proposal is made for a Non-Consent Well that has been previously Completed as a well capable of producing  
37 in paying quantities, but is no longer capable of producing in paying quantities, such Non-Consenting Party shall pay (or  
38 reimburse Consenting Parties for, as the case may be) its proportionate share of all costs of drilling, Completing, and  
39 equipping said well from the surface to the Initial Objective, calculated in the manner provided in paragraph (a) above, less  
40 those costs recouped by the Consenting Parties from the sale of production from the well. The Non-Consenting Party shall  
41 also pay its proportionate share of all costs of re-entering said well. The Non-Consenting Parties' proportionate part (based  
42 on the percentage of such well Non-Consenting Party would have owned had it previously participated in such Non-Consent  
43 Well) of the costs of salvable materials and equipment remaining in the hole and salvable surface equipment used in  
44 connection with such well shall be determined in accordance with Exhibit "C." If the Consenting Parties have recouped the  
45 cost of drilling, Completing, and equipping the well at the time such Deepening operation is conducted, then a Non-  
46 Consenting Party may participate in the Deepening of the well with no payment for costs incurred prior to re-entering the  
47 well for Deepening.

48 The foregoing shall not imply a right of any Consenting Party to propose any Deepening for a Non-Consent Well prior  
49 to the drilling of such well to its Initial Objective without the consent of the other Consenting Parties as provided in Article  
50 VI.F.

51 5. Sidetracking: Any party having the right to participate in a proposed Sidetracking operation that does not own an  
52 interest in the affected wellbore at the time of the notice shall, upon electing to participate, tender to the wellbore owners its  
53 proportionate share (equal to its interest in the Sidetracking operation) of the value of that portion of the existing wellbore  
54 to be utilized as follows:

55 (a) If the proposal is for Sidetracking an existing dry hole, reimbursement shall be on the basis of the actual costs  
56 incurred in the initial drilling of the well down to the depth at which the Sidetracking operation is initiated.

57 (b) If the proposal is for Sidetracking a well which has previously produced, reimbursement shall be on the basis of  
58 such party's proportionate share of drilling and equipping costs incurred in the initial drilling of the well down to the depth  
59 at which the Sidetracking operation is conducted, calculated in the manner described in Article VI.B.4(b) above. Such party's  
60 proportionate share of the cost of the well's salvable materials and equipment down to the depth at which the Sidetracking  
61 operation is initiated shall be determined in accordance with the provisions of Exhibit "C."

62 6. Order of Preference of Operations. Except as otherwise specifically provided in this agreement, if any party desires to  
63 propose the conduct of an operation that conflicts with a proposal that has been made by a party under this Article VI, such  
64 party shall have fifteen (15) days from delivery of the initial proposal, in the case of a proposal to drill a well or to perform  
65 an operation on a well where no drilling rig is on location, or twenty-four (24) hours, exclusive of Saturday, Sunday and legal  
66 holidays, from delivery of the initial proposal, if a drilling rig is on location for the well on which such operation is to be  
67 conducted, to deliver to all parties entitled to participate in the proposed operation such party's alternative proposal, such  
68 alternate proposal to contain the same information required to be included in the initial proposal. Each party receiving such  
69 proposals shall elect by delivery of notice to Operator within five (5) days after expiration of the proposal period or within  
70 twenty-four (24) hours (exclusive of Saturday, Sunday and legal holidays) if a drilling rig is on location for the well that is the  
71 subject of the proposals, to participate in one of the competing proposals. Any party not electing within the time required  
72 shall be deemed not to have voted. The proposal receiving the vote of parties owning the largest aggregate percentage  
73 interest of the parties voting shall have priority over all other competing proposals; in the case of a tie vote, the

1 initial proposal shall prevail. Operator shall deliver notice of such result to all parties entitled to participate in the operation  
 2 within five (5) days after expiration of the election period (or within twenty-four (24) hours, exclusive of Saturday, Sunday  
 3 and legal holidays, if a drilling rig is on location). Each party shall then have two (2) days (or twenty-four (24) hours if a rig  
 4 is on location) from receipt of such notice to elect by delivery of notice to Operator to participate in such operation or to  
 5 relinquish interest in the affected well pursuant to the provisions of Article VI.B.2.; failure by a party to deliver notice within  
 6 such period shall be deemed an election not to participate in the prevailing proposal.

7 7. Conformity to Spacing Pattern. Notwithstanding the provisions of this Article VI.B.2., it is agreed that no wells shall be  
 8 proposed to be drilled to or completed in or produced from a Zone from which a well located elsewhere on the Contract  
 9 Area is producing, unless such well conforms to the then-existing well spacing pattern for such Zone.

10 8. Paying Wells. No party shall conduct any Reworking, Deepening, Plugging Back, Completion, Recompletion, or  
 11 Sidetracking operation under this agreement with respect to any well then capable of producing in paying quantities except  
 12 with the consent of all parties that have not relinquished interests in the well at the time of such operation.

13 **C. Completion of Wells; Reworking and Plugging Back:**

14 1. Completion: Without the consent of all parties, no well shall be drilled, Deepened or Sidetracked, except any well  
 15 drilled, Deepened or Sidetracked pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling,  
 16 Deepening or Sidetracking shall include:

17  Option No. 1: ~~All necessary expenditures for the drilling, Deepening or Sidetracking, testing, Completing and~~  
 18 ~~equipping of the well, including necessary tankage and/or surface facilities.~~

19  Option No. 2: All necessary expenditures for the drilling, Deepening or Sidetracking and testing of the well. When  
 20 such well has reached its authorized depth, and all logs, cores and other tests have been completed, and the results  
 21 thereof furnished to the parties, Operator shall give immediate notice to the Non-Operators having the right to  
 22 participate in a Completion attempt whether or not Operator recommends attempting to Complete the well,  
 23 together with Operator's AFE for Completion costs if not previously provided. The parties receiving such notice  
 24 shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect by delivery of  
 25 notice to Operator to participate in a recommended Completion attempt or to make a Completion proposal with an  
 26 accompanying AFE. Operator shall deliver any such Completion proposal, or any Completion proposal conflicting  
 27 with Operator's proposal, to the other parties entitled to participate in such Completion in accordance with the  
 28 procedures specified in Article VI.B.6. Election to participate in a Completion attempt shall include consent to all  
 29 necessary expenditures for the Completing and equipping of such well, including necessary tankage and/or surface  
 30 facilities but excluding any stimulation operation not contained on the Completion AFE. Failure of any party  
 31 receiving such notice to reply within the period above fixed shall constitute an election by that party not to  
 32 participate in the cost of the Completion attempt; provided, that Article VI.B.6. shall control in the case of  
 33 conflicting Completion proposals. If one or more, but less than all of the parties, elect to attempt a Completion, the  
 34 provisions of Article VI.B.2. hereof (the phrase "Reworking, Sidetracking, Deepening, Recompleting or Plugging  
 35 Back" as contained in Article VI.B.2. shall be deemed to include "Completing") shall apply to the operations  
 36 thereafter conducted by less than all parties; provided, however, that Article VI.B.2 shall apply separately to each  
 37 separate Completion or Recompletion attempt undertaken hereunder, and an election to become a Non-Consenting  
 38 Party as to one Completion or Recompletion attempt shall not prevent a party from becoming a Consenting Party  
 39 in subsequent Completion or Recompletion attempts regardless whether the Consenting Parties as to earlier  
 40 Completions or Recompletions have recouped their costs pursuant to Article VI.B.2.; provided further, that any  
 41 recoupment of costs by a Consenting Party shall be made solely from the production attributable to the Zone in  
 42 which the Completion attempt is made. Election by a previous Non-Consenting Party to participate in a subsequent  
 43 Completion or Recompletion attempt shall require such party to pay its proportionate share of the cost of salvable  
 44 materials and equipment installed in the well pursuant to the previous Completion or Recompletion attempt,  
 45 insofar and only insofar as such materials and equipment benefit the Zone in which such party participates in a  
 46 Completion attempt.

47 2. Rework, Recomplete or Plug Back: No well shall be Reworked, Recompleted or Plugged Back except a well Reworked,  
 48 Recompleted, or Plugged Back pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the Reworking,  
 49 Recompleting or Plugging Back of a well shall include all necessary expenditures in conducting such operations and  
 50 Completing and equipping of said well, including necessary tankage and/or surface facilities.

51 **D. Other Operations:**

52 Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of \_\_\_\_\_  
 53 Twenty Five Thousand Dollars (\$ 25,000.00 ) except in connection with the  
 54 drilling, Sidetracking, Reworking, Deepening, Completing, Recompleting or Plugging Back of a well that has been previously  
 55 authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden  
 56 emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion  
 57 are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the  
 58 emergency to the other parties. If Operator prepares an AFE for its own use, Operator shall furnish any Non-Operator so  
 59 requesting an information copy thereof for any single project costing in excess of Twenty Five Thousand Dollars  
 60 ( \$ 25,000.00 ). Any party who has not relinquished its interest in a well shall have the right to propose that  
 61 Operator perform repair work or undertake the installation of artificial lift equipment or ancillary production facilities such as  
 62 salt water disposal wells or to conduct additional work with respect to a well drilled hereunder or other similar project (but  
 63 not including the installation of gathering lines or other transportation or marketing facilities, the installation of which shall  
 64 be governed by separate agreement between the parties) reasonably estimated to require an expenditure in excess of the  
 65 amount first set forth above in this Article VI.D. (except in connection with an operation required to be proposed under  
 66 Articles VI.B.1. or VI.C.1. Option No. 2, which shall be governed exclusively by those Articles). Operator shall deliver such  
 67 proposal to all parties entitled to participate therein. If within thirty (30) days thereof Operator secures the written consent  
 68 of any party or parties owning at least 51 % of the interests of the parties entitled to participate in such operation,  
 69 each party having the right to participate in such project shall be bound by the terms of such proposal and shall be obligated  
 70 to pay its proportionate share of the costs of the proposed project as if it had consented to such project pursuant to the terms  
 71 of the proposal.

72 **E. Abandonment of Wells:**

73 1. Abandonment of Dry Holes: Except for any well drilled or Deepened pursuant to Article VI.B.2., any well which has  
 74 been drilled or Deepened under the terms of this agreement and is proposed to be completed as a dry hole shall not be

1 plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any  
 2 party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after  
 3 delivery of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the  
 4 proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the  
 5 cost, risk and expense of the parties who participated in the cost of drilling or Deepening such well. Any party who objects to  
 6 plugging and abandoning such well by notice delivered to Operator within forty-eight (48) hours (exclusive of Saturday,  
 7 Sunday and legal holidays) after delivery of notice of the proposed plugging shall take over the well as of the end of such  
 8 forty-eight (48) hour notice period and conduct further operations in search of Oil and/or Gas subject to the provisions of  
 9 Article VI.B.; failure of such party to provide proof reasonably satisfactory to Operator of its financial capability to conduct  
 10 such operations or to take over the well within such period or thereafter to conduct operations on such well or plug and  
 11 abandon such well shall entitle Operator to retain or take possession of the well and plug and abandon the well. The party  
 12 taking over the well shall indemnify Operator (if Operator is an abandoning party) and the other abandoning parties against  
 13 liability for any further operations conducted on such well except for the costs of plugging and abandoning the well and  
 14 restoring the surface, for which the abandoning parties shall remain proportionately liable.

15 2. Abandonment of Wells That Have Produced: Except for any well in which a Non-Consent operation has been  
 16 conducted hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has  
 17 been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to  
 18 such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk  
 19 and expense of all the parties hereto. Failure of a party to reply within sixty (60) days of delivery of notice of proposed  
 20 abandonment shall be deemed an election to consent to the proposal. If, within sixty (60) days after delivery of notice of the  
 21 proposed abandonment of any well, all parties do not agree to the abandonment of such well, those wishing to continue its  
 22 operation from the Zone then open to production shall be obligated to take over the well as of the expiration of the  
 23 applicable notice period and shall indemnify Operator (if Operator is an abandoning party) and the other abandoning parties  
 24 against liability for any further operations on the well conducted by such parties. Failure of such party or parties to provide  
 25 proof reasonably satisfactory to Operator of their financial capability to conduct such operations or to take over the well  
 26 within the required period or thereafter to conduct operations on such well shall entitle Operator to retain or take possession  
 27 of such well and plug and abandon the well.

28 Parties taking over a well as provided herein shall tender to each of the other parties its proportionate share of the value of  
 29 the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C," less the estimated cost  
 30 of salvaging and the estimated cost of plugging and abandoning and restoring the surface; provided, however, that in the event  
 31 the estimated plugging and abandoning and surface restoration costs and the estimated cost of salvaging are higher than the  
 32 value of the well's salvable material and equipment, each of the abandoning parties shall tender to the parties continuing  
 33 operations their proportionate shares of the estimated excess cost. Each abandoning party shall assign to the non-abandoning  
 34 parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and material, all  
 35 of its interest in the wellbore of the well and related equipment, together with its interest in the Leasehold insofar and only  
 36 insofar as such Leasehold covers the right to obtain production from that wellbore in the Zone then open to production. If the  
 37 interest of the abandoning party is or includes an Oil and Gas Interest, such party shall execute and deliver to the non-  
 38 abandoning party or parties an oil and gas lease, limited to the wellbore and the Zone then open to production, for a term of  
 39 one (1) year and so long thereafter as Oil and/or Gas is produced from the Zone covered thereby, such lease to be on the form  
 40 attached as Exhibit "B." The assignments or leases so limited shall encompass the Drilling Unit upon which the well is located.  
 41 The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their  
 42 respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract  
 43 Area of all assignees. There shall be no readjustment of interests in the remaining portions of the Contract Area.

44 Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production  
 45 from the well in the Zone then open other than the royalties retained in any lease made under the terms of this Article. Upon  
 46 request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and  
 47 charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate  
 48 ownership of the assigned well. Upon proposed abandonment of the producing Zone assigned or leased, the assignor or lessor  
 49 shall then have the option to repurchase its prior interest in the well (using the same valuation formula) and participate in  
 50 further operations therein subject to the provisions hereof.

51 3. Abandonment of Non-Consent Operations: The provisions of Article VI.E.1. or VI.E.2. above shall be applicable as  
 52 between Consenting Parties in the event of the proposed abandonment of any well excepted from said Articles; provided,  
 53 however, no well shall be permanently plugged and abandoned unless and until all parties having the right to conduct further  
 54 operations therein have been notified of the proposed abandonment and afforded the opportunity to elect to take over the well  
 55 in accordance with the provisions of this Article VI.E.; and provided further, that Non-Consenting Parties who own an interest  
 56 in a portion of the well shall pay their proportionate shares of abandonment and surface restoration costs for such well as  
 57 provided in Article VI.B.2.(b).

58 **F. Termination of Operations:**

59 Upon the commencement of an operation for the drilling, Reworking, Sidetracking, Plugging Back, Deepening, testing,  
 60 Completion or plugging of a well, including but not limited to the Initial Well, such operation shall not be terminated without  
 61 consent of parties bearing 51 % of the costs of such operation; provided, however, that in the event granite or other  
 62 practically impenetrable substance or condition in the hole is encountered which renders further operations impractical,  
 63 Operator may discontinue operations and give notice of such condition in the manner provided in Article VI.B.1; and the  
 64 provisions of Article VI.B. or VI.E. shall thereafter apply to such operation, as appropriate.

65 **G. Taking Production in Kind:**

66  **Option No. 1: Gas Balancing Agreement Attached**

67 Each party shall take in kind or separately dispose of its proportionate share of all Oil and Gas produced from the  
 68 Contract Area, exclusive of production which may be used in development and producing operations and in preparing and  
 69 treating Oil and Gas for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking  
 70 in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any  
 71 party taking its share of production in kind shall be required to pay for only its proportionate share of such part of  
 72 Operator's surface facilities which it uses.

73 Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in  
 74 production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment

~~directly from the purchaser thereof for its share of all production.~~  
 If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the Oil produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such Oil or sell it to others at any time and from time to time, for the account of the non-taking party. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of said production and shall be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise at any time its right to take in kind, or separately dispose of, its share of all Oil not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of Oil shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year.

Any such sale by Operator shall be in a manner commercially reasonable under the circumstances but Operator shall have no duty to share any existing market or to obtain a price equal to that received under any existing market. The sale or delivery by Operator of a non-taking party's share of Oil under the terms of any existing contract of Operator shall not give the non-taking party any interest in or make the non-taking party a party to said contract. No purchase shall be made by Operator without first giving the non-taking party at least ten (10) days written notice of such intended purchase and the price to be paid or the pricing basis to be used.

All parties shall give timely written notice to Operator of their Gas marketing arrangements for the following month, excluding price, and shall notify Operator immediately in the event of a change in such arrangements. Operator shall maintain records of all marketing arrangements, and of volumes actually sold or transported, which records shall be made available to Non-Operators upon reasonable request.

In the event one or more parties' separate disposition of its share of the Gas causes split-stream deliveries to separate pipelines and/or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total Gas sales to be allocated to it, the balancing or accounting between the parties shall be in accordance with any Gas balancing agreement between the parties hereto, whether such an agreement is attached as Exhibit "E" or is a separate agreement. Operator shall give notice to all parties of the first sales of Gas from any well under this agreement.

**Option No. 2: No Gas Balancing Agreement:**

Each party shall take in kind or separately dispose of its proportionate share of all Oil and Gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating Oil and Gas for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment directly from the purchaser thereof for its share of all production.

If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the Oil and/or Gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such Oil and/or Gas or sell it to others at any time and from time to time, for the account of the non-taking party. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of said production and shall be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise its right to take in kind, or separately dispose of, its share of all Oil and/or Gas not previously delivered to a purchaser; provided, however, that the effective date of any such revocation may be deferred at Operator's election for a period not to exceed ninety (90) days if Operator has committed such production to a purchase contract having a term extending beyond such ten (10) -day period. Any purchase or sale by Operator of any other party's share of Oil and/or Gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year.

Any such sale by Operator shall be in a manner commercially reasonable under the circumstances, but Operator shall have no duty to share any existing market or transportation arrangement or to obtain a price or transportation fee equal to that received under any existing market or transportation arrangement. The sale or delivery by Operator of a non-taking party's share of production under the terms of any existing contract of Operator shall not give the non-taking party any interest in or make the non-taking party a party to said contract. No purchase of Oil and Gas and no sale of Gas shall be made by Operator without first giving the non-taking party ten days written notice of such intended purchase or sale and the price to be paid or the pricing basis to be used. Operator shall give notice to all parties of the first sale of Gas from any well under this Agreement.

All parties shall give timely written notice to Operator of their Gas marketing arrangements for the following month, excluding price, and shall notify Operator immediately in the event of a change in such arrangements. Operator shall maintain records of all marketing arrangements, and of volumes actually sold or transported, which records shall be made available to Non-Operators upon reasonable request.

**ARTICLE VII.**

**EXPENDITURES AND LIABILITY OF PARTIES**

**A. Liability of Parties:**

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally, and no party shall have any liability to third parties hereunder to satisfy the default of any other party in the payment of any expense or obligation hereunder. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership, joint venture, agency relationship or association, or to render the parties liable as partners, co-venturers, or principals. In their relations with each other under this agreement, the parties shall not be considered fiduciaries or to have established a confidential relationship but rather shall be free to act on an arm's-length basis in accordance with their own respective self-interest, subject, however, to the obligation of the parties to act in good faith in their dealings with each other with respect to activities hereunder.

Accepted and attested in witness whereof, the undersigned have hereunto set their hands and seals at the City of Houston, Texas, this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

**B. Liens and Security Interests:**

Each party grants to the other parties hereto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest and/or purchase money security interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith, to secure performance of all of its obligations under this agreement including but not limited to payment of expense, interest and fees, the proper disbursement of all monies paid hereunder, the assignment or relinquishment of interest in Oil and Gas Leases as required hereunder, and the proper performance of operations hereunder. Such lien and security interest granted by each party hereto shall include such party's leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the Contract Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject to this agreement, the Oil and Gas when extracted therefrom and equipment situated thereon or used or obtained for use in connection therewith (including, without limitation, all wells, tools, and tubular goods), and accounts (including, without limitation, accounts arising from gas imbalances or from the sale of Oil and/or Gas at the wellhead), contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of the foregoing.

To perfect the lien and security agreement provided herein, each party hereto shall execute and acknowledge the recording supplement and/or any financing statement prepared and submitted by any party hereto in conjunction herewith or at any time following execution hereof, and Operator is authorized to file this agreement or the recording supplement executed herewith as a lien or mortgage in the applicable real estate records and as a financing statement with the proper officer under the Uniform Commercial Code in the state in which the Contract Area is situated and such other states as Operator shall deem appropriate to perfect the security interest granted hereunder. Any party may file this agreement, the recording supplement executed herewith, or such other documents as it deems necessary as a lien or mortgage in the applicable real estate records and/or a financing statement with the proper officer under the Uniform Commercial Code.

Each party represents and warrants to the other parties hereto that the lien and security interest granted by such party to the other parties shall be a first and prior lien, and each party hereby agrees to maintain the priority of said lien and security interest against all persons acquiring an interest in Oil and Gas Leases and Interests covered by this agreement by, through or under such party. All parties acquiring an interest in Oil and Gas Leases and Oil and Gas Interests covered by this agreement, whether by assignment, merger, mortgage, operation of law, or otherwise, shall be deemed to have taken subject to the lien and security interest granted by this Article VII.B. as to all obligations attributable to such interest hereunder whether or not such obligations arise before or after such interest is acquired.

To the extent that parties have a security interest under the Uniform Commercial Code of the state in which the Contract Area is situated, they shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by a party for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any party in the payment of its share of expenses, interests or fees, or upon the improper use of funds by the Operator, the other parties shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting party's share of Oil and Gas until the amount owed by such party, plus interest as provided in "Exhibit C," has been received, and shall have the right to offset the amount owed against the proceeds from the sale of such defaulting party's share of Oil and Gas. All purchasers of production may rely on a notification of default from the non-defaulting party or parties stating the amount due as a result of the default, and all parties waive any recourse available against purchasers for releasing production proceeds as provided in this paragraph.

If any party fails to pay its share of cost within one hundred twenty (120) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid by each party so paying its share of the unpaid amount shall be secured by the liens and security rights described in Article VII.B., and each paying party may independently pursue any remedy available hereunder or otherwise.

If any party does not perform all of its obligations hereunder, and the failure to perform subjects such party to foreclosure or execution proceedings pursuant to the provisions of this agreement, to the extent allowed by governing law, the defaulting party waives any available right of redemption from and after the date of judgment, any required valuation or appraisal of the mortgaged or secured property prior to sale, any available right to stay execution or to require a marshalling of assets and any required bond in the event a receiver is appointed. In addition, to the extent permitted by applicable law, each party hereby grants to the other parties a power of sale as to any property that is subject to the lien and security rights granted hereunder, such power to be exercised in the manner provided by applicable law or otherwise in a commercially reasonable manner and upon reasonable notice.

Each party agrees that the other parties shall be entitled to utilize the provisions of Oil and Gas lien law or other lien law of any state in which the Contract Area is situated to enforce the obligations of each party hereunder. Without limiting the generality of the foregoing, to the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the mechanics' or materialmen's lien law of the state in which the Contract Area is situated in order to secure the payment to Operator of any sum due hereunder for services performed or materials supplied by Operator.

**C. Advances:**

Operator, at its election, shall have the right from time to time to demand and receive from one or more of the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

**D. Defaults and Remedies:**

If any party fails to discharge any financial obligation under this agreement, including without limitation the failure to make any advance under the preceding Article VII.C. or any other provision of this agreement, within the period required for such payment hereunder, then in addition to the remedies provided in Article VII.B. or elsewhere in this agreement, the remedies specified below shall be applicable. For purposes of this Article VII.D., all notices and elections shall be delivered

1 only by Operator, except that Operator shall deliver any such notice and election requested by a non-defaulting Non-Operator,  
 2 and when Operator is the party in default, the applicable notices and elections can be delivered by any Non-Operator.  
 3 Election of any one or more of the following remedies shall not preclude the subsequent use of any other remedy specified  
 4 below or otherwise available to a non-defaulting party.

5 1. Suspension of Rights: Any party may deliver to the party in default a Notice of Default, which shall specify the default,  
 6 specify the action to be taken to cure the default, and specify that failure to take such action will result in the exercise of one  
 7 or more of the remedies provided in this Article. If the default is not cured within thirty (30) days of the delivery of such  
 8 Notice of Default, all of the rights of the defaulting party granted by this agreement may upon notice be suspended until the  
 9 default is cured, without prejudice to the right of the non-defaulting party or parties to continue to enforce the obligations of  
 10 the defaulting party previously accrued or thereafter accruing under this agreement. If Operator is the party in default, the  
 11 Non-Operators shall have in addition the right, by vote of Non-Operators owning a majority in interest in the Contract Area  
 12 after excluding the voting interest of Operator, to appoint a new Operator effective immediately. The rights of a defaulting  
 13 party that may be suspended hereunder at the election of the non-defaulting parties shall include, without limitation, the right  
 14 to receive information as to any operation conducted hereunder during the period of such default, the right to elect to  
 15 participate in an operation proposed under Article VI.B. of this agreement, the right to participate in an operation being  
 16 conducted under this agreement even if the party has previously elected to participate in such operation, and the right to  
 17 receive proceeds of production from any well subject to this agreement.

18 2. Suit for Damages: Non-defaulting parties or Operator for the benefit of non-defaulting parties may sue (at joint  
 19 account expense) to collect the amounts in default, plus interest accruing on the amounts recovered from the date of default  
 20 until the date of collection at the rate specified in Exhibit "C" attached hereto. Nothing herein shall prevent any party from  
 21 suing any defaulting party to collect consequential damages accruing to such party as a result of the default.

22 3. Deemed Non-Consent: The non-defaulting party may deliver a written Notice of Non-Consent Election to the  
 23 defaulting party at any time after the expiration of the thirty-day cure period following delivery of the Notice of Default, in  
 24 which event if the billing is for the drilling of a new well or the Plugging Back, Sidetracking, Reworking or Deepening of a  
 25 well which is to be or has been plugged as a dry hole, or for the Completion or Recompletion of any well, the defaulting  
 26 party will be conclusively deemed to have elected not to participate in the operation and to be a Non-Consenting Party with  
 27 respect thereto under Article VI.B. or VI.C., as the case may be, to the extent of the costs unpaid by such party,  
 28 notwithstanding any election to participate theretofore made. If election is made to proceed under this provision, then the  
 29 non-defaulting parties may not elect to sue for the unpaid amount pursuant to Article VII.D.2.

30 Until the delivery of such Notice of Non-Consent Election to the defaulting party, such party shall have the right to cure  
 31 its default by paying its unpaid share of costs plus interest at the rate set forth in Exhibit "C," provided, however, such  
 32 payment shall not prejudice the rights of the non-defaulting parties to pursue remedies for damages incurred by the non-  
 33 defaulting parties as a result of the default. Any interest relinquished pursuant to this Article VII.D.3. shall be offered to the  
 34 non-defaulting parties in proportion to their interests, and the non-defaulting parties electing to participate in the ownership  
 35 of such interest shall be required to contribute their shares of the defaulted amount upon their election to participate therein.

36 4. Advance Payment: If a default is not cured within thirty (30) days of the delivery of a Notice of Default, Operator, or  
 37 Non-Operators if Operator is the defaulting party, may thereafter require advance payment from the defaulting  
 38 party of such defaulting party's anticipated share of any item of expense for which Operator, or Non-Operators, as the case may  
 39 be, would be entitled to reimbursement under any provision of this agreement, whether or not such expense was the subject of  
 40 the previous default. Such right includes, but is not limited to, the right to require advance payment for the estimated costs of  
 41 drilling a well or Completion of a well as to which an election to participate in drilling or Completion has been made. If the  
 42 defaulting party fails to pay the required advance payment, the non-defaulting parties may pursue any of the remedies provided  
 43 in this Article VII.D. or any other default remedy provided elsewhere in this agreement. Any excess of funds advanced remaining  
 44 when the operation is completed and all costs have been paid shall be promptly returned to the advancing party.

45 5. Costs and Attorneys' Fees. In the event any party is required to bring legal proceedings to enforce any financial  
 46 obligation of a party hereunder, the prevailing party in such action shall be entitled to recover all court costs, costs of  
 47 collection, and a reasonable attorney's fee, which the lien provided for herein shall also secure.

48 **E. Rentals, Shut-in Well Payments and Minimum Royalties:**

49 Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid  
 50 by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties  
 51 own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to  
 52 make said payments for and on behalf of all such parties. Any party may request, and shall be entitled to receive, proper  
 53 evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or  
 54 minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which  
 55 results from such non-payment shall be borne in accordance with the provisions of Article IV.B.2.

56 Operator shall notify Non-Operators of the anticipated completion of a shut-in well, or the shutting in or return to  
 57 production of a producing well, at least five (5) days (excluding Saturday, Sunday and legal holidays) prior to taking such  
 58 action, or at the earliest opportunity permitted by circumstances, but assumes no liability for failure to do so. In the event of  
 59 failure by Operator to so notify Non-Operators, the loss of any lease contributed hereto by Non-Operators for failure to make  
 60 timely payments of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article  
 61 IV.B.3.

62 **F. Taxes:**

63 Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all  
 64 property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed  
 65 thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as  
 66 to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on Leases and Oil and  
 67 Gas Interests contributed by such Non-Operator. If the assessed valuation of any Lease is reduced by reason of its being  
 68 subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes  
 69 resulting therefrom shall inure to the benefit of the owner or owners of such Lease, and Operator shall adjust the charge to  
 70 such owner or owners so as to reflect the benefit of such reduction. If the ad valorem taxes are based in whole or in part  
 71 upon separate valuations of each party's working interest, then notwithstanding anything to the contrary herein, charges to  
 72 the joint account shall be made and paid by the parties hereto in accordance with the tax value generated by each party's  
 73 working interest. Operator shall bill the other parties for their proportionate shares of all tax payments in the manner  
 74 provided in Exhibit "C."

1 If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner  
 2 prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final  
 3 determination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes  
 4 and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for  
 5 the joint account, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be  
 6 paid by them, as provided in Exhibit "C."

7 Each party shall pay or cause to be paid all production, severance, excise, gathering and other taxes imposed upon or with respect  
 8 to the production or handling of such party's share of Oil and Gas produced under the terms of this agreement.

#### 9 ARTICLE VIII.

#### 10 ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

##### 11 A. Surrender of Leases:

12 The Leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole  
 13 or in part unless all parties consent thereto.

14 However, should any party desire to surrender its interest in any Lease or in any portion thereof, such party shall give written  
 15 notice of the proposed surrender to all parties, and the parties to whom such notice is delivered shall have thirty (30) days after  
 16 delivery of the notice within which to notify the party proposing the surrender whether they elect to consent thereto. Failure of a  
 17 party to whom such notice is delivered to reply within said 30-day period shall constitute a consent to the surrender of the Leases  
 18 described in the notice. If all parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or  
 19 implied warranty of title, all of its interest in such Lease, or portion thereof, and any well, material and equipment which may be  
 20 located thereon and any rights in production thereafter secured, to the parties not consenting to such surrender. If the interest of the  
 21 assigning party is or includes an Oil and Gas Interest, the assigning party shall execute and deliver to the party or parties not  
 22 consenting to such surrender an oil and gas lease covering such Oil and Gas Interest for a term of one (1) year and so long  
 23 thereafter as Oil and/or Gas is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B."  
 24 Upon such assignment or lease, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore  
 25 accrued, with respect to the interest assigned or leased and the operation of any well attributable thereto, and the assigning party  
 26 shall have no further interest in the assigned or leased premises and its equipment and production other than the royalties retained  
 27 in any lease made under the terms of this Article. The party assignee or lessee shall pay to the party assignor or lessor the  
 28 reasonable salvage value of the latter's interest in any well's salvable materials and equipment attributable to the assigned or leased  
 29 acreage. The value of all salvable materials and equipment shall be determined in accordance with the provisions of Exhibit "C," less  
 30 the estimated cost of salvaging and the estimated cost of plugging and abandoning and restoring the surface. If such value is less  
 31 than such costs, then the party assignor or lessor shall pay to the party assignee or lessee the amount of such deficit. If the  
 32 assignment or lease is in favor of more than one party, the interest shall be shared by such parties in the proportions that the  
 33 interest of each bears to the total interest of all such parties. If the interest of the parties to whom the assignment is to be made  
 34 varies according to depth, then the interest assigned shall similarly reflect such variances.

35 Any assignment, lease or surrender made under this provision shall not reduce or change the assignor's, lessor's or surrendering  
 36 party's interest as it was immediately before the assignment, lease or surrender in the balance of the Contract Area; and the acreage  
 37 assigned, leased or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this  
 38 agreement but shall be deemed subject to an Operating Agreement in the form of this agreement.

##### 39 B. Renewal or Extension of Leases:

40 If any party secures a renewal or replacement of an Oil and Gas Lease or Interest subject to this agreement, then all other parties  
 41 shall be notified promptly upon such acquisition or, in the case of a replacement Lease taken before expiration of an existing Lease,  
 42 promptly upon expiration of the existing Lease. The parties notified shall have the right for a period of thirty (30) days following  
 43 delivery of such notice in which to elect to participate in the ownership of the renewal or replacement Lease, insofar as such Lease  
 44 affects lands within the Contract Area, by paying to the party who acquired it their proportionate shares of the acquisition cost  
 45 allocated to that part of such Lease within the Contract Area, which shall be in proportion to the interests held at that time by the  
 46 parties in the Contract Area. Each party who participates in the purchase of a renewal or replacement Lease shall be given an  
 47 assignment of its proportionate interest therein by the acquiring party.

48 If some, but less than all, of the parties elect to participate in the purchase of a renewal or replacement Lease, it shall be owned  
 49 by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in  
 50 the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the  
 51 purchase of such renewal or replacement Lease. The acquisition of a renewal or replacement Lease by any or all of the parties hereto  
 52 shall not cause a readjustment of the interests of the parties stated in Exhibit "A," but any renewal or replacement Lease in which  
 53 less than all parties elect to participate shall not be subject to this agreement but shall be deemed subject to a separate Operating  
 54 Agreement in the form of this agreement.

55 If the interests of the parties in the Contract Area vary according to depth, then their right to participate proportionately in  
 56 renewal or replacement Leases and their right to receive an assignment of interest shall also reflect such depth variances.

57 The provisions of this Article shall apply to renewal or replacement Leases whether they are for the entire interest covered by  
 58 the expiring Lease or cover only a portion of its area or an interest therein. Any renewal or replacement Lease taken before the  
 59 expiration of its predecessor Lease, or taken or contracted for or becoming effective within six (6) months after the expiration of the  
 60 existing Lease, shall be subject to this provision so long as this agreement is in effect at the time of such acquisition or at the time  
 61 the renewal or replacement Lease becomes effective; but any Lease taken or contracted for more than six (6) months after the  
 62 expiration of an existing Lease shall not be deemed a renewal or replacement Lease and shall not be subject to the provisions of this  
 63 agreement.

64 The provisions in this Article shall also be applicable to extensions of Oil and Gas Leases.

##### 65 C. Acreage or Cash Contributions:

66 While this agreement is in force, if any party contracts for a contribution of cash towards the drilling of a well or any other  
 67 operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall  
 68 be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom  
 69 the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the  
 70 proportions said Drilling Parties shared the cost of drilling the well. Such acreage shall become a separate Contract Area and, to the  
 71 extent possible, be governed by provisions identical to this agreement. Each party shall promptly notify all other parties of any  
 72 acreage or cash contributions it may obtain in support of any well or any other operation on the Contract Area. The above  
 73 provisions shall also be applicable to optional rights to earn acreage outside the Contract Area which are in support of well drilled  
 74 inside the Contract Area.

1 If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder,  
 2 such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

3 **D. Assignment; Maintenance of Uniform Interest:**

4 For the purpose of maintaining uniformity of ownership in the Contract Area in the Oil and Gas Leases, Oil and Gas  
 5 Interests, wells, equipment and production covered by this agreement no party shall sell, encumber, transfer or make other  
 6 disposition of its interest in the Oil and Gas Leases and Oil and Gas Interests embraced within the Contract Area or in wells,  
 7 equipment and production unless such disposition covers either:

- 8 1. the entire interest of the party in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production; or
- 9 2. an equal undivided percent of the party's interest in all Oil and Gas Leases, Oil and Gas Interests, wells,  
 10 equipment and production in the Contract Area.

11 Every sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement  
 12 and shall be made without prejudice to the right of the other parties, and any transferee of an ownership interest in any Oil and  
 13 Gas Lease or Interest shall be deemed a party to this agreement as to the interest conveyed from and after the effective date of  
 14 the transfer of ownership; provided, however, that the other parties shall not be required to recognize any such sale,  
 15 encumbrance, transfer or other disposition for any purpose hereunder until thirty (30) days after they have received a copy of the  
 16 instrument of transfer or other satisfactory evidence thereof in writing from the transferor or transferee. No assignment or other  
 17 disposition of interest by a party shall relieve such party of obligations previously incurred by such party hereunder with respect  
 18 to the interest transferred, including without limitation the obligation of a party to pay all costs attributable to an operation  
 19 conducted hereunder in which such party has agreed to participate prior to making such assignment, and the lien and security  
 20 interest granted by Article VII.B. shall continue to burden the interest transferred to secure payment of any such obligations.

21 If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion,  
 22 may require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures,  
 23 receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to  
 24 bind, the co-owners of such party's interest within the scope of the operations embraced in this agreement; however, all such co-  
 25 owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of  
 26 the Oil and Gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale  
 27 proceeds thereof.

28 **E. Waiver of Rights to Partition:**

29 If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an  
 30 undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its  
 31 undivided interest therein.

32 **F. Preferential Right to Purchase:**

33  (Optional; Check if applicable.)

34 Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract  
 35 Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which  
 36 shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase  
 37 price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall then have an  
 38 optional prior right, for a period of ten (10) days after the notice is delivered, to purchase for the stated consideration on the  
 39 same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the  
 40 purchasing parties shall share the purchased interest in the proportion that the interest of each bears to the total interest of all  
 41 purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage  
 42 its interests, or to transfer title to its interests to its mortgagee in lieu of or pursuant to foreclosure of a mortgage of its interests,  
 43 or to dispose of its interests by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets  
 44 to any party or by transfer of its interests to a subsidiary or parent company or to a subsidiary of a parent company, or to any  
 45 company in which such party owns a majority of the stock.

46 **ARTICLE IX.**

47 **INTERNAL REVENUE CODE ELECTION**

48 If, for federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, and if the  
 49 parties have not otherwise agreed to form a tax partnership pursuant to Exhibit "G" or other agreement between them, each  
 50 party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K," Chapter 1, Subtitle  
 51 "A," of the Internal Revenue Code of 1986, as amended ("Code"), as permitted and authorized by Section 761 of the Code and  
 52 the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected  
 53 such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal  
 54 Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by  
 55 Treasury Regulations §1.761. Should there be any requirement that each party hereby affected give further evidence of this  
 56 election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal  
 57 Revenue Service or as may be necessary to evidence this election. No such party shall give any notices or take any other action  
 58 inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract  
 59 Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K," Chapter  
 60 1, Subtitle "A," of the Code, under which an election similar to that provided by Section 761 of the Code is permitted, each party  
 61 hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each  
 62 such party states that the income derived by such party from operations hereunder can be adequately determined without the  
 63 computation of partnership taxable income.

64 **ARTICLE X.**

65 **CLAIMS AND LAWSUITS**

66 Operator may settle any single uninsured third party damage claim or suit arising from operations hereunder if the expenditure  
 67 does not exceed Twenty Five Thousand Dollars (\$ 25,000.00 ) and if the payment is in complete settlement  
 68 of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over  
 69 the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expenses of handling, settling,  
 70 or otherwise discharging such claim or suit shall be at the joint expense of the parties participating in the operation from which the  
 71 claim or suit arises. If a claim is made against any party or if any party is sued on account of any matter arising from operations  
 72 hereunder over which such individual has no control because of the rights given Operator by this agreement, such party shall  
 73 immediately notify all other parties, and the claim or suite shall be treated as any other claim or suit involving operations hereunder.

Accepted and authorized in writing by the  
 American Association of Petroleum Landmen

**ARTICLE XI.  
FORCE MAJEURE**

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to indemnify or make money payments or furnish security, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure. The term "force majeure," as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood or other act of nature, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable. The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

**ARTICLE XII.  
NOTICES**

All notices authorized or required between the parties by any of the provisions of this agreement, unless otherwise specifically provided, shall be in writing and delivered in person or by United States mail, courier service, telegram, telex, telecopier or any other form of facsimile, postage or charges prepaid, and addressed to such parties at the addresses listed on Exhibit "A." All telephone or oral notices permitted by this agreement shall be confirmed immediately thereafter by written notice. The originating notice given under any provision hereof shall be deemed delivered only when received by the party to whom such notice is directed, and the time for such party to deliver any notice in response thereto shall run from the date the originating notice is received. "Receipt" for purposes of this agreement with respect to written notice delivered hereunder shall be actual delivery of the notice to the address of the party to be notified specified in accordance with this agreement, or to the telecopy, facsimile or telex machine of such party. The second or any responsive notice shall be deemed delivered when deposited in the United States mail or at the office of the courier or telegraph service, or upon transmittal by telex, telecopy or facsimile, or when personally delivered to the party to be notified, provided, that when response is required within 24 or 48 hours, such response shall be given orally or by telephone, telex, telecopy or other facsimile within such period. Each party shall have the right to change its address at any time, and from time to time, by giving written notice thereof to all other parties. If a party is not available to receive notice orally or by telephone when a party attempts to deliver a notice required to be delivered within 24 or 48 hours, the notice may be delivered in writing by any other method specified herein and shall be deemed delivered in the same manner provided above for any responsive notice.

**ARTICLE XIII.  
TERM OF AGREEMENT**

This agreement shall remain in full force and effect as to the Oil and Gas Leases and/or Oil and Gas Interests subject hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any Lease or Oil and Gas Interest contributed by any other party beyond the term of this agreement.

- Option No. 1: So long as any of the Oil and Gas Leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise.
- Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in the Completion of a well as a well capable of production of Oil and/or Gas in paying quantities, this agreement shall continue in force so long as any such well is capable of production, and for an additional period of 120 days thereafter; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling, Reworking, Deepening, Sidetracking, Plugging Back, testing or attempting to Complete or Re-complete a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is capable of producing Oil and/or Gas from the Contract Area, this agreement shall terminate unless drilling, Deepening, Sidetracking, Completing, Re-completing, Plugging Back or Reworking operations are commenced within 90 days from the date of abandonment of said well. "Abandonment" for such purposes shall mean either (i) a decision by all parties not to conduct any further operations on the well or (ii) the elapse of 180 days from the conduct of any operations on the well, whichever first occurs.

The termination of this agreement shall not relieve any party hereto from any expense, liability or other obligation or any remedy therefor which has accrued or attached prior to the date of such termination.

Upon termination of this agreement and the satisfaction of all obligations hereunder, in the event a memorandum of this Operating Agreement has been filed of record, Operator is authorized to file of record in all necessary recording offices a notice of termination, and each party hereto agrees to execute such a notice of termination as to Operator's interest, upon request of Operator, if Operator has satisfied all its financial obligations.

**ARTICLE XIV.  
COMPLIANCE WITH LAWS AND REGULATIONS**

**A. Laws, Regulations and Orders:**

This agreement shall be subject to the applicable laws of the state in which the Contract Area is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations and orders.

**B. Governing Law:**

This agreement and all matters pertaining hereto, including but not limited to matters of performance, non-performance, breach, remedies, procedures, rights, duties, and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state of \_\_\_\_\_ shall govern.

**C. Regulatory Agencies:**

Nothing herein contained shall grant, or be construed to grant, Operator the right or authority to waive or release any rights, privileges, or obligations which Non-Operators may have under federal or state laws or under rules, regulations or

1 orders promulgated under such laws in reference to oil, gas and mineral operations, including the location, operation, or  
2 production of wells, on tracts offsetting or adjacent to the Contract Area.

3 With respect to the operations hereunder, Non-Operators agree to release Operator from any and all losses, damages,  
4 injuries, claims and causes of action arising out of, incident to or resulting directly or indirectly from Operator's interpretation  
5 or application of rules, rulings, regulations or orders of the Department of Energy or Federal Energy Regulatory Commission  
6 or predecessor or successor agencies to the extent such interpretation or application was made in good faith and does not  
7 constitute gross negligence. Each Non-Operator further agrees to reimburse Operator for such Non-Operator's share of  
8 production or any refund, fine, levy or other governmental sanction that Operator may be required to pay as a result of such  
9 an incorrect interpretation or application, together with interest and penalties thereon owing by Operator as a result of such  
10 incorrect interpretation or application.

11 **ARTICLE XV.**  
12 **MISCELLANEOUS**

13 **A. Execution:**

14 This agreement shall be binding upon each Non-Operator when this agreement or a counterpart thereof has been  
15 executed by such Non-Operator as Operator notwithstanding that this agreement is not then or thereafter executed by all of  
16 the parties to which it is tendered or which are listed on Exhibit "A" as owning an interest in the Contract Area or which  
17 own, in fact, an interest in the Contract Area. Operator may, however, by written notice to all Non-Operators who have  
18 become bound by this agreement as aforesaid, given at any time prior to the actual spud date of the Initial Well but in no  
19 event later than five days prior to the date specified in Article VI.A. for commencement of the Initial Well, terminate this  
20 agreement if Operator in its sole discretion determines that there is insufficient participation to justify commencement of  
21 drilling operations. In the event of such a termination by Operator, all further obligations of the parties hereunder shall cease  
22 as of such termination. In the event any Non-Operator has advanced or prepaid any share of drilling or other costs  
23 hereunder, all sums so advanced shall be returned to such Non-Operator without interest. In the event Operator proceeds  
24 with drilling operations for the Initial Well without the execution hereof by all persons listed on Exhibit "A" as having a  
25 current working interest in such well, Operator shall indemnify Non-Operators with respect to all costs incurred for the  
26 Initial Well which would have been charged to such person under this agreement if such person had executed the same and  
27 Operator shall receive all revenues which would have been received by such person under this agreement if such person had  
28 executed the same.

29 **B. Successors and Assigns:**

30 This agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective heirs,  
31 devisees, legal representatives, successors and assigns, and the terms hereof shall be deemed to run with the Leases or  
32 Interests included within the Contract Area.

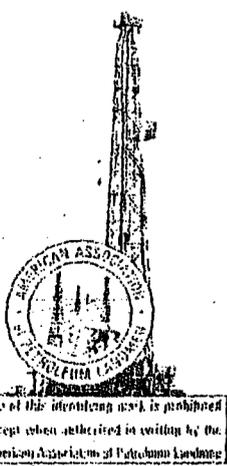
33 **C. Counterparts:**

34 This instrument may be executed in any number of counterparts, each of which shall be considered an original for all  
35 purposes.

36 **D. Severability:**

37 For the purposes of assuming or rejecting this agreement as an executory contract pursuant to federal bankruptcy laws,  
38 this agreement shall not be severable, but rather must be assumed or rejected in its entirety, and the failure of any party to  
39 this agreement to comply with all of its financial obligations provided herein shall be a material default.

40 **ARTICLE XVI.**  
41 **OTHER PROVISIONS**



1 IN WITNESS WHEREOF, this agreement shall be effective as of the 31st day of October,  
2 19 2003.

3 ATTEST OR WITNESS:

4 Sylvia Vanotary  
5 Amber Wood  
6  
7

OPERATOR

McQuadrangle, L.L.C.

By Delbert A. McDougal

Delbert McDougal  
Type or print name

8 Title MANAGER

9 Date 3/31/04

10 Tax ID or S.S. No. 458-80-7000

11  
12 NON-OPERATORS

13  
14  
15 \_\_\_\_\_ By \_\_\_\_\_

16 \_\_\_\_\_  
17 Type or print name

18 Title \_\_\_\_\_

19 Date \_\_\_\_\_

20 Tax ID or S.S. No. \_\_\_\_\_

21  
22  
23 \_\_\_\_\_ By \_\_\_\_\_

24 \_\_\_\_\_  
25 Type or print name

26 Title \_\_\_\_\_

27 Date \_\_\_\_\_

28 Tax ID or S.S. No. \_\_\_\_\_

29  
30 \_\_\_\_\_ By \_\_\_\_\_

31 \_\_\_\_\_  
32 Type or print name

33 Title \_\_\_\_\_

34 Date \_\_\_\_\_

35 Tax ID or S.S. No. \_\_\_\_\_

36 \_\_\_\_\_

37 \_\_\_\_\_



Use of this identifying mark is prohibited except when authorized in writing by the American Association of Petroleum Landmen

ACKNOWLEDGMENTS

Note: The following forms of acknowledgment are the short forms approved by the Uniform Law on Notarial Acts. The validity and effect of these forms in any state will depend upon the statutes of that state.

Individual acknowledgment:

State of \_\_\_\_\_ )

) ss.

County of \_\_\_\_\_ )

This instrument was acknowledged before me on

\_\_\_\_\_ by \_\_\_\_\_

(Seal, if any) \_\_\_\_\_

Title (and Rank) \_\_\_\_\_

My commission expires: \_\_\_\_\_

Acknowledgment in representative capacity:

State of Texas )

) ss.

County of Lubbock )

This instrument was acknowledged before me on

March 31, 2004

by Delbert MCDougal as

\_\_\_\_\_ of McQuadrangle, L.L.C., a Texas Limited Liability Company

(Seal, if any)

Sylvia F. VanStory  
Notary

Title (and Rank) \_\_\_\_\_

My commission expires: 2/10/07

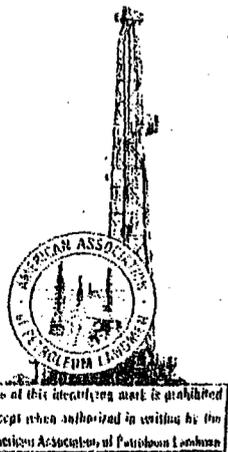
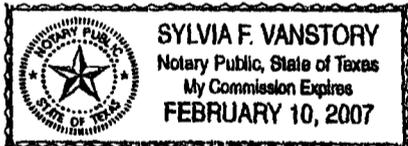


EXHIBIT " "

Attached to and made a part of THE OPERATING AGREEMENT BETWEEN MCQUADRANGLE, LLC, AS  
OPERATOR, AND  
AS NON-OPERATORS, SOUTH REDLAKE UNIT, EDDY COUNTY, NEW MEXICO

ACCOUNTING PROCEDURE  
JOINT OPERATIONS

I. GENERAL PROVISIONS

1. Definitions

"Joint Property" shall mean the real and personal property subject to the agreement to which this Accounting Procedure is attached.

"Joint Operations" shall mean all operations necessary or proper for the development, operation, protection and maintenance of the Joint Property.

"Joint Account" shall mean the account showing the charges paid and credits received in the conduct of the Joint Operations and which are to be shared by the Parties.

"Operator" shall mean the party designated to conduct the Joint Operations.

"Non-Operators" shall mean the Parties to this agreement other than the Operator.

"Parties" shall mean Operator and Non-Operators.

"First Level Supervisors" shall mean those employees whose primary function in Joint Operations is the direct supervision of other employees and/or contract labor directly employed on the Joint Property in a field operating capacity.

"Technical Employees" shall mean those employees having special and specific engineering, geological or other professional skills, and whose primary function in Joint Operations is the handling of specific operating conditions and problems for the benefit of the Joint Property.

"Personal Expenses" shall mean travel and other reasonable reimbursable expenses of Operator's employees.

"Material" shall mean personal property, equipment or supplies acquired or held for use on the Joint Property.

"Controllable Material" shall mean Material which at the time is so classified in the Material Classification Manual as most recently recommended by the Council of Petroleum Accountants Societies.

2. Statement and Billings

Operator shall bill Non-Operators on or before the last day of each month for their proportionate share of the Joint Account for the preceding month. Such bills will be accompanied by statements which identify the authority for expenditure, lease or facility, and all charges and credits summarized by appropriate classifications of investment and expense except that items of Controllable Material and unusual charges and credits shall be separately identified and fully described in detail.

3. Advances and Payments by Non-Operators

A. Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation within fifteen (15) days after receipt of the billing or by the first day of the month for which the advance is required, whichever is later. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

B. Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the ~~10%~~ rate ~~in effect~~ of 12% per annum on the first day of the month in which delinquency occurs plus 1% or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts.

4. Adjustments

Payment of any such bills shall not prejudice the right of any Non-Operator to protest or question the correctness thereof; provided, however, all bills and statements rendered to Non-Operators by Operator during any calendar year shall conclusively be presumed to be true and correct after twenty-four (24) months following the end of any such calendar year, unless within the said twenty-four (24) month period a Non-Operator takes written exception thereto and makes claim on Operator for adjustment. No adjustment favorable to Operator shall be made unless it is made within the same prescribed period. The provisions of this paragraph shall not prevent adjustments resulting from a physical inventory of Controllable Material as provided for in Section V.

## 5. Audits

- A. A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct a joint audit in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator. The audits shall not be conducted more than once each year without prior approval of Operator, except upon the resignation or removal of the Operator, and shall be made at the expense of those Non-Operators approving such audit.
- B. The Operator shall reply in writing to an audit report within 180 days after receipt of such report.

## 6. Approval By Non-Operators

Where an approval or other agreement of the Parties or Non-Operators is expressly required under other sections of this Accounting Procedure and if the agreement to which this Accounting Procedure is attached contains no contrary provisions in regard thereto, Operator shall notify all Non-Operators of the Operator's proposal, and the agreement or approval of a majority in interest of the Non-Operators shall be controlling on all Non-Operators.

## II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

### 1. Ecological and Environmental

Costs incurred for the benefit of the Joint Property as a result of governmental or regulatory requirements to satisfy environmental considerations applicable to the Joint Operations. Such costs may include surveys of an ecological or archaeological nature and pollution control procedures as required by applicable laws and regulations.

### 2. Rentals and Royalties

Lease rentals and royalties paid by Operator for the Joint Operations.

### 3. Labor

- A. (1) Salaries and wages of Operator's field employees directly employed on the Joint Property in the conduct of Joint Operations.
- (2) Salaries of First Level Supervisors in the field.
- (3) Salaries and wages of Technical Employees directly employed on the Joint Property if such charges are excluded from the overhead rates.
- (4) Salaries and wages of Technical Employees either temporarily or permanently assigned to and directly employed in the operation of the Joint Property if such charges are excluded from the overhead rates.
- B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II. Such costs under this Paragraph 3B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 3A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.
- C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II.
- D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II.

### 4. Employee Benefits

Operator's current costs of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II shall be Operator's actual cost not to exceed the percent most recently recommended by the Council of Petroleum Accountants Societies.

### 5. Material

Material purchased or furnished by Operator for use on the Joint Property as provided under Section IV. Only such Material shall be purchased for or transferred to the Joint Property as may be required for immediate use and is reasonably practical and consistent with efficient and economical operations. The accumulation of surplus stocks shall be avoided.

### 6. Transportation

Transportation of employees and Material necessary for the Joint Operations but subject to the following limitations:

- A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store where like material is normally available or railway receiving point nearest the Joint Property unless agreed to by the Parties.

- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store where like material is normally available, or railway receiving point nearest the Joint Property unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.
- C. In the application of subparagraphs A and B above, the option to equalize or charge actual trucking cost is available when the actual charge is \$400 or less excluding accessorial charges. The \$400 will be adjusted to the amount most recently recommended by the Council of Petroleum Accountants Societies.

## 7. Services

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 10 of Section II and Paragraph i, ii, and iii, of Section III. The cost of professional consultant services and contract services of technical personnel directly engaged on the Joint Property if such charges are excluded from the overhead rates. The cost of professional consultant services or contract services of technical personnel not directly engaged on the Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.

## 8. Equipment and Facilities Furnished By Operator

- A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on gross investment less accumulated depreciation not to exceed twenty percent (20%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.
- B. In lieu of charges in paragraph 8A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

## 9. Damages and Losses to Joint Property

All costs or expenses necessary for the repair or replacement of Joint Property made necessary because of damages or losses incurred by fire, flood, storm, theft, accident, or other cause, except those resulting from Operator's gross negligence or willful misconduct. Operator shall furnish Non-Operator written notice of damages or losses incurred as soon as practicable after a report thereof has been received by Operator.

## 10. Legal Expense

Expense of handling, investigating and settling litigation or claims, discharging of liens, payment of judgements and amounts paid for settlement of claims incurred in or resulting from operations under the agreement or necessary to protect or recover the Joint Property, except that no charge for services of Operator's legal staff or fees or expense of outside attorneys shall be made unless previously agreed to by the Parties. All other legal expense is considered to be covered by the overhead provisions of Section III unless otherwise agreed to by the Parties, except as provided in Section I, Paragraph 3.

## 11. Taxes

All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof, or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties. If the ad valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then notwithstanding anything to the contrary herein, charges to the Joint Account shall be made and paid by the Parties hereto in accordance with the tax value generated by each party's working interest.

## 12. Insurance

Net premiums paid for insurance required to be carried for the Joint Operations for the protection of the Parties. In the event Joint Operations are conducted in a state in which Operator may act as self-insurer for Worker's Compensation and/or Employers Liability under the respective state's laws, Operator may, at its election, include the risk under its self-insurance program and in that event, Operator shall include a charge at Operator's cost not to exceed manual rates.

## 13. Abandonment and Reclamation

Costs incurred for abandonment of the Joint Property, including costs required by governmental or other regulatory authority.

## 14. Communications

Cost of acquiring, leasing, installing, operating, repairing and maintaining communication systems, including radio and microwave facilities directly serving the Joint Property. In the event communication facilities/systems serving the Joint Property are Operator owned, charges to the Joint Account shall be made as provided in Paragraph 8 of this Section II.

## 15. Other Expenditures

Any other expenditure not covered or dealt with in the foregoing provisions of this Section II, or in Section III and which is of direct benefit to the Joint Property and is incurred by the Operator in the necessary and proper conduct of the Joint Operations.

### III. OVERHEAD

#### 1. Overhead - Drilling and Producing Operations

- i. As compensation for administrative, supervision, office services and warehousing costs, Operator shall charge drilling and producing operations on either:

( x ) Fixed Rate Basis, Paragraph 1A, or  
 ( ) Percentage Basis, Paragraph 1B

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 3A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

- ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property:

( ) shall be covered by the overhead rates, or  
 ( x ) shall not be covered by the overhead rates.

- iii. The salaries, wages and Personal Expenses of Technical Employees and/or costs of professional consultant services and contract services of technical personnel either temporarily or permanently assigned to and directly employed in the operation of the Joint Property:

( x ) shall be covered by the overhead rates, or  
 ( ) shall not be covered by the overhead rates.

#### A. Overhead - Fixed Rate Basis

- (1) Operator shall charge the Joint Account at the following rates per well per month:

Drilling Well Rate \$ 7,500.00  
 (Prorated for less than a full month)

Producing Well Rate \$ 650.00

- (2) Application of Overhead - Fixed Rate Basis shall be as follows:

##### (a) Drilling Well Rate

- (1) Charges for drilling wells shall begin on the date the well is spudded and terminate on the date the drilling rig, completion rig, or other units used in completion of the well is released, whichever is later, except that no charge shall be made during suspension of drilling or completion operations for fifteen (15) or more consecutive calendar days.
- (2) Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive work days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig or other units used in workover, commence through date of rig or other unit release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive calendar days.

##### (b) Producing Well Rates

- (1) An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.
- (2) Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.
- (3) An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.
- (4) A one-well charge shall be made for the month in which plugging and abandonment operations are completed on any well. This one-well charge shall be made whether or not the well has produced except when drilling well rate applies.
- (5) All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.
- (3) The well rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

#### B. Overhead - Percentage Basis

- (1) Operator shall charge the Joint Account at the following rates:

## (a) Development

\_\_\_\_\_ Percent ( \_\_\_\_\_ %) of the cost of development of the Joint Property exclusive of costs provided under Paragraph 1 of Section II and all salvage credits.

## (b) Operating

\_\_\_\_\_ Percent ( \_\_\_\_\_ %) of the cost of operating the Joint Property exclusive of costs provided under Paragraphs 2 and 10 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.

## (2) Application of Overhead - Percentage Basis shall be as follows:

For the purpose of determining charges on a percentage basis under Paragraph 1B of this Section III, development shall include all costs in connection with drilling, re-drilling, deepening, or any remedial operations on any or all wells involving the use of drilling rig and crew capable of drilling to the producing interval on the Joint Property; also, preliminary expenditures necessary in preparation for drilling and expenditures incurred in abandoning when the well is not completed as a producer, and original cost of construction or installation of fixed assets, the expansion of fixed assets and any other project clearly discernible as a fixed asset, except Major Construction as defined in Paragraph 2 of this Section III. All other costs shall be considered as operating.

## 2. Overhead - Major Construction

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for overhead based on the following rates for any Major Construction project in excess of \$ \_\_\_\_\_ :

- A. 5 % of first \$100,000 or total cost if less, plus
- B. 3 % of costs in excess of \$100,000 but less than \$1,000,000, plus
- C. 2 % of costs in excess of \$1,000,000.

Total cost shall mean the gross cost of any one project. For the purpose of this paragraph, the component parts of a single project shall not be treated separately and the cost of drilling and workover wells and artificial lift equipment shall be excluded.

## 3. Catastrophe Overhead

To compensate Operator for overhead costs incurred in the event of expenditures resulting from a single occurrence due to oil spill, blowout, explosion, fire, storm, hurricane, or other catastrophes as agreed to by the Parties, which are necessary to restore the Joint Property to the equivalent condition that existed prior to the event causing the expenditures, Operator shall either negotiate a rate prior to charging the Joint Account or shall charge the Joint Account for overhead based on the following rates:

- A. 5 % of total costs through \$100,000; plus
- B. 3 % of total costs in excess of \$100,000 but less than \$1,000,000; plus
- C. 2 % of total costs in excess of \$1,000,000.

Expenditures subject to the overheads above will not be reduced by insurance recoveries, and no other overhead provisions of this Section III shall apply.

## 4. Amendment of Rates

The overhead rates provided for in this Section III may be amended from time to time only by mutual agreement between the Parties hereto if, in practice, the rates are found to be insufficient or excessive.

## IV. PRICING OF JOINT ACCOUNT MATERIAL PURCHASES, TRANSFERS AND DISPOSITIONS

Operator is responsible for Joint Account Material and shall make proper and timely charges and credits for all Material movements affecting the Joint Property. Operator shall provide all Material for use on the Joint Property; however, at Operator's option, such Material may be supplied by the Non-Operator. Operator shall make timely disposition of idle and/or surplus Material, such disposal being made either through sale to Operator or Non-Operator, division in kind, or sale to outsiders. Operator may purchase, but shall be under no obligation to purchase, interest of Non-Operators in surplus condition A or B Material. The disposal of surplus Controllable Material not purchased by the Operator shall be agreed to by the Parties.

## 1. Purchases

Material purchased shall be charged at the price paid by Operator after reduction of all discounts received. In case of Material found to be defective or returned to vendor for any other reasons, credit shall be passed to the Joint Account when adjustment has been received by the Operator.

## 2. Transfers and Dispositions

Material furnished to the Joint Property and Material transferred from the Joint Property or disposed of by the Operator, unless otherwise agreed to by the Parties, shall be priced on the following basis exclusive of cash discounts:

A. New Material (Condition A)

(1) Tubular Goods Other than Line Pipe

- (a) Tubular goods, sized 2½ inches OD and larger, except line pipe, shall be priced at Eastern mill published carload base prices effective as of date of movement plus transportation cost using the 80,000 pound carload weight basis to the railway receiving point nearest the Joint Property for which published rail rates for tubular goods exist. If the 80,000 pound rail rate is not offered, the 70,000 pound or 90,000 pound rail rate may be used. Freight charges for tubing will be calculated from Lorain, Ohio and casing from Youngstown, Ohio.
- (b) For grades which are special to one mill only, prices shall be computed at the mill base of that mill plus transportation cost from that mill to the railway receiving point nearest the Joint Property as provided above in Paragraph 2.A.(1)(a). For transportation cost from points other than Eastern mills, the 30,000 pound Oil Field Haulers Association interstate truck rate shall be used.
- (c) Special end finish tubular goods shall be priced at the lowest published out-of-stock price, f.o.b. Houston, Texas, plus transportation cost, using Oil Field Haulers Association interstate 30,000 pound truck rate, to the railway receiving point nearest the Joint Property.
- (d) Macaroni tubing (size less than 2½ inch OD) shall be priced at the lowest published out-of-stock prices f.o.b. the supplier plus transportation costs, using the Oil Field Haulers Association interstate truck rate per weight of tubing transferred, to the railway receiving point nearest the Joint Property.

(2) Line Pipe

- (a) Line pipe movements (except size 24 inch OD and larger with walls ¼ inch and over) 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain, Ohio.
  - (b) Line pipe movements (except size 24 inch OD and larger with walls ¼ inch and over) less than 30,000 pounds shall be priced at Eastern mill published carload base prices effective as of date of shipment, plus 20 percent, plus transportation costs based on freight rates as set forth under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain, Ohio.
  - (c) Line pipe 24 inch OD and over and ¼ inch wall and larger shall be priced f.o.b. the point of manufacture at current new published prices plus transportation cost to the railway receiving point nearest the Joint Property.
  - (d) Line pipe, including fabricated line pipe, drive pipe and conduit not listed on published price lists shall be priced at quoted prices plus freight to the railway receiving point nearest the Joint Property or at prices agreed to by the Parties.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint Property.
  - (4) Unused new Material, except tubular goods, moved from the Joint Property shall be priced at the current new price, in effect on date of movement, as listed by a reliable supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint Property. Unused new tubulars will be priced as provided above in Paragraph 2 A (1) and (2).

B. Good Used Material (Condition B)

Material in sound and serviceable condition and suitable for reuse without reconditioning:

(1) Material moved to the Joint Property

At seventy-five percent (75%) of current new price, as determined by Paragraph A.

(2) Material used on and moved from the Joint Property

- (a) At seventy-five percent (75%) of current new price, as determined by Paragraph A, if Material was originally charged to the Joint Account as new Material or
- (b) At sixty-five percent (65%) of current new price, as determined by Paragraph A, if Material was originally charged to the Joint Account as used Material.

(3) Material not used on and moved from the Joint Property

At seventy-five percent (75%) of current new price as determined by Paragraph A.

The cost of reconditioning, if any, shall be absorbed by the transferring property.

C. Other Used Material

(1) Condition C

Material which is not in sound and serviceable condition and not suitable for its original function until after reconditioning shall be priced at fifty percent (50%) of current new price as determined by Paragraph A. The cost of reconditioning shall be charged to the receiving property, provided Condition C value plus cost of reconditioning does not exceed Condition B value.

**(2) Condition D**

Material, excluding junk, no longer suitable for its original purpose, but usable for some other purpose shall be priced on a basis commensurate with its use. Operator may dispose of Condition D Material under procedures normally used by Operator without prior approval of Non-Operators.

- (a) Casing, tubing, or drill pipe used as line pipe shall be priced as Grade A and B seamless line pipe of comparable size and weight. Used casing, tubing or drill pipe utilized as line pipe shall be priced at used line pipe prices.
- (b) Casing, tubing or drill pipe used as higher pressure service lines than standard line pipe, e.g. power oil lines, shall be priced under normal pricing procedures for casing, tubing, or drill pipe. Upset tubular goods shall be priced on a non upset basis.

**(3) Condition E**

Junk shall be priced at prevailing prices. Operator may dispose of Condition E Material under procedures normally utilized by Operator without prior approval of Non-Operators.

**D. Obsolete Material**

Material which is serviceable and usable for its original function but condition and/or value of such Material is not equivalent to that which would justify a price as provided above may be specially priced as agreed to by the Parties. Such price should result in the Joint Account being charged with the value of the service rendered by such Material.

**E. Pricing Conditions**

- (1) Loading or unloading costs may be charged to the Joint Account at the rate of twenty-five cents (25¢) per hundred weight on all tubular goods movements, in lieu of actual loading or unloading costs sustained at the stocking point. The above rate shall be adjusted as of the first day of April each year following January 1, 1985 by the same percentage increase or decrease used to adjust overhead rates in Section III, Paragraph 1.A(3). Each year, the rate calculated shall be rounded to the nearest cent and shall be the rate in effect until the first day of April next year. Such rate shall be published each year by the Council of Petroleum Accountants Societies.
- (2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

**3. Premium Prices**

Whenever Material is not readily obtainable at published or listed prices because of national emergencies, strikes or other unusual causes over which the Operator has no control, the Operator may charge the Joint Account for the required Material at the Operator's actual cost incurred in providing such Material, in making it suitable for use, and in moving it to the Joint Property; provided notice in writing is furnished to Non-Operators of the proposed charge prior to billing Non-Operators for such Material. Each Non-Operator shall have the right, by so electing and notifying Operator within ten days after receiving notice from Operator, to furnish in kind all or part of his share of such Material, suitable for use and acceptable to Operator.

**4. Warranty of Material Furnished By Operator**

Operator does not warrant the Material furnished. In case of defective Material, credit shall not be passed to the Joint Account until adjustment has been received by Operator from the manufacturers or their agents.

**V. INVENTORIES**

The Operator shall maintain detailed records of Controllable Material.

**1. Periodic Inventories, Notice and Representation**

At reasonable intervals, inventories shall be taken by Operator of the Joint Account Controllable Material. Written notice of intention to take inventory shall be given by Operator at least thirty (30) days before any inventory is to begin so that Non-Operators may be represented when any inventory is taken. Failure of Non-Operators to be represented at an inventory shall bind Non-Operators to accept the inventory taken by Operator.

**2. Reconciliation and Adjustment of Inventories**

Adjustments to the Joint Account resulting from the reconciliation of a physical inventory shall be made within six months following the taking of the inventory. Inventory adjustments shall be made by Operator to the Joint Account for overages and shortages, but, Operator shall be held accountable only for shortages due to lack of reasonable diligence.

**3. Special Inventories**

Special inventories may be taken whenever there is any sale, change of interest, or change of Operator in the Joint Property. It shall be the duty of the party selling to notify all other Parties as quickly as possible after the transfer of interest takes place. In such cases, both the seller and the purchaser shall be governed by such inventory. In cases involving a change of Operator, all Parties shall be governed by such inventory.

**4. Expense of Conducting Inventories**

- A. The expense of conducting periodic inventories shall not be charged to the Joint Account unless agreed to by the Parties.
- B. The expense of conducting special inventories shall be charged to the Parties requesting such inventories, except inventories required due to change of Operator shall be charged to the Joint Account.

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23 following January 1, 1985 by the same percentage increase or decrease used to adjust overhead rates in  
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25 shall be the rate in effect until the first day of April next year. Such rate shall be published each year  
26 by the Council of Petroleum Accountants Societies.

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28 price of new Material.

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33 to the Joint Property; provided notice in writing is furnished to Non-Operators of the proposed charge prior to billing  
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35 ten days after receiving notice from Operator, to furnish in kind all or part of his share of such Material suitable for use  
36 and acceptable to Operator.

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## EXHIBIT "D"

### INSURANCE

All insurance shall be obtained from financially sound, A.M. Best rated B+, Class IV or above, insurance companies authorized to do business in the state in which the operations are to be performed. Each policy shall provide for a waiver of subrogation rights against the other signatory parties. Non-operator(s) shall be named as additional insureds on all insurance policies with the exception of Workman's Compensation. All deductibles, if any, shall be borne by the joint account. The Operator shall carry for the benefit of the joint account the following insurance:

1. Workman's Compensation insurance with statutory limits as required by the State of
2. Comprehensive General Liability Insurance with a \$1,000,000 Combined Single Limit (CSL), \$2,000,000 aggregate limit. Sudden and accidental pollution coverage. DEX. Underground resources and equipment hazard sublimit of \$1,000,000 Property Damage (PD), blowout and cratering of \$1,000,000. Deductible of \$5,000 for PD per occurrence.
3. Comprehensive Automobile Liability including coverage of Owned and Hired/Non-owned automobiles. Bodily Injury/Property Damage Liability CSL per occurrence of \$1,000,000.
4. Commercial Umbrella policy \$2,000,000 CSL in excess of basic underlying coverages.
5. Energy Exploration and Development Policy with a \$10,000,000 limit per occurrence. Deductible of \$2,000,000 per occurrence. Sublimit of \$250,000 for equipment in Operator's care, custody and control with a deductible of \$100,000 per occurrence.

Each Non-Operator shall have the option of carrying its own insurance, except that which is required statutorily in (1) above. Should any Non-Operator elect not to be covered by the Operator's insurance, such Non-Operator shall notify Operator in writing and provide Operator an insurance Certificate(s) evidencing coverage(s) equal to or in excess of those set forth hereinabove within ten (10) days of executing this agreement or prior to the actual spud date of the well(s) covered, whichever occurs first. If such written notice is not received within the above referenced time constraints, the Non-Operator will be billed for its proportionate part of the insurance pertaining to the covered well(s).

If any party provides evidence of insurance so as to elect out of any coverage, such insurance shall include the following provision:

1. All signatory parties hereto shall be named as additional insureds.
2. Each policy shall include a waiver of any rights of subrogation against the other signatory parties hereto.
3. Each policy shall contain a provision-obligating insurer to give Operator written notice of change or cancellation not less than thirty (30) days prior to the effective date of such change or cancellation.

Operator shall require all contractors engaged in operations under this Agreement to comply with the applicable Worker's Compensation and Employer's Liability laws, and to maintain such other insurance, and in such amounts, that the Operator deems necessary.

MODEL FORM RECORDING SUPPLEMENT TO  
OPERATING AGREEMENT AND FINANCING STATEMENT

THIS AGREEMENT, entered into by and between McQuadrangle, LLC South Redlake II Unit, hereinafter referred to as "Operator", and the signatory party or parties other than Operator, hereinafter referred to individually as "Non-Operator", and collectively as "Non-Operators".

WHEREAS, the parties to this agreement are owners of Oil and Gas Leases and/or Oil and Gas Interests in the land identified in Exhibit "A" (said Leases and Interests being hereinafter called the "Contract Area"), and in any instance in which the Leases or Interests of a party are not of record, the record owner and the party hereto that owns the interest or rights therein are reflected on Exhibit "A";

WHEREAS, the parties hereto have executed an Operating Agreement dated October 31, 2003 (herein the "Operating Agreement", covering the Contract Area for the purpose of exploring and developing such lands, Leases and Interests for Oil and Gas and

WHEREAS, the parties hereto have executed this agreement for the purpose of imparting notice to all persons of the rights and obligations of the parties under the Operating Agreement and for the further purpose of perfecting those rights capable of perfection.

NOW, THEREFORE, in consideration of the mutual rights and obligations of the parties hereto, it is agreed as follows:

1. This agreement supplements the Operating Agreement, which Agreement in its entirety is incorporated herein by reference, and all terms used herein shall have the meaning ascribed to them in the Operating Agreement.

2. The parties do hereby agree that:

A. The Oil and Gas Leases and/or Oil and Gas Interests of the parties comprising the Contract Area shall be subject to and burdened with the terms and provisions of this agreement and the Operating Agreement, and the parties do hereby commit such Leases and Interests to the performance thereof.

B. The exploration and development of the Contract Area for Oil and Gas shall be governed by the terms and provisions of the Operating Agreement, as supplemented by this agreement.

C. All costs and liabilities incurred in operations under this agreement and the Operating Agreement shall be borne and paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties hereto, as provided in the Operating Agreement.

D. Regardless of the record title ownership to the Oil and Gas Leases and/or Oil and Gas Interests identified on Exhibit "A", all production of Oil and Gas from the Contract Area shall be owned by the parties as provided in the Operating Agreement; provided nothing contained in this agreement shall be deemed an assignment or cross-assignment of interests covered hereby.

E. Each party shall pay or deliver, or cause to be paid or delivered, all burdens on its share of the production from the Contract Area as provided in the Operating Agreement.

F. An overriding royalty, production payment, net profits interest or other burden payable out of production hereafter created, assignments of production given as security for the payment of money and those overriding royalties, production payments and other burdens payable out of production heretofore created and defined as Subsequently Created Interests in the Operating Agreement shall be (i) borne solely by the party whose interest is burdened therewith, (ii) subject to suspension if a party is required to assign or relinquish to another party an interest which is subject to such burden, and (iii) subject to the lien and security interest hereinafter provided if the party subject to such burden fails to pay its share of expenses chargeable hereunder and under the Operating Agreement, all upon the terms and provisions and in the times and manner provided by the Operating Agreement.

G. The Oil and Gas Leases and/or Oil and Gas Interests which are subject hereto may not be assigned or transferred except in accordance with those terms, provisions and restrictions in the Operating Agreement regulating such transfers. This agreement and the Operating Agreement shall be binding upon and shall inure to the benefit of the parties hereto, and their respective heirs, devisees, legal representatives, and assigns, and the terms hereof shall be deemed to run with the leases or interests included within the lease Contract Area.

H. The parties shall have the right to acquire an interest in renewal, extension and replacement leases, leases proposed to be surrendered, wells proposed to be abandoned, and interests to be relinquished as a result of non-participation in subsequent operations, all in accordance with the terms and provisions of the Operating Agreement.

I. The rights and obligations of the parties and the adjustment of interests among them in the event of a failure or loss of title, each party's right to propose operations, obligations with respect to participation in operations on the Contract Area and the consequences of a failure to participate in operations, the rights and obligations of the parties regarding the marketing of production, and the rights and remedies of the parties for failure to comply with financial obligations shall be as provided in the Operating Agreement.

J. Each party's interest under this agreement and under the Operating Agreement shall be subject to relinquishment for its failure to participate in subsequent operations and each party's share of production and costs shall be reallocated on the basis of such relinquishment, all upon the terms and provisions provided in the Operating Agreement.

K. All other matters with respect to exploration and development of the Contract Area and the ownership and transfer of the Oil and Gas Leases and/or Oil and Gas Interest therein shall be governed by the terms and provisions of the Operating Agreement.

3. The parties hereby grant reciprocal liens and security interests as follows:

A. Each party grants to the other parties hereto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest and/or purchase money security interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith, to secure performance of all of its obligations under this agreement and the Operating Agreement including but not limited to payment of expense, interest and fees, the proper disbursement of all monies paid under this agreement and the Operating Agreement, the assignment or relinquishment of interest in Oil and Gas Leases as required under this agreement and the Operating Agreement, and the proper performance of operations under this agreement and the Operating Agreement. Such lien and security interest granted by each party hereto shall include such party's leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the Contract Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject to this agreement and the Operating Agreement, the Oil and Gas when extracted therefrom and equipment situated thereon or used or obtained for use in connection therewith (including, without limitation, all wells, tools, and tubular goods), and accounts (including, without limitation, accounts arising from the sale of production at the wellhead),

1 contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of  
2 the foregoing.

3 B. Each party represents and warrants to the other parties hereto that the lien and security interest granted by such  
4 party to the other parties shall be a first and prior lien, and each party hereby agrees to maintain the priority of said lien  
5 and security interest against all persons acquiring an interest in Oil and Gas Leases and Interests covered by this  
6 agreement and the Operating Agreement by through or under such party. All parties acquiring an interest in Oil and  
7 Gas Leases and Oil and Gas Interests covered by this agreement and the Operating Agreement, whether by assignment,  
8 merger, mortgage, operation of law, or otherwise, shall be deemed to have taken subject to the lien and security interest  
9 granted by the Operating Agreement and this instrument as to all obligations attributable to such interest under this  
10 agreement and the Operating Agreement whether or not such obligations arise before or after such interest is acquired.

11 C. To the extent that the parties have a security interest under the Uniform Commercial Code of the state in which  
12 the Contract Area is situated, they shall be entitled to exercise the rights and remedies of a secured party under the Code.  
13 The bringing of a suit and the obtaining of judgment by a party for the secured indebtedness shall not be deemed an  
14 election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In  
15 addition, upon default by any party in the payment of its share of expenses, interest or fees, or upon the improper use of  
16 funds by the Operator, the other parties shall have the right, without prejudice to other rights or remedies, to collect  
17 from the purchaser the proceeds from the sale of such defaulting party's share of Oil and Gas until the amount owed by  
18 such party, plus interest, has been received, and shall have the right to offset the amount owed against the proceeds from  
19 the sale of such defaulting party's share of Oil and Gas. All purchasers of production may rely on a notification of default  
20 from the non-defaulting party or parties stating the amount due as a result of the default, and all parties waive any  
21 recourse available against purchasers for releasing production proceeds as provided in this paragraph.

22 D. If any party fails to pay its share of expense within one hundred-twenty (120) days after rendition of a statement  
23 therefor by Operator the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid  
24 amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid  
25 by each party so paying its share of the unpaid amount shall be secured by the liens and security rights described in this  
26 paragraph 3 and in the Operating Agreement, and each paying party may independently pursue any remedy available  
27 under the Operating Agreement or otherwise.

28 E. If any party does not perform all of its obligations under this agreement or the Operating Agreement, and the  
29 failure to perform subjects such party to foreclosure or execution proceedings pursuant to the provisions of this  
30 agreement or the Operating Agreement, to the extent allowed by governing law, the defaulting party waives any  
31 available right of redemption from and after the date of judgment, any required valuation or appraisal of the  
32 mortgaged or secured property prior to sale, any available right to stay execution or to require a marshalling of assets  
33 and any required bond in the event a receiver is appointed. In addition, to the extent permitted by applicable law, each  
34 party hereby grants to the other parties a power of sale as to any property that is subject to the lien and security rights  
35 granted hereunder or under the Operating Agreement, such power to be exercised in the manner provided by applicable  
36 law or otherwise in a commercially reasonable manner and upon reasonable notice.

37 F. The lien and security interest granted by this paragraph 3 supplements identical rights granted under the  
38 Operating Agreement.

39 G. To the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the  
40 mechanics' or materialmen's lien law of the state in which the Contract Area is situated in order to secure the payment  
41 to Operator of any sum due under this agreement and the Operating Agreement for services performed or materials  
42 supplied by Operator.

43 H. The above described security will be financed at the wellhead of the well or wells located on the Contract Area and  
44 this Recording Supplement may be filed in the land records in the County or Parish in which the Contract Area is  
45 located, and as a financing statement in all recording offices required under the Uniform Commercial Code or other  
46 applicable state statutes to perfect the above-described security interest, and any party hereto may file a continuation  
47 statement as necessary under the Uniform Commercial Code, or other state laws.

48 4. This agreement shall be effective as of the date of the Operating Agreement as above recited. Upon termination of  
49 this agreement and the Operating Agreement and the satisfaction of all obligations thereunder, Operator is authorized to file  
50 of record in all necessary recording offices a notice of termination, and each party hereto agrees to execute such a notice of  
51 termination as to Operator's interest, upon the request of Operator, if Operator has complied with all of its financial  
52 obligations.

53 5. This agreement and the Operating Agreement shall be binding upon and shall inure to the benefit of the parties  
54 hereto and their respective heirs, devisees, legal representatives, successors and assigns. No sale, encumbrance, transfer or  
55 other disposition shall be made by any party of any interest in the Leases or Interests subject hereto except as expressly  
56 permitted under the Operating Agreement and, if permitted, shall be made expressly subject to this agreement and the  
57 Operating Agreement and without prejudice to the rights of the other parties. If the transfer is permitted, the assignee of an  
58 ownership interest in any Oil and Gas Lease shall be deemed a party to this agreement and the Operating Agreement as to  
59 the interest assigned from and after the effective date of the transfer of ownership; provided, however, that the other parties  
60 shall not be required to recognize any such sale, encumbrance, transfer or other disposition for any purpose hereunder until  
61 thirty (30) days after they have received a copy of the instrument of transfer or other satisfactory evidence thereof in writing  
62 from the transferor or transferee. No assignment or other disposition of interest by a party shall relieve such party of  
63 obligations previously incurred by such party under this agreement or the Operating Agreement with respect to the interest  
64 transferred, including without limitation the obligation of a party to pay all costs attributable to an operation conducted under  
65 this agreement and the Operating Agreement in which such party has agreed to participate prior to making such assignment,  
66 and the lien and security interest granted by Article VII.B. of the Operating Agreement and hereby shall continue to burden  
67 the interest transferred to secure payment of any such obligations.

68 6. In the event of a conflict between the terms and provisions of this agreement and the terms and provisions of the  
69 Operating Agreement, then, as between the parties, the terms and provisions of the Operating Agreement shall control.

70 7. This agreement shall be binding upon each Non-Operator when this agreement or a counterpart thereof has been  
71 executed by such Non-Operator and Operator notwithstanding that this agreement is not then or thereafter executed by all of  
72 the parties to which it is tendered or which are listed on Exhibit "A" as owning an interest in the Contract Area or which  
73 own, in fact, an interest in the Contract Area. In the event that any provision herein is illegal or unenforceable, the  
74 remaining provisions shall not be affected, and shall be enforced as if the illegal or unenforceable provision did not appear herein.

1 8. Other provisions.

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IN WITNESS WHEREOF, this agreement shall be effective as of the 31st day of October, 2003.

ATTEST OR WITNESS:

OPERATOR

Ambler Wood

Delbert D. McDougal

By: DELBERT McDOUGAL

Type or Print Name

Title: MANAGER

Date:

Address: 7008 Salem

Lubbock, Texas

ATTEST OR WITNESS:

NON-OPERATORS

By:

Type or Print Name

Title:

Date:

Address:

ATTEST OR WITNESS:

By:

Type or Print Name

Title:

Date:

Address:

ATTEST OR WITNESS:

By:

Type or Print Name

Title:

Date:

Address:

ATTEST OR WITNESS:

By:

Type or Print Name

Title:

Date:

Address:

CASE 13370:

**Application of McQuadrangle, LC for statutory unitization of the South RedLake II Unit Area, Eddy County, New Mexico.** Applicant in the above-styled cause, seeks an order unitizing, for the purpose of establishing an enhanced recovery project, all mineral interest in the Grayburg formation, Red Lake Queen-Grayburg-San Andres Pool, underlying 961.61 acres, more or less, of Federal and State lands in the following acreage:

**TOWNSHIP 17 SOUTH, RANGE 27 EAST, NMPM**

Section 35: E/2, E/2 SW/4, SE/4 NW/4,

Section 36: W/2, SW/4 NE/4

**TOWNSHIP 18 SOUTH, RANGE 27 EAST, NMPM**

Section 1: Lot 4

Section 2: Lots 1, 2, 3

Said unit to be designated the South RedLake II Unit.

Among the matters to be considered at the hearing will be the necessity of unit operations; the designation of a unit operator; the designation of horizontal and vertical limits of the unit area; the determination of the fair, reasonable, and equitable allocation of production and costs of production, including capital investment, to each of the various tracts in the unit area; the determination of credits and charges to be made among the various owners in the unit area for their investment in wells and equipment and such other matters as may be necessary and appropriate for carrying on efficient unit operations; including but not limited to, unit voting procedures, selection, removal or substitution of unit operator, and time of commencement and termination of unit operations. Applicant also requests that any such order issued in this case include a non-consent penalty for risk to be charged against carried working interests within the unit area upon such terms and conditions to be determined by the Division as just and reasonable. Said unit area is located approximately 16 miles southeast of Artesia, New Mexico.



October 14, 2004

**CERTIFIED MAIL-RETURN RECEIPT REQUESTED**

**TO: ALL AFFECTED INTEREST OWNERS IN THE SOUTH REDLAKE II UNIT AREA.**

**Re: Application of McQuadrangle, LC for statutory unitization of the South RedLake II Unit Area, Eddy County, New Mexico.**

Ladies and Gentlemen:

This letter is to advise you that McQuadrangle, LC has filed the enclosed application with the New Mexico Oil Conservation Division seeking an order statutorily unitizing for the purpose of a secondary recovery project, and at a later date a tertiary recovery project, all mineral interests from an upper limit described as 100 feet below mean sea level or at the top of the Grayburg formation, whichever is higher, to a lower limit at the base of the San Andres formation; the geologic markers having been previously found to occur at 1,430 feet and the base of which is found at 1,762 feet in the Carper-Sivley Joint Account Magruder Well No. 13, located 330 feet from the South line and 480 feet from the East line of Section 35, Township 17 South, Range 27 East, NMPM, Eddy County, New Mexico, as recorded on Welex Electric log taken on march 28, 1960, said log being measured from a kelly bushing elevation of 3,654 feet above sea level, underlying 961.61 acres, more or less, of Federal, and State of New Mexico lands comprised of the following described acreage:

**TOWNSHIP 17 SOUTH, RANGE 27 EAST, NMPM**

Section 35: E/2, E/2 SW/4, SE/4 NW/4,  
Section 36: W/2, SW/4 NE/4

**TOWNSHIP 18 SOUTH, RANGE 27 EAST, NMPM**

Section 1: Lot 4  
Section 2: Lots 1, 2, 3

A copy of the proposed Unit Agreement and Unit Operating Agreement are enclosed. Said unit is to be designated the South RedLakes II Unit.

Among the matters to be considered at the hearing on this application will be the necessity of unit operations; the designation of a unit operator; the determination of the horizontal and vertical limits of the unit area; the determination of the fair, reasonable and equitable allocation of production and costs of production, including capital investment, to each of the various tracts in the unit area; the determination of credits and charges to be made among the



various owners in the unit area for their investments in wells and equipment; a non-consent penalty for risk to be charged against carried working interest owners within the unit area upon such terms and conditions to be determined by the Division as just and reasonable; and such other matters as may be necessary and appropriate for carrying on efficient unit operations; including, but not limited to, unit voting procedures, selection, removal or substitution of unit operator, and time of commencement and termination of unit operations.

This application has been set for hearing before a Division Examiner on November 4, 2004 at the Oil Conservation Division Hearing Room in its Santa Fe office located at 1220 South Saint Francis Drive, Santa Fe, NM 87505. You are not required to attend this hearing but, as the owner of an interest that may be affected by this application, you may appear and present testimony. Failure to appear at that time and become a party of record will preclude you from challenging this matter at a later date.

Parties appearing in cases are required by Division Rule 1208.B to file a Pre-hearing Statement three days in advance of a scheduled hearing at the Division's Santa Fe Office. This statement must include: the names of the parties and their attorneys; a concise statement of the case; the names of all witnesses the party will call to testify at the hearing; the approximate time the party will need to present its case; and identification of any procedural matters that are to be resolved prior to the hearing.

Very truly yours,

A handwritten signature in black ink, appearing to read "William F. Carr".

William F. Carr  
Attorney for McQuadrangle, LC

Enclosure

cc: Mr. Delbert McDougal  
Mr. Jim Pierce  
David R. Vandiver, Esq.

**APPLICATION OF MCQUADRANGLE, LC  
FOR STATUTORY UNITIZATION OF THE  
SOUTH REDLAKE II UNIT AREA**

**EXHIBIT A**

Commissioner of Public Lands  
P. O. Box 1148  
Santa Fe, NM 87504-1148

Robert L. Huguley Sr.  
6145 Quail Avenue #130  
El Paso, TX 79924-4336

MMS  
Royalty Management Program  
P. O. Box 5760  
Denver, CO 80217-5760

Joan A. Hudson  
8053 San Vista Circle  
Naples, FL 34109-7177

Johney Cockburn Estate  
Thelma V. Cockburn Ind. Ex.  
1006 W. Third Street  
Lampasas, TX 76550-2518

Jonel Susan Grasso  
11 Ocean Ridge  
Laguna Niguel, CA 92677

Colaro Corporation  
400 One Energy Square  
4925 Greenville Avenue  
Dallas, TX 75206-4012

John Bedingfield  
P. O. Box 630  
Artesia, NM 88211-0630

Florence Dooley Estate  
Patrick T. Dooley, Personal Rep.  
1006 S. 2nd Street  
Artesia, NM 88210

Lillie M. Yates Estate  
S.P. Yates, Frank Yates Jr., and B. W.  
Harper Co., Personal Representatives  
P. O. Box 840  
Artesia, NM 88211-0840

Mary Dorothea Duggan  
15 E. Greenway Plaza #12G  
Houston, TX 77046-1504

William P. Dooley Estate  
Patrick Dooley, Personal Representative  
1006 S. 2nd Street  
Artesia, NM 88210-2808

Frank E. Hawley Life Est.  
21 Goldenridge Court  
San Mateo, CA 94402-3717

Jim and Pearl Hawley Family Living  
Trust  
5857 Westhaven Drive  
Fort Worth, TX 76132

Myrna Sue Zumwalt  
101 N. Filmore Street  
Cortez, CO 81321-3311

Richard H. Sweaney III  
P. O. Box 1803  
Forney, TX 75126

Everett R. Jones, Jr.  
Suite 1420 LB No. 12  
8080 N. Central Expressway  
Dallas, TX 75206-1806

Gary W. Sweaney  
12938 King Circle  
Cypress, TX 77429

Mesa Oil Co. AC #533319-13  
P. O. Box 125  
Artesia, NM 88211-0125

Kay Sorvillo  
3507 Stonehaven  
San Antonio, TX 78230

Jon J. Nelson  
P. O. Box 885  
Seguin, TX 78156-0885

Francine C. Sweaney  
3335 Colony Drive  
San Antonio, TX 78230

Scout Oil Co. AC #53319-13  
c/o Western Bank NA  
P. O. Box 500  
Artesia, NM 88211-0500

Katherine K. McIntyre  
620 Camino Real Avenue  
El Paso, TX 79922-2008

John H. Trigg  
P. O. Box 520  
Roswell, NM 88202-0520

Trigg Family Trust  
Pauline V. Trigg Trustee  
P. O. Box 520  
Roswell, NM 88202-0520

Yates Brothers  
105 S. 4th Street  
Artesia, NM 88211-2124

Rolla R. Hinkle III  
P. O. Box 2292  
Roswell, NM 88202-2292

Etz Southern Trust  
George H. Etz Jr. Trustee  
1105 Xanthisma  
McAllen, TX 78504-3519

Cross Timbers Oil Company  
Attn: D/O Dept.  
810 Houston Street, Suite 2000  
Fort Worth, TX 76102-6298

Sandra Leigh Terry  
P. O. Box 12617  
El Paso, TX 79912-0617

Madison M. Hinkle  
P. O. Box 2292  
Roswell, NM 88202-2292

Sue Lynn Terry  
6112 N. Mesa PMB 216  
El Paso, TX 79912-4516

Summit Overseas Exploration Inc.  
Post Office Box 260590  
Lakewood, CO 80226-0590

Paul Slayton  
P. O. Box 2035  
Roswell, NM 88202-2035

Michael McDowell  
326 South 5th  
Shelton, WA 98584

Mary L. Boling  
P. O. Box 768  
Artesia, NM 88211-0768

Sharbro Oil Ltd. Co.  
P. O. Box 840  
Artesia, NM 88211-0840

Randolph M. Richardson  
P. O. Box 2423  
Roswell, NM 88202-2423

HDS Group Inc Agent FBO  
Fred C. Durham, Janet R. Sam,  
Kathryn F. Hardwick  
P. O. Box 3546  
Midland, TX 79702-3546

JKL Co.  
P. O. Box 204  
Midland, TX 79702-0204

John J. Schaller  
3520 Lawndale Drive  
Greensboro, NC 72408

Howard B. Wright Estate  
B. Kent Pomeroy Anc. Pr.  
Ste 101, 3839 N. 3rd Street  
Phoenix, AZ 85012-2068

Wilma Donohue Moleen Estate  
Chase Bank of Texas Executor  
P. O. Box 10966  
Midland, TX 79702-0966

Pitch Energy Corp.  
P. O. Box 304  
Artesia, NM 88211-0304

David W. Jamison  
418 73rd NE  
Olympia, WA 98506-9707

Robert L. Huguley Jr.  
#123 6145 Quail  
El Paso, TX 79924

Sharon Ann Huguley Childs  
P. O. Box 7781  
Corpus Christi, TX 78467-7781

Mary C. Cass Ind. Executor  
Wheeler Cass Estate  
8209 Magnetic  
El Paso, TX 79904

PAM Inc.  
P. O. Box 508  
Artesia, NM 88211-0508

Lou Frost  
408 W. 19th Street  
Roswell, NM 88201-3358

William J. Wright  
916 S. Roselawn  
Artesia, NM 88210

Edward B. Stewart  
2005 Hessian Road  
Charlottesville, VA 22903

Henry Russell Farms  
P. O. Box 203  
Roswell, NM 88202-0203

Steve Pitt  
1180 Mercury Drive  
Lafayette, CO 80026

Charles W. Froehlich Jr.  
1444 Windsong Lane  
Escondido, CA 92026

Pamela June Krueger  
P. O. Box 551023  
Jacksonville, FL 32255-1023

James F. Roberts  
P. O. Box 504  
Key Colony, FL 33051

Morris E. Schertz  
P. O. Drawer 2588  
Roswell, NM 88202-2588

Thomas W. Flynn  
824 Symphony Isles Blvd.  
Ruskin, FL 33572

Barbara Kruse Frankenfield  
12 Laura Elizabeth Court  
Mansfield, TX 76063

Rebecca Scott  
P. O. Box 4885  
Santa Fe, NM 87502

Fred & Juliette Turner Estate  
Lynn D. Durham and Clarence  
Scharbauer Jr Trustees/TX Properties  
P. O. Box 910  
Midland, TX 79702-0910  
Ruth O. Hill Living Trust  
Ruth O. Hill Trustee  
c/o Jack Funk  
10679 Nathanson Avenue  
Cupertino, CA 95014-1330

Judy N. Deans  
409 Commerce Road  
Artesia, NM 88210-9432

Leland Price Inc.  
P. O. Box 508  
Artesia, NM 88210-0508

John W. & Jean Gates Revocable  
Trust  
706 W. Grand Avenue  
Artesia, NM 88210-1935

Thomas W. Pettit  
151 W. Trinity Road  
Glen Ellen, CA 95442

John Nelson Jr.  
P. O. Box 885  
Seguin, TX 78155-0885

TMTM Joint Venture  
c/o Delbert McDougal  
Suite 200, 7008 Salem Avenue  
Lubbock, TX 79424

Annice Miller  
c/o Bank of America  
Oil & Gas Acct Trust #9109  
P. O. Box 840738  
Dallas, TX 75284-0738

Boling Enterprises Ltd.  
Robert Michael Boling Manager  
P. O. Box 2563  
Roswell, NM 88202

Losee Investments LLC  
P. O. Box 1720  
Artesia, NM 88211-1720

Manix Energy LLC  
P. O. Box 2818  
Midland, TX 79702-2818

McQuadrangle LC  
7008 Salem  
Lubbock, TX 79424

Celtic Oil Co.  
P. O. Box 125  
Artesia, NM 88211-0125

Lulu E. Harbold Estate  
Ruth Turbeville Jones Executrix  
P. O. Box 504  
Mesilla Park, NM 88047-0504

Summit Overseas Exploration, Inc.  
c/o Martin P. Averill  
Jenkins & Gilchrist  
1445 Ross Avenue, Ste 3200  
Dallas, TX 75202