

UNIT OPERATING AGREEMENT

NORTH CAPROCK CELERO QUEEN UNIT  
Lea and Chaves Counties, New Mexico

EFFECTIVE DATE

November 1, 2012

Oil Conservation Division  
Case No. \_\_\_\_\_  
Exhibit No. 5

UNIT OPERATING AGREEMENT  
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TABLE OF CONTENTS

SECTION	PAGE
Preliminary Recitals.....	1
 ARTICLE 1 CONFIRMATION OF UNIT AGREEMENT  	
1.1 Confirmation of Unit Agreement.....	1
 ARTICLE 2 EXHIBITS  	
2.1 Exhibits .....	1
2.1.1 Exhibits A and B: Reference to Unit Agreement.....	1
2.1.2 Exhibit C: Unit Participation .....	1
2.1.3 Exhibit D: Accounting Procedure.....	2
2.1.4 Exhibit E: Insurance Provisions.....	2
2.2 Revision of Exhibits.....	2
 ARTICLE 3 SUPERVISION OF OPERATIONS BY WORKING INTEREST OWNERS  	
3.1 Overall Supervision .....	2
3.2 Specific Authorities and Duties .....	2
3.2.1 Method of Operation.....	2
3.2.2 Drilling of Wells .....	2
3.2.3 Well Recompletions and Change of Status.....	2
3.2.4 Expenditures .....	2
3.2.5 Disposition of Unit Equipment.....	2
3.2.6 Appearance Before a Court or Regulatory Body.....	2
3.2.7 Audits .....	3
3.2.8 Inventories.....	3
3.2.9 Technical Services .....	3
3.2.10 Assignments to Committee .....	3
3.2.11 Removal of Unit Operator .....	3

3.2.12	Enlargement of Unit Area.....	3
3.2.13	Adjustment and Readjustment of Investments .....	3
3.2.14	Termination.....	3

#### ARTICLE 4 MANNER OF EXERCISING SUPERVISION

4.1	Designation of Representatives.....	3
4.2	Meetings.....	3
4.3	Voting Procedure .....	4
4.3.1	Voting Interest .....	4
4.3.2	Vote Required-Generally .....	4
4.3.3	Vote at Meeting by Non-attending Working Interest Owners.....	4
4.3.4	Poll Votes.....	4

#### ARTICLE 5 INDIVIDUAL RIGHTS OF WORKING INTEREST OWNERS

5.1	Reservation of Rights.....	4
5.2	Specific Rights.....	4
5.2.1	Access to Unit Area .....	4
5.2.2	Reports .....	4

#### ARTICLE 6 UNIT OPERATOR

6.1	Initial Unit Operator.....	5
6.2	Resignation or Removal.....	5
6.3	Selection of Successor .....	5

#### ARTICLE 7 AUTHORITIES AND DUTIES OF UNIT OPERATOR

7.1	Exclusive Right to Operate Unit.....	5
7.2	Workmanlike Conduct .....	5
7.3	Liens and Encumbrances .....	5
7.4	Employees.....	5
7.5	Records .....	6
7.6	Reports to Working Interest Owners .....	6
7.7	Reports to Governmental Authorities .....	6
7.8	Engineering and Geological Information.....	6
7.9	Expenditures .....	6
7.10	Wells Drilled by Unit Operator.....	6
7.11	Taking in Kind.....	6

ARTICLE 8  
TAXES

8.1	Ad Valorem Taxes .....	7
8.2	Other Taxes .....	7

ARTICLE 9  
INSURANCE

9.1	Insurance .....	7
9.1.1	Workmen's Compensation Law .....	7
9.1.2	Employer's Liability Insurance .....	7
9.1.3	Other Insurance .....	7

ARTICLE 10  
ADJUSTMENT OF INVESTMENTS

10.1	Personal Property Taken Over .....	7
10.1.1	Wells and Casing .....	7
10.1.2	Well and Lease Equipment .....	8
10.1.3	Records .....	8
10.2	Inventory and Evaluation of Personal Property .....	8
10.3	Investment Adjustment .....	8
10.4	General Facilities .....	8
10.5	Ownership of Personal Property and Facilities .....	8

ARTICLE 11  
UNIT EXPENSE

11.1	Basis of Charge to Working Interest Owners .....	8
11.2	Budgets .....	9
11.3	Advance Billings .....	9
11.4	Unpaid Ordinary Unit Expenses .....	9
11.5	Commingling of Funds .....	10
11.6	Liens and Security Interests .....	10
11.7	Uncommitted Royalty .....	12
11.8	Non-participating Working Interest Owners .....	12

ARTICLE 12  
NON-UNITIZED FORMATIONS

12.1	Right to Operate .....	12
------	------------------------	----

ARTICLE 13  
TITLES

13.1	Warranty and Indemnity .....	13
13.2	Failure Because of Unit Operations .....	13

ARTICLE 14  
LIABILITY, CLAIMS AND SUITS

14.1	Individual Liability .....	13
14.2	Settlements .....	13

ARTICLE 15  
INTERNAL REVENUE PROVISION

15.1	Internal Revenue Provision .....	14
------	----------------------------------	----

ARTICLE 16  
NOTICES

16.1	Notices .....	14
------	---------------	----

ARTICLE 17  
WITHDRAWAL OF WORKING INTEREST OWNER

17.1	Withdrawal .....	15
------	------------------	----

ARTICLE 18  
ABANDONMENT OF WELLS

18.1	Rights of Former Owners .....	15
18.2	Plugging .....	15

ARTICLE 19  
EFFECTIVE DATE AND TERM

19.1	Effective Date .....	15
19.2	Term .....	16

ARTICLE 20  
ABANDONMENT OF OPERATIONS

20.1	Termination .....	16
20.1.1	Oil and Gas Rights .....	16

20.1.2	Right to Operate .....	16
20.1.3	Salvaging Wells .....	16
20.1.4	Cost of Salvaging .....	16

## ARTICLE 21 EXECUTION

21.1	Original, Counterpart, or Other Instrument .....	16
------	--	----

## ARTICLE 22 SEVERABILITY

22.1	Severability .....	16
------	--------------------	----

## ARTICLE 23 SUCCESSORS AND ASSIGNS

23.1	Successors and Assigns .....	17
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## UNIT OPERATING AGREEMENT

North Caprock Celero Queen Unit, Lea and Chaves Counties, New Mexico

This Agreement, entered into as of the 1st day of November, 2012, by the parties who have signed the original of this instrument, a counterpart thereof, or other instrument agreeing to be bound by the provisions hereof;

### WITNESSETH:

WHEREAS, by order of the New Mexico Oil Conservation Commission, as entered in Case No. 14914 dated October \_\_, 2012, the parties hereto designated as Working Interest Owners are subject to, or have executed, as of the date hereof, an agreement entitled, "Unit Agreement, North Caprock Celero Queen Unit, Lea and Chaves Counties, New Mexico herein referred to as "Unit Agreement", which, among other things, provides for a separate agreement to be entered into by Working Interest Owners to provide for the development and operation of the Unit Area as therein defined;

NOW, THEREFORE, In consideration of the mutual agreements herein set forth, it is agreed as follows:

#### Article 1

#### CONFIRMATION OF UNIT AGREEMENT

1.1 Confirmation of Unit Agreement. The Unit Agreement is hereby confirmed and by reference made a part of this agreement. The definitions in the Unit Agreement are adopted for all purposes of this agreement. If there is any conflict between the Unit Agreement and this agreement, the Unit Agreement shall govern.

#### Article 2

#### EXHIBITS

2.1 Exhibits. The following exhibits are incorporated herein by reference:

2.1.1 Exhibits A and B of the Unit Agreement.

2.1.2 Exhibit C, attached hereto, is a schedule showing the total Unit Participation of each Working Interest Owner. Exhibit C, or a revision thereof, shall not be conclusive as to the information therein, except it may be used as showing the Unit Participations of the Working Interest Owners for purposes of this agreement until shown to be in error or is revised as herein authorized.

2.1.3 Exhibit D, attached hereto, is the Accounting Procedure applicable to Unit Operations. If there is any conflict between this agreement and Exhibit D, this agreement shall govern.

2.1.4 Exhibit E, attached hereto, contains insurance provisions applicable to Unit Operations.

2.2 Revision of Exhibits. Whenever Exhibits A and B are revised, Exhibit C shall be revised accordingly and be effective as of the same date. Unit Operator shall also revise Exhibit C from time to time as required to conform to changes in ownership of which Unit Operator has been notified as provided in the Unit Agreement.

### Article 3

#### SUPERVISION OF OPERATIONS BY WORKING INTEREST OWNERS

3.1 Overall Supervision. Working Interest Owners shall exercise overall supervision and control of all matters pertaining to Unit Operations pursuant to this agreement and the Unit Agreement. In the exercise of such authority, each Working Interest Owner shall act solely in its own behalf in the capacity of an individual owner and not on behalf of the owners as an entirety.

3.2 Specific Authorities and Duties. The matters with respect to which the Working Interest Owners shall decide and take action shall include, but not be limited to, the following:

3.2.1 Method of Operation. The method of operation, including any type of pressure maintenance, secondary recovery, or other recovery program to be employed.

3.2.2 Drilling of Wells. The drilling of any well whether for production of Unitized Substances, for use as an injection well, or for other purposes.

3.2.3 Well Recompletions and Change of Status. The recompletion, abandonment, or change of status of any well, or the use of any well for injection or other purposes.

3.2.4 Expenditures. The making of any single expenditure in excess of Seventy-five Thousand and No/100 Dollars (\$75,000.00); provided that, approval by Working Interest Owners of the drilling, reworking, deepening, or plugging back of any well shall include approval of all necessary expenditures required therefor, and for completing, testing, and equipping the same, including necessary flow lines, separators, and lease tankage, or injection equipment.

3.2.5 Disposition of Unit Equipment. The selling or otherwise disposing of any major item of surplus Unit Equipment, if the current list price of new equipment similar thereto is Forty Thousand and No/100 Dollars (\$40,000.00) or more.

3.2.6 Appearance Before a Court or Regulatory Agency. The designating of a representative to appear before any court or regulatory agency in matters pertaining to Unit



Operations; provided that, such designation shall not prevent any Working Interest Owner from appearing in person or from designating another representative in its own behalf.

3.2.7 Audits. The auditing of the accounts of Unit Operator pertaining to Unit Operations hereunder; provided that, the audits shall

(a) not be conducted more than once each year except upon the resignation or removal of Unit Operator,

(b) be made at the expense of all Working Interest Owners other than the Working Interest Owner designated as Unit Operator, and

(c) be made upon not less than thirty (30) days' written notice to Unit Operator.

3.2.8 Inventories. The taking of periodic inventories under the terms of Exhibit D.

3.2.9 Technical Services. The authorizing of charges to the joint account for services by consultants or Unit Operator's technical personnel not covered by the overhead charges provided by Exhibit D.

3.2.10 Assignments to Committees. The appointment of committees to study any problems in connection with Unit Operations.

3.2.11 The removal of Unit Operator and the selection of a successor.

3.2.12 The enlargement of the Unit Area.

3.2.13 The adjustment and readjustment of investments.

3.2.14 The termination of the Unit Agreement.

#### Article 4 MANNER OF EXERCISING SUPERVISION

4.1 Designation of Representatives. Each Working Interest Owner shall in writing inform Unit Operator of the names and addresses of the representative and alternate who are authorized to represent and bind such Working Interest Owner with respect to Unit Operations. The representative or alternate may be changed from time to time by written notice to Unit Operator.

4.2 Meetings. All meetings of Working Interest Owners shall be called by Unit Operator upon its own motion or at the request of one or more Working Interest Owners having a total Unit Participation of not less than two percent (2%). No meeting shall be called on less than fourteen (14) days' advance written notice, with agenda for the meeting attached. Unit Operator

shall determine and notify Working Interest Owners of the time and place for the meeting. Working Interest Owners who attend the meeting shall not be prevented from amending items or other items presented in the agenda or from deciding the amended item or other items presented at the meeting. Working Interest Owners may attend any meeting by telephone, or other live-voice electronic means. The representative of Unit Operator shall be chairman of each meeting.

4.3 Voting Procedure, Working Interest Owners shall decide all matters coming before them as follows:

4.3.1 Voting Interest. Each Working Interest Owner shall have a voting interest equal to its Unit Participation.

4.3.2 Vote Required---Generally. Unless otherwise provided herein or in the Unit Agreement, all matters shall be decided by an affirmative vote of seventy-five percent (75%) or more voting interest; provided that, should any one Working Interest Owner have more than seventy-five percent (75%) voting interest, its vote must be supported by the vote of one or more Working Interest Owners.

4.3.3 Vote at Meeting by Non-attending Working Interest Owner. Any Working Interest Owner who is not represented at a meeting may vote by letter or telegram addressed to the representative of the Unit Operator if its vote is received prior to the vote on the item.

4.3.4 Poll Votes. Working Interest Owners may vote on and decide, by letter or telegram, any matter submitted in writing to Working Interest Owners, if no meeting is requested, as provided in Section 4.2, within seven (7) days after the proposal is sent to Working Interest Owners. Unit Operator will give prompt notice of the results of the voting to all Working Interest Owners.

## Article 5

### INDIVIDUAL RIGHTS OF WORKING INTEREST OWNERS

5.1 Reservation of Rights. Working Interest Owners severally reserve to themselves all their rights, except as otherwise provided in this agreement and the Unit Agreement.

5.2 Specific Rights. Each Working Interest Owner shall have, among others, the following specific rights:

5.2.1 Access to Unit Area. Access to the Unit Area at all reasonable times to inspect Unit Operations, all wells, and the records and data pertaining thereto.

5.2.2 Reports. The right to receive from Unit Operator, upon written request, copies of all reports to any governmental agency, reports of crude oil runs and stocks, inventory reports, and all other information pertaining to Unit Operations. The cost of gathering, and furnishing information not ordinarily furnished by Unit Operator to all Working Interest Owners shall be charged to the Working Interest Owner who requests the information.

## Article 6 UNIT OPERATOR

6.1 Initial Unit Operator Celero Energy II, LP is hereby designated as Unit Operator.

6.2 Resignation or Removal. Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence or no longer owns an interest in the Unit Area, Operator shall be deemed to resign 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 two or more Non-Operators owning eighty percent (80%) interest based on ownership as shown on Exhibit "A". Such vote shall not be deemed effective until a written notice has been delivered to the Operator by Non-Operator detailing the alleged default and Operator has failed to terminate the default within 30 days from its receipt of the notice or, if the default concerns an operation then being conducted, within 48 hours of its receipt of the notice. For the 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 operations contained Article 7.2 herein or material failure or inability to perform its obligations under this Agreement.

6.3 Selection of Successor. Upon the resignation or removal of a Unit Operator, a successor Unit Operator shall be selected by Working Interest Owners.

## Article 7 AUTHORITIES AND DUTIES OF UNIT OPERATOR

7.1 Exclusive Right to Operate Unit. Subject to the provisions of this agreement and to instructions from Working Interest Owners, Unit Operator shall have the exclusive right and be obligated to conduct Unit Operations.

7.2 Workmanlike Conduct. Unit Operator shall conduct Unit Operations in a good and workmanlike manner as would a prudent operator under the same or similar circumstances. Unit Operator shall freely consult with Working Interest Owners and keep them informed of all matters which Unit Operator, in the exercise of its best judgment, considers important. Unit Operator shall not be liable to Working Interest Owners for damages, unless such damages result from its gross negligence or willful misconduct.

7.3 Liens and Encumbrances. Unit Operator shall endeavor to keep the lands and leases in the Unit Area free from all liens and encumbrances occasioned by Unit Operations, except the lien of Unit Operator granted hereunder.

7.4 Employees. The number of employees used by Unit Operator in conducting Unit Operations, their selection, hours of labor, and compensation shall be determined by Unit Operator. Such employees shall be the employees of Unit Operator.

7.5 Records. Unit Operator shall keep correct books, accounts, and records of Unit Operations.

7.6 Reports to Working Interest Owners. Unit Operator shall furnish to Working Interest Owners periodic reports of Unit Operations.

7.7 Reports to Governmental Authorities. Unit Operator shall make all reports to governmental authorities that it has the duty to make as Unit Operator.

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

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

7.8 Engineering and Geological Information. Unit Operator shall furnish to a Working Interest Owner, upon written request, a copy of the log and other engineering and geological data pertaining to wells drilled for Unit Operations.

7.9 Expenditures. Unit Operator is authorized to make single expenditures not in excess of Seventy-five Thousand and No/100 Dollars (\$75,000.00) without prior approval of Working Interest Owners. If an emergency occurs, Unit Operator may immediately make or incur such expenditures as in its opinion are required to deal with the emergency. Unit Operator shall report to Working Interest Owners, as promptly as possible, the nature of the emergency and the action taken.

7.10 Wells Drilled by Unit Operator. All wells drilled by Unit Operator shall be at the usual rates prevailing in the area. Unit Operator may employ its own tools and equipment, but the charge therefor shall not exceed the prevailing rate in the area, and the work shall be performed by Unit Operator under the same terms and conditions as are usual in the area in contracts of independent contractors doing work of a similar nature.

7.11 Taking in Kind. If, pursuant to the Unit Agreement, Operator is purchasing or selling more than its share of Unitized Substances pursuant to the Unit Agreement, 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.

## Article 8 TAXES

8.1 Ad Valorem Taxes. Unit Operator shall make and file all necessary ad valorem tax renditions and returns with the proper taxing authorities covering all real and personal property of each Working Interest Owner used or held by Unit Operator in Unit Operations. Unit Operator shall settle assessments arising therefrom. All such ad valorem taxes shall be paid by Unit Operator and charged to the joint account; provided that, if the interest of a Working Interest Owner is subject to a separately assessed overriding royalty interest, production payment, or other interest in excess of a one eighth (1/8) royalty, such Working Interest Owner shall be given credit for the reduction in taxes paid resulting therefrom.

8.2 Other Taxes. Each Working Interest Owner shall pay or cause to be paid all production, severance, gathering, and other taxes imposed upon or in respect of the production or handling of its share of Unitized Substances.

## Article 9 INSURANCE

9.1 Insurance. Unit Operator, with respect to Unit Operations, shall do the following:

9.1.1 Comply with the Workmen's Compensation Law of the State of New Mexico.

9.1.2 Carry Employer's Liability and other insurance required by the laws of the State of New Mexico.

9.1.3 Carry other insurance as set forth in Exhibit E.

## Article 10 ADJUSTMENT OF INVESTMENTS

10.1 Personal Property Taken Over. Upon the Effective Date hereof, Working Interest Owners shall deliver to Unit Operator the following:

10.1.1 Wells and Casing. All wells completed in the Unitized Formation, together with the casing therein.

10.1.2 Well and Lease Equipment. The tubing in each such well, the wellhead connections thereon, and all other lease and operating equipment that is used in this operation of such wells which Working Interest Owners determine necessary or desirable for conducting Unit Operations.

10.1.3 Records. A copy of all production and well records that pertain to such wells.

10.2 Inventory and Evaluation of Personal Property. Working Interest Owners shall at Unit Expense inventory and evaluate in accordance with the provisions of Exhibit D the personal property taken over.

10.3 Investment Adjustment. Upon approval by Working Interest Owners of the inventory and evaluation, each Working Interest Owner shall be credited with the value of its interest in all personal property taken over under Section 10.1.2, and shall be charged with an amount equal to that obtained by multiplying the total value of all personal property taken over under Section 10.1.2 by such Working Interest Owner's Unit Participation. If the charge against any Working Interest Owner is greater than the amount credited to such Working Interest Owner, the resulting net charge shall be an item of Unit Expense chargeable against such Working Interest Owner. If the credit to any Working Interest Owner is greater than the amount charged against such Working Interest Owner, the resulting net credit shall be paid to such Working Interest Owner by Unit Operator out of funds received by it in settlement of the net charges described above.

10.4 General Facilities. The acquisition of warehouses, warehouse stock, lease houses, camps, facility systems, and office buildings necessary for Unit Operations shall be by negotiation by the owners thereof and Unit Operator, subject to the approval of Working Interest Owners.

10.5 Ownership of Personal Property and Facilities. Each Working Interest Owner, individually, shall by virtue hereof own an undivided interest, equal to its Unit Participation, in all personal property and facilities taken over or otherwise acquired by Unit Operator pursuant to this agreement.

## Article 11 UNIT EXPENSE

11.1 Basis of Charge to Working Interest Owners. Unit Operator initially shall pay all Unit Expenses for Unit Operations that do not otherwise require Working Interest Owner approval pursuant to Article 3 and all approved Unit Operations (hereinafter "Ordinary Unit Expenses"). Each Working Interest Owner shall reimburse Unit Operator for its share of Ordinary Unit Expenses. Each Working Interest Owner's share of Ordinary Unit Expenses shall be allocated in proportion to its Unit Participation at the time such Ordinary Unit Expense is incurred. All charges, credits, and accounting for Ordinary Unit Expenses shall be in accordance with Exhibit D.

11.2 Budgets. Before or as soon as practical after the effective date hereof, Unit Operator shall prepare a budget of estimated Unit Expense for the remainder of the calendar year, and, on or before the first day of each November thereafter, shall prepare such a budget for anticipated Ordinary Unit Expenses anticipated for the ensuing calendar year. A budget shall set forth the estimated Ordinary Unit Expense by quarterly periods. Budgets shall be estimates only, and shall be adjusted or corrected by Working Interest Owners and Unit Operator whenever an adjustment or correction is proper. A copy of each budget and adjusted budget shall promptly be furnished to each Working Interest Owner.

11.3 Advance Billings. Unit Operator shall have the right, without prejudice to its other rights or remedies, to require Working Interest Owners to advance their respective shares of estimated Ordinary Unit Expenses by submitting to each Working Interest Owner, on or before the 15<sup>th</sup> day of any month, an itemized estimate thereof for the succeeding month, together with an invoice for such Working Interest Owner's share thereof. Within thirty (30) days thereafter, each Working Interest Owner shall pay to Unit Operator its respective share of such estimate. Adjustments between estimated and actual Ordinary Unit Expenses shall be made by Unit Operator at the close of each calendar month, and the accounts of Working Interest Owners shall be adjusted accordingly. If a Working Interest Owner fails to advance its respective share of estimated Ordinary Unit Expenses as provided in this Section 11.3, such Working Interest Owner's share of any such advanced billings shall be treated as an item of Unpaid Ordinary Unit Expenses pursuant to Section 11.4.

11.4 Unpaid Ordinary Unit Expenses. If any Working Interest Owner fails or is unable to pay (i) its share of Ordinary Unit Expenses within sixty (60) days after rendition of a statement therefore by Unit Operator, or (ii) its share of advanced billings in accordance with Section 11.3, the unpaid balance shall be paid to Unit Operator by the non-defaulting Working Interest Owners (or by Unit Operator as applicable under Section 11.3) as if it were Ordinary Unit Expenses in the proportion that the Unit Participation of each such non-defaulting Working Interest Owner bears to the total Unit Participation of all such non-defaulting Working Interest Owners. Such unpaid amount shall bear interest at the prime rate set by Chase Manhattan Bank of New York for the same period plus five percent (5%) per annum or the maximum contract rate permitted by applicable usury laws, whichever is the lesser. Working Interest Owners (or Unit Operator, as applicable) so paying the same shall be reimbursed therefor, together with interest thereon, when the amount so carried and the interest thereon are collected from the defaulting Working Interest Owner's share of the sale of Unitized Substances. During the time that any Working Interest Owner fails to pay its share of Ordinary Unit Expenses, the Unit Operator shall be entitled to collect and receive from the purchaser of production, the proceeds from such defaulting Working Interest Owner's share of the sale of Unitized Substances. All credits to any such defaulting Working Interest Owner on account of the sale or disposal of Unit Equipment, or otherwise, shall also be applied against the unpaid share of Ordinary Unit Expenses charged against such defaulting Working Interest Owner until such Working Interest Owner's share of Ordinary Unit Expenses are paid in full, together with any interest accrued thereon.

Notwithstanding the foregoing, Unit Operator shall have the option, but not the obligation, to elect to carry or otherwise finance any defaulting Working Interest Owner(s) in lieu of having all non-defaulting Working Interest Owners participate in the carrying or otherwise financing any defaulting Working Interest Owner(s). Unit Operator upon such election shall be entitled to recovery of the money advanced on behalf of a defaulting Working Interest Owner, plus any additional administrative charges and interest as provided herein.

11.5 Commingling of Funds. No funds received by Unit Operator under this agreement need be segregated or maintained by it as a separate fund, but may be commingled with its own funds.

Operator shall hold for the account of the Non-Operators any funds of the Non-Operators advanced or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the Unit Area, and such funds shall remain the funds of the Non-Operators on whose account they are advanced or paid until used for their intended purpose or otherwise delivered to the Non-Operators or applied toward the payment of debts as provided herein. Nothing in this Agreement shall be construed to establish a fiduciary relationship between Operator and Non-Operators for any purpose other than to account for Non-Operator funds as herein specifically provided. Nothing in this Agreement shall require the maintenance by Operator of separate accounts for the funds of Non-Operators unless the parties otherwise specifically agree.

11.6 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 Unit 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 Unit 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 11.5 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 Unit 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 D", 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 sixty (60) 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 herein, 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 marshaling 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 Unit 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 Unit Area is situated in order to secure the payment to Operator of any sum due hereunder for services performed or materials supplied by Operator.

11.7 Uncommitted Royalty. Should an owner of a Royalty Interest in any Tract fail to become a party to the Unit Agreement, and, as a result thereof, the actual Royalty Interest payments with respect to such Tract are more or less than the Royalty Interest payments computed on the basis of the Unitized Substances that are allocated to such Tract under the Unit Agreement, the difference shall be borne by or inure to the benefit of Working Interest Owners, in proportion to their respective Unit Participations; however, the difference to be borne by or inure to the benefit of Working Interest Owners shall not exceed an amount computed on the basis of one eighth (1/8) of the difference between the Unitized Substances allocated to the Tract and the Unitized Substances produced from the Tract. Such adjustments shall be made by charges and credits to the joint account.

11.8 Non-participating Working Interest Owners. Upon approval by and upon entry of an order of the New Mexico Oil Conservation Division, this Agreement supersedes that certain Unit Operating Agreement Rock Queen Unit, dated October 1, 1959, revised December 1, 1987, as authorized by Article 7, Statutory Unitization Act, §70-7-1. Et seq., N.M.S.A., and governs the relationship of all Working Interest Owners in lands included in the Unit Area. Any Working Interest Owner that does not join in, or ratify this Agreement ("Non-participating Working Interest Owner") shall (a) have no voting rights as to Unit Operations, (b) be deemed non-participating in all Unit operations conducted in accordance with this Agreement, and (c) shall not be entitled to notice of, or to attend meetings of the Working Interest Owners. The ownership interest, and development obligations of each Non-participating Working Interest Owner shall be allocated to the Working Interest Owners executing, or ratifying this Agreement, and costs incurred on behalf of such Non-participating Working Interest Owners may be recouped by those Working Interest Owners from the participation share of proceeds from the sale of oil and gas attributable to the ownership of the Non-participating Working Interest Owners, and such recoupment shall include the actual costs incurred plus two hundred percent (200%) of such costs.

## Article 12 NON-UNITIZED FORMATIONS

12.1 Right to Operate. Any Working Interest Owner that now has or hereafter acquires the right to drill for and produce oil, gas, or other minerals, from other than the Unitized Formation, shall have the right to do so notwithstanding this agreement or the Unit Agreement.

In exercising the right, however, the Working Interest Owner shall exercise reasonable precaution to prevent reasonable interference with Unit Operations. No Working Interest Owner shall produce Unitized Substances through any well drilled or operated by it. If any Working Interest Owner drills any well into or through the Unitized Formation, the Unitized Formation shall be protected in a manner satisfactory to Working Interest Owners so that the production of Unitized Substances will not adversely be affected.

### Article 13 TITLES

13.1 Warranty and Indemnity. Each Working Interest Owner represents and warrants that it is the owner of the respective working interests set forth opposite its name in Exhibit C, and hereby agrees to indemnify and hold harmless the other Working Interest Owners from any loss due to failure, in whole or in part, of its title to any such interest, except failure of title arising out of Unit Operations; provided that, such indemnity shall be limited to an amount equal to the net value that has been received from the sale or receipt of Unitized Substances attributed to the interest as to which title failed. Each failure of title will be deemed to be effective, insofar as this agreement is concerned, as of the first day of the calendar month in which such failure is finally determined, and there shall be no retroactive adjustment of Unit Expenses, or retroactive allocation of Unitized Substances or the proceeds therefrom, as a result of title failure.

13.2 Failure Because of Unit Operations. The failure of title to any Working Interest in any Tract by reason of Unit Operations, including non-production from such Tract, shall not change the Unit Participation of the Working Interest Owner whose title failed in relation to the Unit Participations of the other Working Interest Owners at the time of the title failure.

### Article 14 LIABILITY, CLAIMS, AND SUITS

14.1 Individual Liability. 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 Unit Area. Accordingly, the liens granted among the parties in Article 11.5 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 parties, co-venturers, or principles. In their relations with each other under the 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.

14.2 Settlements. Unit Operator may settle any single damage claim or suit involving Unit Operations but not involving an expenditure in excess of Fifty Thousand and no/100 Dollars (\$50,000.00) provided the payment is in complete settlement of such claim or suit. If the amount

required for settlement exceeds the above specified amount, Working Interest Owners shall assume and take over the further handling of the claim or suit unless such authority is expressly delegated to Unit Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be an item of Unit Expenses. If a claim is made against any Working Interest Owner or if any Working Interest Owner is sued on account of any matter arising from Unit Operations and over which such Working Interest Owner individually has no control because of the rights given Working Interest Owners and Unit Operator by this agreement and the Unit Agreement, the Working Interest Owner shall immediately notify the Unit Operator, and the claim or suit shall be treated as any other claim or suit involving Unit Operations.

## Article 15 INTERNAL REVENUE PROVISION

15.1 Internal Revenue Provision. Each Working Interest Owner hereby elects that it and the operations covered by this agreement be excluded from the application of Subchapter K of chapter I of Subtitle A of the Internal Revenue Code of 1954, or such portion thereof as the Secretary of the Treasury of the United States or his delegate shall permit by election to be excluded therefrom. Unit Operator is hereby authorized and directed to execute on behalf of each Working Interest Owner such additional or further evidence of the election as may be required by regulations issued under said Subchapter K. Should the regulations require each party to execute such further evidence, each Working Interest Owner agrees to execute or join in the execution thereof. The election hereby made and the other provisions of this paragraph shall apply in like manner to applicable state laws, regulations, and rulings now in effect or hereafter enacted that have an effect similar to the federal provisions referred to herein.

## Article 16 NOTICES

16.1 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 17 WITHDRAWAL OF WORKING INTEREST OWNER

17.1 Withdrawal. A Working Interest Owner may withdraw from this agreement by transferring, without warranty of title, either express or implied, to the other Working Interest Owner who do not desire to withdraw, all its Oil and Gas Rights together with its interest in all Unit Equipment and in all wells used in Unit Operation. Such transfer shall not relieve said Working Interest Owner from obligation or liability incurred prior to the date of the delivery of the transfer, which delivery may be made to Unit Operator as Agent for the transferees. The interest transferred shall be owned by the transferees in proportion to their respective Unit Participations. The transferees, in proportion to the respective interests so acquired, shall pay transferor, for its, interest in Unit Equipment, the fair salvage value thereof as estimated and fixed by Working Interest Owners. After the date of delivery of the transfer, the withdrawing Working Interest Owner shall be relieved from all further obligations and liability hereunder and under the Unit Agreement, and the rights of such Working Interest Owner hereunder and under the Unit Agreement shall cease insofar as they existed by virtue of the interest transferred.

#### Article 18 ABANDONMENT OF WELLS

18.1 Rights of Former Owners. If Working Interest Owners decide to abandon permanently any well within the Unit Area prior to termination of the Unit Agreement, Unit Operator shall give written notice thereof to the Working Interest Owners of the Tract on which the well is located, and they shall have the option for a period of ninety (90) days after the sending of such notice to notify Unit Operator in writing of their election to take over and own the well. Within ten (10) days after the Working Interest Owners of the Tract have notified Unit Operator of their election to take over the well, they shall pay Unit Operator, for credit to the joint account, the amount estimated by Working Interest Owners to be the net salvage value of the casing and equipment in and on the well. The Working Interest Owners of the Tract, by taking over the well, agree to seal off effectively and protect the Unitized Formation, and upon abandonment to plug the well in compliance with applicable laws and regulations.

18.2 Plugging. If the Working Interest Owners of a Tract do not elect to take over a well located thereon which is proposed for abandonment, Unit Operator shall plug and abandon the well in compliance with applicable laws and regulations.

#### Article 19 EFFECTIVE DATE AND TERM

19.1 Effective Date. This agreement shall become effective on the date and at the time that the Unit Agreement becomes effective.

19.2 Term. This agreement shall continue in effect so long as the Unit Agreement remains in effect, and thereafter until (a) all unit wells have been abandoned and plugged or turned over to Working Interest Owners in accordance with Article 20, (b) all Unit Equipment and real property acquired for the joint account have been disposed of by Unit Operator in accordance with instructions of Working Interest Owners, and (c) there has been a final accounting.

## Article 20 ABANDONMENT OF OPERATIONS

20.1 Termination. Upon termination of the Unit Agreement, the following will occur:

20.1.1 Oil and Gas Rights. Oil and Gas Rights in and to each separate Tract shall no longer be affected by this agreement, and thereafter the parties shall be governed by the terms and provisions of the leases, contracts, and other instruments affecting the separate Tracts.

20.1.2 Right to Operate. Working Interest Owners of any Tract that desire to take over and continue to operate wells located thereon may do so by paying Unit Operator, for credit to the joint account, the net salvage value of the casing and equipment in and on the wells taken over, as estimated by Working Interest Owners, and by agreeing to plug properly each well at such time as it is abandoned.

20.1.3 Salvaging Wells. Unit Operator shall salvage as much of the casing and equipment in or on wells not taken over by Working Interest Owners of separate Tracts as can economically and reasonably be salvaged, and shall cause the wells to be plugged and abandoned properly.

20.1.4 Cost of Salvaging. Working Interest Owners shall share the cost of salvaging, liquidation or other distribution of assets and properties used in Unit Operation in proportion to their respective Unit Participations.

## Article 21 EXECUTION

21.1 Original Counterpart, or Other Instrument. A party may become a party to this agreement by signing the original of this instrument, a counterpart thereof, or other instrument agreeing to be bound by the provisions hereof. The signing of any such instrument shall have the same effect as if all the parties had signed the same instrument.

## Article 22 SEVERABILITY

22.1 Severability. For the purposes of assuming or rejecting this Agreement as an executory contract pursuant to federal bankruptcy laws, this Agreement shall not be severable, but rather must be assumed or rejected in its entirety, and the failure of any party to this

Agreement to comply with all of its financial obligations provided herein shall be a material default.

Article 23  
SUCCESSORS AND ASSIGNS

23.1 Successors and Assigns. The provisions hereof shall be covenants running with lands, leases, and interests covered hereby, and shall be binding upon and inure to the benefit of the respective heirs, devisees, legal representatives, successors, and assigns of the parties hereto.

IN WITNESS WHEREOF, The parties hereto have executed this agreement on the dates opposite their respective signatures.

UNIT OPERATOR:

Celero Energy II, LP  
By: Celero Energy Holdings II, LLC

By: \_\_\_\_\_  
Name: John E. Lodge, CPL  
Title: Vice President, Land

WORKING INTEREST OWNERS:

Celero Energy II, LP  
By: Celero Energy Holdings II, LLC

By: \_\_\_\_\_  
Name: John E. Lodge, CPL  
Title: Vice President, Land

STATE OF MIDLAND       §  
COUNTY OF MIDLAND   §

This instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 2010, by John E. Lodge, Vice President, of Celero Energy Holdings II, LLC, a Delaware limited Liability Company, General Partner of Celero Energy Celero Energy II, LP, a Delaware limited partnership, on behalf of said partnership.

\_\_\_\_\_  
Notary Public for the  
State of Texas

EXHIBIT "C"  
UNIT OPERATING AGREEMENT  
NORTH CAPROCK CELERO QUEEN UNIT  
LEA AND CHAVES COUNTIES, NEW MEXICO

WORKING INTEREST OWNERS

Celero Energy , II LP  
400 West Illinois Ave., Suite 1601  
Midland, Texas 79701

UNIT INTERESTS

1.000000



## EXHIBIT " D "

### ACCOUNTING PROCEDURE JOINT OPERATIONS

Attached to and made part of that certain the Operating Agreement by and between Celero Energy II, LP

#### I. GENERAL PROVISIONS

IF THE PARTIES FAIL TO SELECT EITHER ONE OF COMPETING "ALTERNATIVE" PROVISIONS, OR SELECT ALL THE COMPETING "ALTERNATIVE" PROVISIONS, ALTERNATIVE 1 IN EACH SUCH INSTANCE SHALL BE DEEMED TO HAVE BEEN ADOPTED BY THE PARTIES AS A RESULT OF ANY SUCH OMISSION OR DUPLICATE NOTATION.

IN THE EVENT THAT ANY "OPTIONAL" PROVISION OF THIS ACCOUNTING PROCEDURE IS NOT ADOPTED BY THE PARTIES TO THE AGREEMENT BY A TYPED, PRINTED OR HANDWRITTEN INDICATION, SUCH PROVISION SHALL NOT FORM A PART OF THIS ACCOUNTING PROCEDURE, AND NO INFERENCE SHALL BE MADE CONCERNING THE INTENT OF THE PARTIES IN SUCH EVENT.

#### I. DEFINITIONS

All terms used in this Accounting Procedure shall have the following meaning, unless otherwise expressly defined in the Agreement:

"Affiliate" means for a person, another person that controls, is controlled by, or is under common control with that person. In this definition, (a) control means the ownership by one person, directly or indirectly, of more than fifty percent (50%) of the voting securities of a corporation or, for other persons, the equivalent ownership interest (such as partnership interests), and (b) "person" means an individual, corporation, partnership, trust, estate, unincorporated organization, association, or other legal entity.

"Agreement" means the operating agreement, farmout agreement, or other contract between the Parties to which this Accounting Procedure is attached.

"Controllable Material" means Material that, at the time of acquisition or disposition by the Joint Account, as applicable, is so classified in the Material Classification Manual most recently recommended by the Council of Petroleum Accountants Societies (COPAS).

"Equalized Freight" means the procedure of charging transportation cost to the Joint Account based upon the distance from the nearest Railway Receiving Point to the property.

"Excluded Amount" means a specified excluded trucking amount most recently recommended by COPAS.

"Field Office" means a structure, or portion of a structure, whether a temporary or permanent installation, the primary function of which is to directly serve daily operation and maintenance activities of the Joint Property and which serves as a staging area for directly chargeable field personnel.

"First Level Supervision" means those employees whose primary function in Joint Operations is the direct oversight of the Operator's field employees and/or contract labor directly employed On-site in a field operating capacity. First Level Supervision functions may include, but are not limited to:

- Responsibility for field employees and contract labor engaged in activities that can include field operations, maintenance, construction, well remedial work, equipment movement and drilling
- Responsibility for day-to-day direct oversight of rig operations
- Responsibility for day-to-day direct oversight of construction operations
- Coordination of job priorities and approval of work procedures
- Responsibility for optimal resource utilization (equipment, Materials, personnel)
- Responsibility for meeting production and field operating expense targets
- Representation of the Parties in local matters involving community, vendors, regulatory agents and landowners, as an incidental part of the supervisor's operating responsibilities
- Responsibility for all emergency responses with field staff
- Responsibility for implementing safety and environmental practices
- Responsibility for field adherence to company policy
- Responsibility for employment decisions and performance appraisals for field personnel
- Oversight of sub-groups for field functions such as electrical, safety, environmental, telecommunications, which may have group or team leaders.

"Joint Account" means the account showing the charges paid and credits received in the conduct of the Joint Operations that are to be shared by the Parties, but does not include proceeds attributable to hydrocarbons and by-products produced under the Agreement.

"Joint Operations" means all operations necessary or proper for the exploration, appraisal, development, production, protection, maintenance, repair, abandonment, and restoration of the Joint Property.

- 1 "Joint Property" means the real and personal property subject to the Agreement.
- 2
- 3 "Laws" means any laws, rules, regulations, decrees, and orders of the United States of America or any state thereof and all other
- 4 governmental bodies, agencies, and other authorities having jurisdiction over or affecting the provisions contained in or the transactions
- 5 contemplated by the Agreement or the Parties and their operations, whether such laws now exist or are hereafter amended, enacted,
- 6 promulgated or issued.
- 7
- 8 "Material" means personal property, equipment, supplies, or consumables acquired or held for use by the Joint Property.
- 9
- 10 "Non-Operators" means the Parties to the Agreement other than the Operator.
- 11
- 12 "Offshore Facilities" means platforms, surface and subsea development and production systems, and other support systems such as oil and
- 13 gas handling facilities, living quarters, offices, shops, cranes, electrical supply equipment and systems, fuel and water storage and piping,
- 14 heliport, marine docking installations, communication facilities, navigation aids, and other similar facilities necessary in the conduct of
- 15 offshore operations, all of which are located offshore.
- 16
- 17 "Off-site" means any location that is not considered On-site as defined in this Accounting Procedure.
- 18
- 19 "On-site" means on the Joint Property when in direct conduct of Joint Operations. The term "On-site" shall also include that portion of
- 20 Offshore Facilities, Shore Base Facilities, fabrication yards, and staging areas from which Joint Operations are conducted, or other
- 21 facilities that directly control equipment on the Joint Property, regardless of whether such facilities are owned by the Joint Account.
- 22
- 23 "Operator" means the Party designated pursuant to the Agreement to conduct the Joint Operations.
- 24
- 25 "Parties" means legal entities signatory to the Agreement or their successors and assigns. Parties shall be referred to individually as
- 26 "Party."
- 27
- 28 "Participating Interest" means the percentage of the costs and risks of conducting an operation under the Agreement that a Party agrees,
- 29 or is otherwise obligated, to pay and bear.
- 30
- 31 "Participating Party" means a Party that approves a proposed operation or otherwise agrees, or becomes liable, to pay and bear a share of
- 32 the costs and risks of conducting an operation under the Agreement.
- 33
- 34 "Personal Expenses" means reimbursed costs for travel and temporary living expenses.
- 35
- 36 "Railway Receiving Point" means the railhead nearest the Joint Property for which freight rates are published, even though an actual
- 37 railhead may not exist.
- 38
- 39 "Shore Base Facilities" means onshore support facilities that during Joint Operations provide such services to the Joint Property as a
- 40 receiving and transshipment point for Materials; debarkation point for drilling and production personnel and services; communication,
- 41 scheduling and dispatching center; and other associated functions serving the Joint Property.
- 42
- 43 "Supply Store" means a recognized source or common stock point for a given Material item.
- 44
- 45 "Technical Services" means services providing specific engineering, geoscience, or other professional skills, such as those performed by
- 46 engineers, geologists, geophysicists, and technicians, required to handle specific operating conditions and problems for the benefit of Joint
- 47 Operations; provided, however, Technical Services shall not include those functions specifically identified as overhead under the second
- 48 paragraph of the introduction of Section III (*Overhead*). Technical Services may be provided by the Operator, Operator's Affiliate, Non-
- 49 Operator, Non-Operator Affiliates, and/or third parties.
- 50

## 51 2. STATEMENTS AND BILLINGS

- 52
- 53 The Operator shall bill Non-Operators on or before the last day of the month for their proportionate share of the Joint Account for the
- 54 preceding month. Such bills shall be accompanied by statements that identify the AFE (authority for expenditure), lease or facility, and all
- 55 charges and credits summarized by appropriate categories of investment and expense. Controllable Material shall be separately identified
- 56 and fully described in detail, or at the Operator's option. Controllable Material may be summarized by major Material classifications.
- 57 Intangible drilling costs, audit adjustments, and unusual charges and credits shall be separately and clearly identified.
- 58
- 59 The Operator may make available to Non-Operators any statements and bills required under Section I.2 and/or Section I.3.A (*Advances*
- 60 *and Payments by the Parties*) via email, electronic data interchange, internet websites or other equivalent electronic media in lieu of paper
- 61 copies. The Operator shall provide the Non-Operators instructions and any necessary information to access and receive the statements and
- 62 bills within the timeframes specified herein. A statement or billing shall be deemed as delivered twenty-four (24) hours (exclusive of
- 63 weekends and holidays) after the Operator notifies the Non-Operator that the statement or billing is available on the website and/or sent via
- 64 email or electronic data interchange transmission. Each Non-Operator individually shall elect to receive statements and billings
- 65 electronically, if available from the Operator, or request paper copies. Such election may be changed upon thirty (30) days prior written
- 66 notice to the Operator.

3. ADVANCES AND PAYMENTS BY THE PARTIES

A. Unless otherwise provided for in the Agreement, the Operator may require the Non-Operators to advance their share of the estimated cash outlay for the succeeding month's operations within fifteen (15) days after receipt of the advance request or by the first day of the month for which the advance is required, whichever is later. The Operator shall adjust each monthly billing to reflect advances received from the Non-Operators for such month. If a refund is due, the Operator shall apply the amount to be refunded to the subsequent month's billing or advance, unless the Non-Operator sends the Operator a written request for a cash refund. The Operator shall remit the refund to the Non-Operator within fifteen (15) days of receipt of such written request.

B. Except as provided below, each Party shall pay its proportionate share of all bills in full within fifteen (15) days of receipt date. If payment is not made within such time, the unpaid balance shall bear interest compounded monthly at the prime rate published by the *Wall Street Journal* on the first day of each month the payment is delinquent, plus three percent (3%), per annum, or the maximum contract rate permitted by the applicable usury Laws governing the Joint Property, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts. If the *Wall Street Journal* ceases to be published or discontinues publishing a prime rate, the unpaid balance shall bear interest compounded monthly at the prime rate published by the Federal Reserve plus three percent (3%), per annum. Interest shall begin accruing on the first day of the month in which the payment was due. Payment shall not be reduced or delayed as a result of inquiries or anticipated credits unless the Operator has agreed. Notwithstanding the foregoing, the Non-Operator may reduce payment, provided it furnishes documentation and explanation to the Operator at the time payment is made, to the extent such reduction is caused by:

- (1) being billed at an incorrect working interest or Participating Interest that is higher than such Non-Operator's actual working interest or Participating Interest, as applicable; or
- (2) being billed for a project or AFE requiring approval of the Parties under the Agreement that the Non-Operator has not approved or is not otherwise obligated to pay under the Agreement; or
- (3) being billed for a property in which the Non-Operator no longer owns a working interest, provided the Non-Operator has furnished the Operator a copy of the recorded assignment or letter in-lieu. Notwithstanding the foregoing, the Non-Operator shall remain responsible for paying bills attributable to the interest it sold or transferred for any bills rendered during the thirty (30) day period following the Operator's receipt of such written notice; or
- (4) charges outside the adjustment period, as provided in Section 1.4 (Adjustments).

4. ADJUSTMENTS

A. Payment of any such bills shall not prejudice the right of any Party to protest or question the correctness thereof; however, all bills and statements, including payout statements, rendered during any calendar year shall conclusively be presumed to be true and correct, with respect only to expenditures, after twenty-four (24) months following the end of any such calendar year, unless within said period a Party takes specific detailed written exception thereto making a claim for adjustment. The Operator shall provide a response to all written exceptions, whether or not contained in an audit report, within the time periods prescribed in Section 1.5 (Expenditure Audits).

B. All adjustments initiated by the Operator, except those described in items (1) through (4) of this Section 1.4.B, are limited to the twenty-four (24) month period following the end of the calendar year in which the original charge appeared or should have appeared on the Operator's Joint Account statement or payout statement. Adjustments that may be made beyond the twenty-four (24) month period are limited to adjustments resulting from the following:

- (1) a physical inventory of Controllable Material as provided for in Section V (Inventories of Controllable Material), or
- (2) an offsetting entry (whether in whole or in part) that is the direct result of a specific joint interest audit exception granted by the Operator relating to another property, or
- (3) a government/regulatory audit, or
- (4) a working interest ownership or Participating Interest adjustment.

5. EXPENDITURE AUDITS

A. A Non-Operator, upon written notice to the Operator and all other Non-Operators, shall have the right to audit the Operator's accounts and records relating to the Joint Account within the twenty-four (24) month period following the end of such calendar year in which such bill was rendered; however, conducting an audit shall not extend the time for the taking of written exception to and the adjustment of accounts as provided for in Section 1.4 (Adjustments). Any Party that is subject to payout accounting under the Agreement shall have the right to audit the accounts and records of the Party responsible for preparing the payout statements, or of the Party furnishing information to the Party responsible for preparing payout statements. Audits of payout accounts may include the volumes of hydrocarbons produced and saved and proceeds received for such hydrocarbons as they pertain to payout accounting required under the Agreement. Unless otherwise provided in the Agreement, audits of a payout account shall be conducted within the twenty-four (24) month period following the end of the calendar year in which the payout statement was rendered.

Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct a joint audit in a manner that will result in a minimum of inconvenience to the Operator. The 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 the Operator, except upon the resignation or removal of the Operator, and shall be made at the expense of

those Non-Operators approving such audit.

The Non-Operator leading the audit (hereinafter "lead audit company") shall issue the audit report within ninety (90) days after completion of the audit testing and analysis; however, the ninety (90) day time period shall not extend the twenty-four (24) month requirement for taking specific detailed written exception as required in Section 1.4.A (*Adjustments*) above. All claims shall be supported with sufficient documentation.

A timely filed written exception or audit report containing written exceptions (hereinafter "written exceptions") shall, with respect to the claims made therein, preclude the Operator from asserting a statute of limitations defense against such claims, and the Operator hereby waives its right to assert any statute of limitations defense against such claims for so long as any Non-Operator continues to comply with the deadlines for resolving exceptions provided in this Accounting Procedure. If the Non-Operators fail to comply with the additional deadlines in Section 1.5.B or 1.5.C, the Operator's waiver of its rights to assert a statute of limitations defense against the claims brought by the Non-Operators shall lapse, and such claims shall then be subject to the applicable statute of limitations, provided that such waiver shall not lapse in the event that the Operator has failed to comply with the deadlines in Section 1.5.B or 1.5.C.

B. The Operator shall provide a written response to all exceptions in an audit report within one hundred eighty (180) days after Operator receives such report. Denied exceptions should be accompanied by a substantive response. If the Operator fails to provide substantive response to an exception within this one hundred eighty (180) day period, the Operator will owe interest on that exception or portion thereof, if ultimately granted, from the date it received the audit report. Interest shall be calculated using the rate set forth in Section 1.3.B (*Advances and Payments by the Parties*).

C. The lead audit company shall reply to the Operator's response to an audit report within ninety (90) days of receipt, and the Operator shall reply to the lead audit company's follow-up response within ninety (90) days of receipt; provided, however, each Non-Operator shall have the right to represent itself if it disagrees with the lead audit company's position or believes the lead audit company is not adequately fulfilling its duties. Unless otherwise provided for in Section 1.5.E, if the Operator fails to provide substantive response to an exception within this ninety (90) day period, the Operator will owe interest on that exception or portion thereof, if ultimately granted, from the date it received the audit report. Interest shall be calculated using the rate set forth in Section 1.3.B (*Advances and Payments by the Parties*).

D. If any Party fails to meet the deadlines in Sections 1.5.B or 1.5.C or if any audit issues are outstanding fifteen (15) months after Operator receives the audit report, the Operator or any Non-Operator participating in the audit has the right to call a resolution meeting, as set forth in this Section 1.5.D or it may invoke the dispute resolution procedures included in the Agreement, if applicable. The meeting will require one month's written notice to the Operator and all Non-Operators participating in the audit. The meeting shall be held at the Operator's office or mutually agreed location, and shall be attended by representatives of the Parties with authority to resolve such outstanding issues. Any Party who fails to attend the resolution meeting shall be bound by any resolution reached at the meeting. The lead audit company will make good faith efforts to coordinate the response and positions of the Non-Operator participants throughout the resolution process; however, each Non-Operator shall have the right to represent itself. Attendees will make good faith efforts to resolve outstanding issues, and each Party will be required to present substantive information supporting its position. A resolution meeting may be held as often as agreed to by the Parties. Issues unresolved at one meeting may be discussed at subsequent meetings until each such issue is resolved.

If the Agreement contains no dispute resolution procedures and the audit issues cannot be resolved by negotiation, the dispute shall be submitted to mediation. In such event, promptly following one Party's written request for mediation, the Parties to the dispute shall choose a mutually acceptable mediator and share the costs of mediation services equally. The Parties shall each have present at the mediation at least one individual who has the authority to settle the dispute. The Parties shall make reasonable efforts to ensure that the mediation commences within sixty (60) days of the date of the mediation request. Notwithstanding the above, any Party may file a lawsuit or complaint (1) if the Parties are unable after reasonable efforts, to commence mediation within sixty (60) days of the date of the mediation request, (2) for statute of limitations reasons, or (3) to seek a preliminary injunction or other provisional judicial relief, if in its sole judgment an injunction or other provisional relief is necessary to avoid irreparable damage or to preserve the status quo. Despite such action, the Parties shall continue to try to resolve the dispute by mediation.

E. ☐ (*Optional Provision – Forfeiture Penalties*)

If the Non-Operators fail to meet the deadline in Section 1.5.C, any unresolved exceptions that were not addressed by the Non-Operators within one (1) year following receipt of the last substantive response of the Operator shall be deemed to have been withdrawn by the Non-Operators. If the Operator fails to meet the deadlines in Section 1.5.B or 1.5.C, any unresolved exceptions that were not addressed by the Operator within one (1) year following receipt of the audit report or receipt of the last substantive response of the Non-Operators, whichever is later, shall be deemed to have been granted by the Operator and adjustments shall be made, without interest, to the Joint Account.

## 6. APPROVAL BY PARTIES

### A. GENERAL MATTERS

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, the

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.

This Section 1.6.A applies to specific situations of limited duration where a Party proposes to change the accounting for charges from that prescribed in this Accounting Procedure. This provision does not apply to amendments to this Accounting Procedure, which are covered by Section 1.6.B.

#### B. AMENDMENTS

If the Agreement to which this Accounting Procedure is attached contains no contrary provisions in regard thereto, this Accounting Procedure can be amended by an affirmative vote of \_\_\_\_\_ (\_\_\_\_\_) or more Parties, one of which is the Operator, having a combined working interest of at least \_\_\_\_\_ percent (\_\_\_\_\_%), which approval shall be binding on all Parties, provided, however, approval of at least one (1) Non-Operator shall be required.

#### C. AFFILIATES

For the purpose of administering the voting procedures of Sections 1.6.A and 1.6.B, if Parties to this Agreement are Affiliates of each other, then such Affiliates shall be combined and treated as a single Party having the combined working interest or Participating Interest of such Affiliates.

For the purposes of administering the voting procedures in Section 1.6.A, if a Non-Operator is an Affiliate of the Operator, votes under Section 1.6.A shall require the majority in interest of the Non-Operator(s) after excluding the interest of the Operator's Affiliate.

### II. DIRECT CHARGES

The Operator shall charge the Joint Account with the following items:

#### 1. RENTALS AND ROYALTIES

Lease rentals and royalties paid by the Operator, on behalf of all Parties, for the Joint Operations.

#### 2. LABOR

A. Salaries and wages, including incentive compensation programs as set forth in COPAS MFI-37 ("Chargeability of Incentive Compensation Programs"), for:

- (1) Operator's field employees directly employed On-site in the conduct of Joint Operations,
- (2) Operator's employees directly employed on Shore Base Facilities, Offshore Facilities, or other facilities serving the Joint Property if such costs are not charged under Section II.6 (*Equipment and Facilities Furnished by Operator*) or are not a function covered under Section III (*Overhead*),
- (3) Operator's employees providing First Level Supervision,
- (4) Operator's employees providing On-site Technical Services for the Joint Property if such charges are excluded from the overhead rates in Section III (*Overhead*),
- (5) Operator's employees providing Off-site Technical Services for the Joint Property if such charges are excluded from the overhead rates in Section III (*Overhead*).

Charges for the Operator's employees identified in Section II.2.A may be made based on the employee's actual salaries and wages, or in lieu thereof, a day rate representing the Operator's average salaries and wages of the employee's specific job category.

Charges for personnel chargeable under this Section II.2.A who are foreign nationals shall not exceed comparable compensation paid to an equivalent U.S. employee pursuant to this Section II.2, unless otherwise approved by the Parties pursuant to Section 1.6.A (*General Matters*).

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 Section II.2.A, excluding severance payments or other termination allowances. Such costs under this Section II.2.B 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 Section II.2.A. 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 that are applicable to costs chargeable to the Joint Account under Sections II.2.A and B.

- 1 D. Personal Expenses of personnel whose salaries and wages are chargeable to the Joint Account under Section II.2.A when the  
2 expenses are incurred in connection with directly chargeable activities.  
3
- 4 E. Reasonable relocation costs incurred in transferring to the Joint Property personnel whose salaries and wages are chargeable to the  
5 Joint Account under Section II.2.A. Notwithstanding the foregoing, relocation costs that result from reorganization or merger of a  
6 Party, or that are for the primary benefit of the Operator, shall not be chargeable to the Joint Account. Extraordinary relocation  
7 costs, such as those incurred as a result of transfers from remote locations, such as Alaska or overseas, shall not be charged to the  
8 Joint Account unless approved by the Parties pursuant to Section I.6.A (*General Matters*).  
9
- 10 F. Training costs as specified in COPAS MFI-35 ("Charging of Training Costs to the Joint Account") for personnel whose salaries and  
11 wages are chargeable under Section II.2.A. This training charge shall include the wages, salaries, training course cost, and Personal  
12 Expenses incurred during the training session. The training cost shall be charged or allocated to the property or properties directly  
13 benefiting from the training. The cost of the training course shall not exceed prevailing commercial rates, where such rates are  
14 available.  
15
- 16 G. Operator's current cost of established plans for employee benefits, as described in COPAS MFI-27 ("Employee Benefits Chargeable  
17 to Joint Operations and Subject to Percentage Limitation"), applicable to the Operator's labor costs chargeable to the Joint Account  
18 under Sections II.2.A and B based on the Operator's actual cost not to exceed the employee benefits limitation percentage most  
19 recently recommended by COPAS.  
20
- 21 H. Award payments to employees, in accordance with COPAS MFI-49 ("Awards to Employees and Contractors") for personnel whose  
22 salaries and wages are chargeable under Section II.2.A.  
23

### 24 3. MATERIAL.

25  
26 Material purchased or furnished by the Operator for use on the Joint Property in the conduct of Joint Operations as provided under Section  
27 IV (*Material Purchases, Transfers, and Dispositions*). Only such Material shall be purchased for or transferred to the Joint Property as  
28 may be required for immediate use or is reasonably practical and consistent with efficient and economical operations. The accumulation  
29 of surplus stocks shall be avoided.  
30

### 31 4. TRANSPORTATION

- 32  
33 A. Transportation of the Operator's, Operator's Affiliate's, or contractor's personnel necessary for Joint Operations.  
34
- 35 B. Transportation of Material between the Joint Property and another property, or from the Operator's warehouse or other storage point  
36 to the Joint Property, shall be charged to the receiving property using one of the methods listed below. Transportation of Material  
37 from the Joint Property to the Operator's warehouse or other storage point shall be paid for by the Joint Property using one of the  
38 methods listed below:  
39
- 40 (1) If the actual trucking charge is less than or equal to the Excluded Amount the Operator may charge actual trucking cost or a  
41 theoretical charge from the Railway Receiving Point to the Joint Property. The basis for the theoretical charge is the per  
42 hundred weight charge plus fuel surcharges from the Railway Receiving Point to the Joint Property. The Operator shall  
43 consistently apply the selected alternative.  
44
- 45 (2) If the actual trucking charge is greater than the Excluded Amount, the Operator shall charge Equalized Freight. Accessorial  
46 charges such as loading and unloading costs, split pick-up costs, detention, call out charges, and permit fees shall be charged  
47 directly to the Joint Property and shall not be included when calculating the Equalized Freight.  
48

### 49 5. SERVICES

50  
51 The cost of contract services, equipment, and utilities used in the conduct of Joint Operations, except for contract services, equipment, and  
52 utilities covered by Section III (*Overhead*), or Section II.7 (*Affiliates*), or excluded under Section II.9 (*Legal Expense*). Awards paid to  
53 contractors shall be chargeable pursuant to COPAS MFI-49 ("Awards to Employees and Contractors").  
54

55 The costs of third party Technical Services are chargeable to the extent excluded from the overhead rates under Section III (*Overhead*).  
56

### 57 6. EQUIPMENT AND FACILITIES FURNISHED BY OPERATOR

58  
59 In the absence of a separately negotiated agreement, equipment and facilities furnished by the Operator will be charged as follows:  
60

- 61 A. The Operator shall charge the Joint Account for use of Operator-owned equipment and facilities, including but not limited to  
62 production facilities, Shore Base Facilities, Offshore Facilities, and Field Offices, at rates commensurate with the costs of ownership  
63 and operation. The cost of Field Offices shall be chargeable to the extent the Field Offices provide direct service to personnel who  
64 are chargeable pursuant to Section II.2.A (*Labor*). Such rates may include labor, maintenance, repairs, other operating expense,  
65 insurance, taxes, depreciation using straight line depreciation method, and interest on gross investment less accumulated depreciation  
66 not to exceed        per annum; provided, however, depreciation shall not be charged when the  
the prime rate posted at Wells Fargo Bank plus 1%

equipment and facilities investment have been fully depreciated. The rate may include an element of the estimated cost for abandonment, reclamation, and dismantlement. Such rates shall not exceed the average commercial rates currently prevailing in the immediate area of the Joint Property.

- B. In lieu of charges in Section II.6.A above, the Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property, less twenty percent (20%). If equipment and facilities are charged under this Section II.6.B, the Operator shall adequately document and support commercial rates and shall periodically review and update the rate and the supporting documentation. For automotive equipment, the Operator may elect to use rates published by the Petroleum Motor Transport Association (PMTA) or such other organization recognized by COPAS as the official source of rates.

## 7. AFFILIATES

- A. Charges for an Affiliate's goods and/or services used in operations requiring an AFE or other authorization from the Non-Operators may be made without the approval of the Parties provided (i) the Affiliate is identified and the Affiliate goods and services are specifically detailed in the approved AFE or other authorization, and (ii) the total costs for such Affiliate's goods and services billed to such individual project do not exceed \$ 25,000. If the total costs for an Affiliate's goods and services charged to such individual project are not specifically detailed in the approved AFE or authorization or exceed such amount, charges for such Affiliate shall require approval of the Parties, pursuant to Section I.6.A (*General Matters*).

- B. For an Affiliate's goods and/or services used in operations not requiring an AFE or other authorization from the Non-Operators, charges for such Affiliate's goods and services shall require approval of the Parties, pursuant to Section I.6.A (*General Matters*), if the charges exceed \$ 100,000 in a given calendar year.

- C. The cost of the Affiliate's goods or services shall not exceed average commercial rates prevailing in the area of the Joint Property, unless the Operator obtains the Non-Operators' approval of such rates. The Operator shall adequately document and support commercial rates and shall periodically review and update the rate and the supporting documentation; provided, however, documentation of commercial rates shall not be required if the Operator obtains Non-Operator approval of its Affiliate's rates or charges prior to billing Non-Operators for such Affiliate's goods and services. Notwithstanding the foregoing, direct charges for Affiliate-owned communication facilities or systems shall be made pursuant to Section II.12 (*Communications*).

If the Parties fail to designate an amount in Sections II.7.A or II.7.B, in each instance the amount deemed adopted by the Parties as a result of such omission shall be the amount established as the Operator's expenditure limitation in the Agreement. If the Agreement does not contain an Operator's expenditure limitation, the amount deemed adopted by the Parties as a result of such omission shall be zero dollars (\$ 0.00).

## 8. DAMAGES AND LOSSES TO JOINT PROPERTY

All costs or expenses necessary for the repair or replacement of Joint Property resulting from damages or losses incurred, except to the extent such damages or losses result from a Party's or Parties' gross negligence or willful misconduct, in which case such Party or Parties shall be solely liable.

The Operator shall furnish the Non-Operator written notice of damages or losses incurred as soon as practicable after a report has been received by the Operator.

## 9. LEGAL EXPENSE

Recording fees and costs of handling, settling, or otherwise discharging litigation, claims, and liens incurred in or resulting from operations under the Agreement, or necessary to protect or recover the Joint Property, to the extent permitted under the Agreement. Costs of the Operator's or Affiliate's legal staff or outside attorneys, including fees and expenses, are not chargeable unless approved by the Parties pursuant to Section I.6.A (*General Matters*) or otherwise provided for in the Agreement.

Notwithstanding the foregoing paragraph, costs for procuring abstracts, fees paid to outside attorneys for title examinations (including preliminary, supplemental, shut-in royalty opinions, division order title opinions), and curative work shall be chargeable to the extent permitted as a direct charge in the Agreement.

## 10. TAXES AND PERMITS

All taxes and permitting fees of every kind and nature, assessed or levied upon or in connection with the Joint Property, or the production therefrom, and which have been paid by the Operator for the benefit of the Parties, including penalties and interest, except to the extent the penalties and interest result from the Operator's gross negligence or willful misconduct.

If ad valorem taxes paid by the Operator are based in whole or in part upon separate valuations of each Party's working interest, then notwithstanding any contrary provisions, the charges to the Parties will be made in accordance with the tax value generated by each Party's working interest.

Costs of tax consultants or advisors, the Operator's employees, or Operator's Affiliate employees in matters regarding ad valorem or other tax matters, are not permitted as direct charges unless approved by the Parties pursuant to Section I.6.A (*General Matters*).

Charges to the Joint Account resulting from sales/use tax audits, including extrapolated amounts and penalties and interest, are permitted, provided the Non-Operator shall be allowed to review the invoices and other underlying source documents which served as the basis for tax charges and to determine that the correct amount of taxes were charged to the Joint Account. If the Non-Operator is not permitted to review such documentation, the sales/use tax amount shall not be directly charged unless the Operator can conclusively document the amount owed by the Joint Account.

#### 11. INSURANCE

Net premiums paid for insurance required to be carried for Joint Operations for the protection of the Parties. If Joint Operations are conducted at locations where the Operator acts as self-insurer in regard to its worker's compensation and employer's liability insurance obligation, the Operator shall charge the Joint Account manual rates for the risk assumed in its self-insurance program as regulated by the jurisdiction governing the Joint Property. In the case of offshore operations in federal waters, the manual rates of the adjacent state shall be used for personnel performing work On-site, and such rates shall be adjusted for offshore operations by the U.S. Longshoreman and Harbor Workers (USL&H) or Jones Act surcharge, as appropriate.

#### 12. COMMUNICATIONS

Costs of acquiring, leasing, installing, operating, repairing, and maintaining communication facilities or systems, including satellite, radio and microwave facilities, between the Joint Property and the Operator's office(s) directly responsible for field operations in accordance with the provisions of COPAS MFI-44 ("Field Computer and Communication Systems"). If the communications facilities or systems serving the Joint Property are Operator-owned, charges to the Joint Account shall be made as provided in Section II.6 (*Equipment and Facilities Furnished by Operator*). If the communication facilities or systems serving the Joint Property are owned by the Operator's Affiliate, charges to the Joint Account shall not exceed average commercial rates prevailing in the area of the Joint Property. The Operator shall adequately document and support commercial rates and shall periodically review and update the rate and the supporting documentation.

#### 13. ECOLOGICAL, ENVIRONMENTAL, AND SAFETY

Costs incurred for Technical Services and drafting to comply with ecological, environmental and safety Laws or standards recommended by Occupational Safety and Health Administration (OSHA) or other regulatory authorities. All other labor and functions incurred for ecological, environmental and safety matters, including management, administration, and permitting, shall be covered by Sections II.2 (*Labor*), II.5 (*Services*), or Section III (*Overhead*), as applicable.

Costs to provide or have available pollution containment and removal equipment plus actual costs of control and cleanup and resulting responsibilities of oil and other spills as well as discharges from permitted outfalls as required by applicable Laws, or other pollution containment and removal equipment deemed appropriate by the Operator for prudent operations, are directly chargeable.

#### 14. ABANDONMENT AND RECLAMATION

Costs incurred for abandonment and reclamation of the Joint Property, including costs required by lease agreements or by Laws.

#### 15. OTHER EXPENDITURES

Any other expenditure not covered or dealt with in the foregoing provisions of this Section II (*Direct Charges*), or in Section III (*Overhead*) 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. Charges made under this Section II.15 shall require approval of the Parties, pursuant to Section I.6.A (*General Matters*).

### III. OVERHEAD

As compensation for costs not specifically identified as chargeable to the Joint Account pursuant to Section II (*Direct Charges*), the Operator shall charge the Joint Account in accordance with this Section III.

Functions included in the overhead rates regardless of whether performed by the Operator, Operator's Affiliates or third parties and regardless of location, shall include, but not be limited to, costs and expenses of:

- warehousing, other than for warehouses that are jointly owned under this Agreement
- design and drafting (except when allowed as a direct charge under Sections II.13, III.1.A(ii), and III.2, Option B)
- inventory costs not chargeable under Section V (*Inventories of Controllable Material*)
- procurement
- administration
- accounting and auditing
- gas dispatching and gas chart integration



- 1 • human resources
- 2 • management
- 3 • supervision not directly charged under Section II.2 (*Labor*)
- 4 • legal services not directly chargeable under Section II.9 (*Legal Expense*)
- 5 • taxation, other than those costs identified as directly chargeable under Section II.10 (*Taxes and Permits*)
- 6 • preparation and monitoring of permits and certifications; preparing regulatory reports; appearances before or meetings with
- 7 governmental agencies or other authorities having jurisdiction over the Joint Property, other than On-site inspections; reviewing,
- 8 interpreting, or submitting comments on or lobbying with respect to Laws or proposed Laws.
- 9

10 Overhead charges shall include the salaries or wages plus applicable payroll burdens, benefits, and Personal Expenses of personnel performing

11 overhead functions, as well as office and other related expenses of overhead functions.

12

### 13 I. OVERHEAD—DRILLING AND PRODUCING OPERATIONS

14

15 As compensation for costs incurred but not chargeable under Section II (*Direct Charges*) and not covered by other provisions of this

16 Section III, the Operator shall charge on either:

17

- 18 ☒ (Alternative 1) Fixed Rate Basis, Section III.1.B.
- 19 ☐ (Alternative 2) Percentage Basis, Section III.1.C.
- 20

#### 21 A. TECHNICAL SERVICES

22

- 23 (i) Except as otherwise provided in Section II.13 (*Ecological, Environmental, and Safety*) and Section III.2 (*Overhead – Major*
- 24 *Construction and Catastrophe*), or by approval of the Parties pursuant to Section I.6.A (*General Matters*), the salaries, wages,
- 25 related payroll burdens and benefits, and Personal Expenses for On-site Technical Services, including third party Technical
- 26 Services:

27 ☒ (Alternative 1 – Direct) shall be charged direct to the Joint Account.

28 ☐ (Alternative 2 – Overhead) shall be covered by the overhead rates.

29

- 30
- 31
- 32 (ii) Except as otherwise provided in Section II.13 (*Ecological, Environmental, and Safety*) and Section III.2 (*Overhead – Major*
- 33 *Construction and Catastrophe*), or by approval of the Parties pursuant to Section I.6.A (*General Matters*), the salaries, wages,
- 34 related payroll burdens and benefits, and Personal Expenses for Off-site Technical Services, including third party Technical
- 35 Services:

36 ☒ (Alternative 1 – All Overhead) shall be covered by the overhead rates.

37 ☐ (Alternative 2 – All Direct) shall be charged direct to the Joint Account.

38

39 ☐ (Alternative 3 – Drilling Direct) shall be charged direct to the Joint Account, only to the extent such Technical Services

40 are directly attributable to drilling, redrilling, deepening, or sidetracking operations, through completion, temporary

41 abandonment, or abandonment if a dry hole. Off-site Technical Services for all other operations, including workover,

42 recompletion, abandonment of producing wells, and the construction or expansion of fixed assets not covered by Section

43 III.2 (*Overhead – Major Construction and Catastrophe*) shall be covered by the overhead rates.

44

45 Notwithstanding anything to the contrary in this Section III, Technical Services provided by Operator's Affiliates are subject to limitations

46 set forth in Section II.7 (*Affiliates*). Charges for Technical personnel performing non-technical work shall not be governed by this Section

47 III.1.A, but instead governed by other provisions of this Accounting Procedure relating to the type of work being performed.

48

#### 49 B. OVERHEAD—FIXED RATE BASIS

50

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

52 Drilling Well Rate per month \$ 5000.00 (prorated for less than a full month)

53 Producing Well Rate per month \$ 500.00

54

- 55 (2) Application of Overhead—Drilling Well Rate shall be as follows:
- 56

- 57 (a) Charges for onshore drilling wells shall begin on the spud date and terminate on the date the drilling and/or completion
- 58 equipment used on the well is released, whichever occurs later. Charges for offshore and inland waters drilling wells shall
- 59 begin on the date the drilling or completion equipment arrives on location and terminate on the date the drilling or completion
- 60 equipment moves off location, or is released, whichever occurs first. No charge shall be made during suspension of drilling
- 61 and/or completion operations for fifteen (15) or more consecutive calendar days.
- 62
- 63
- 64
- 65
- 66

- 1 (b) Charges for any well undergoing any type of workover, recompletion, and/or abandonment for a period of five (5) or more  
2 consecutive work-days shall be made at the Drilling Well Rate. Such charges shall be applied for the period from date  
3 operations, with rig or other units used in operations, commence through date of rig or other unit release, except that no charges  
4 shall be made during suspension of operations for fifteen (15) or more consecutive calendar days.  
5
- 6 (3) Application of Overhead—Producing Well Rate shall be as follows:  
7
- 8 (a) An active well that is produced, injected into for recovery or disposal, or used to obtain water supply to support operations for  
9 any portion of the month shall be considered as a one-well charge for the entire month.  
10
- 11 (b) Each active completion in a multi-completed well shall be considered as a one-well charge provided each completion is  
12 considered a separate well by the governing regulatory authority.  
13
- 14 (c) A one-well charge shall be made for the month in which plugging and abandonment operations are completed on any well,  
15 unless the Drilling Well Rate applies, as provided in Sections III.1.B.(2)(a) or (b). This one-well charge shall be made whether  
16 or not the well has produced.  
17
- 18 (d) An active gas well shut in because of overproduction or failure of a purchaser, processor, or transporter to take production shall  
19 be considered as a one-well charge provided the gas well is directly connected to a permanent sales outlet.  
20
- 21 (e) Any well not meeting the criteria set forth in Sections III.1.B.(3) (a), (b), (c), or (d) shall not qualify for a producing overhead  
22 charge.  
23
- 24 (4) The well rates shall be adjusted on the first day of April each year following the effective date of the Agreement; provided,  
25 however, if this Accounting Procedure is attached to or otherwise governing the payout accounting under a farmout agreement, the  
26 rates shall be adjusted on the first day of April each year following the effective date of such farmout agreement. The adjustment  
27 shall be computed by applying the adjustment factor most recently published by COPAS. The adjusted rates shall be the initial or  
28 amended rates agreed to by the Parties increased or decreased by the adjustment factor described herein, for each year from the  
29 effective date of such rates, in accordance with COPAS MFI-47 ("Adjustment of Overhead Rates").  
30

## 31 32 **2. OVERHEAD—MAJOR CONSTRUCTION AND CATASTROPHE** 33

34 To compensate the Operator for overhead costs incurred in connection with a Major Construction project or Catastrophe, the Operator  
35 shall either negotiate a rate prior to the beginning of the project, or shall charge the Joint Account for overhead based on the following  
36 rates for any Major Construction project in excess of the Operator's expenditure limit under the Agreement, or for any Catastrophe  
37 regardless of the amount. If the Agreement to which this Accounting Procedure is attached does not contain an expenditure limit, Major  
38 Construction Overhead shall be assessed for any single Major Construction project costing in excess of \$100,000 gross.  
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1 Major Construction shall mean the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly  
2 discernible as a fixed asset required for the development and operation of the Joint Property, or in the dismantlement, abandonment,  
3 removal, and restoration of platforms, production equipment, and other operating facilities.

4  
5 Catastrophe is defined as a sudden calamitous event bringing damage, loss, or destruction to property or the environment, such as an oil  
6 spill, blowout, explosion, fire, storm, hurricane, or other disaster. The overhead rate shall be applied to those costs necessary to restore the  
7 Joint Property to the equivalent condition that existed prior to the event.

8  
9 A. If the Operator absorbs the engineering, design and drafting costs related to the project:

10  
11 (1) 5 % of total costs if such costs are less than \$100,000; plus

12  
13 (2) 3 % of total costs in excess of \$100,000 but less than \$1,000,000; plus

14  
15 (3) 2 % of total costs in excess of \$1,000,000.

16  
17 B. If the Operator charges engineering, design and drafting costs related to the project directly to the Joint Account:

18  
19 (1) 5 % of total costs if such costs are less than \$100,000; plus

20  
21 (2) 3 % of total costs in excess of \$100,000 but less than \$1,000,000; plus

22  
23 (3) 2 % of total costs in excess of \$1,000,000.

24  
25 Total cost shall mean the gross cost of any one project. For the purpose of this paragraph, the component parts of a single Major  
26 Construction project shall not be treated separately, and the cost of drilling and workover wells and purchasing and installing pumping  
27 units and downhole artificial lift equipment shall be excluded. For Catastrophes, the rates shall be applied to all costs associated with each  
28 single occurrence or event.

29  
30 On each project, the Operator shall advise the Non-Operator(s) in advance which of the above options shall apply.

31  
32 For the purposes of calculating Catastrophe Overhead, the cost of drilling relief wells, substitute wells, or conducting other well operations  
33 directly resulting from the catastrophic event shall be included. Expenditures to which these rates apply shall not be reduced by salvage or  
34 insurance recoveries. Expenditures that qualify for Major Construction or Catastrophe Overhead shall not qualify for overhead under any  
35 other overhead provisions.

36  
37 In the event of any conflict between the provisions of this Section III.2 and the provisions of Sections II.2 (*Labor*), II.5 (*Services*), or II.7  
38 (*Affiliates*), the provisions of this Section III.2 shall govern.

### 39 40 3. AMENDMENT OF OVERHEAD RATES

41  
42 The overhead rates provided for in this Section III may be amended from time to time if, in practice, the rates are found to be insufficient  
43 or excessive, in accordance with the provisions of Section I.6.B (*Amendments*).

## 44 45 46 IV. MATERIAL PURCHASES, TRANSFERS, AND DISPOSITIONS

47  
48 The Operator is responsible for Joint Account Material and shall make proper and timely charges and credits for direct purchases, transfers, and  
49 dispositions. The Operator shall provide all Material for use in the conduct of Joint Operations; however, Material may be supplied by the Non-  
50 Operators, at the Operator's option. Material furnished by any Party shall be furnished without any express or implied warranties as to quality,  
51 fitness for use, or any other matter.

### 52 53 1. DIRECT PURCHASES

54  
55 Direct purchases shall be charged to the Joint Account at the price paid by the Operator after deduction of all discounts received. The  
56 Operator shall make good faith efforts to take discounts offered by suppliers, but shall not be liable for failure to take discounts except to  
57 the extent such failure was the result of the Operator's gross negligence or willful misconduct. A direct purchase shall be deemed to occur  
58 when an agreement is made between an Operator and a third party for the acquisition of Material for a specific well site or location.  
59 Material provided by the Operator under "vendor stocking programs," where the initial use is for a Joint Property and title of the Material  
60 does not pass from the manufacturer, distributor, or agent until usage, is considered a direct purchase. If Material is found to be defective  
61 or is returned to the manufacturer, distributor, or agent for any other reason, credit shall be passed to the Joint Account within sixty (60)  
62 days after the Operator has received adjustment from the manufacturer, distributor, or agent.

## 2. TRANSFERS

A transfer is determined to occur when the Operator (i) furnishes Material from a storage facility or from another operated property, (ii) has assumed liability for the storage costs and changes in value, and (iii) has previously secured and held title to the transferred Material. Similarly, the removal of Material from the Joint Property to a storage facility or to another operated property is also considered a transfer; provided, however, Material that is moved from the Joint Property to a storage location for safe-keeping pending disposition may remain charged to the Joint Account and is not considered a transfer. Material shall be disposed of in accordance with Section IV.3 (*Disposition of Surplus*) and the Agreement to which this Accounting Procedure is attached.

### A. PRICING

The value of Material transferred to/from the Joint Property should generally reflect the market value on the date of physical transfer. Regardless of the pricing method used, the Operator shall make available to the Non-Operators sufficient documentation to verify the Material valuation. When higher than specification grade or size tubulars are used in the conduct of Joint Operations, the Operator shall charge the Joint Account at the equivalent price for well design specification tubulars, unless such higher specification grade or sized tubulars are approved by the Parties pursuant to Section 1.6.A (*General Matters*). Transfers of new Material will be priced using one of the following pricing methods; provided, however, the Operator shall use consistent pricing methods, and not alternate between methods for the purpose of choosing the method most favorable to the Operator for a specific transfer:

- (1) Using published prices in effect on date of movement as adjusted by the appropriate COPAS Historical Price Multiplier (HPM) or prices provided by the COPAS Computerized Equipment Pricing System (CEPS).
  - (a) For oil country tubulars and line pipe, the published price shall be based upon eastern mill carload base prices (Houston, Texas, for special end) adjusted as of date of movement, plus transportation cost as defined in Section IV.2.B (*Freight*).
  - (b) For other Material, the published price shall be the published list price in effect at date of movement, as listed by a Supply Store nearest the Joint Property where like Material is normally available, or point of manufacture plus transportation costs as defined in Section IV.2.B (*Freight*).
- (2) Based on a price quotation from a vendor that reflects a current realistic acquisition cost.
- (3) Based on the amount paid by the Operator for like Material in the vicinity of the Joint Property within the previous twelve (12) months from the date of physical transfer.
- (4) As agreed to by the Participating Parties for Material being transferred to the Joint Property, and by the Parties owning the Material for Material being transferred from the Joint Property.

### B. FREIGHT

Transportation costs shall be added to the Material transfer price using the method prescribed by the COPAS Computerized Equipment Pricing System (CEPS). If not using CEPS, transportation costs shall be calculated as follows:

- (1) Transportation costs for oil country tubulars and line pipe shall be calculated using the distance from eastern mill to the Railway Receiving Point based on the carload weight basis as recommended by the COPAS MFI-38 ("Material Pricing Manual") and other COPAS MFIs in effect at the time of the transfer.
- (2) Transportation costs for special mill items shall be calculated from that mill's shipping point to the Railway Receiving Point. For transportation costs from other than eastern mills, the 30,000-pound interstate truck rate shall be used. Transportation costs for macaroni tubing shall be calculated based on the interstate truck rate per weight of tubing transferred to the Railway Receiving Point.
- (3) Transportation costs for special end tubular goods shall be calculated using the interstate truck rate from Houston, Texas, to the Railway Receiving Point.
- (4) Transportation costs for Material other than that described in Sections IV.2.B.(1) through (3), shall be calculated from the Supply Store or point of manufacture, whichever is appropriate, to the Railway Receiving Point.

Regardless of whether using CEPS or manually calculating transportation costs, transportation costs from the Railway Receiving Point to the Joint Property are in addition to the foregoing, and may be charged to the Joint Account based on actual costs incurred. All transportation costs are subject to Equalized Freight as provided in Section II.4 (*Transportation*) of this Accounting Procedure.

### C. TAXES

Sales and use taxes shall be added to the Material transfer price using either the method contained in the COPAS Computerized Equipment Pricing System (CEPS) or the applicable tax rate in effect for the Joint Property at the time and place of transfer. In either case, the Joint Account shall be charged or credited at the rate that would have governed had the Material been a direct purchase.

D. CONDITION

(1) Condition "A" – New and unused Material in sound and serviceable condition shall be charged at one hundred percent (100%) of the price as determined in Sections IV.2.A (*Pricing*), IV.2.B (*Freight*), and IV.2.C (*Taxes*). Material transferred from the Joint Property that was not placed in service shall be credited as charged without gain or loss; provided, however, any unused Material that was charged to the Joint Account through a direct purchase will be credited to the Joint Account at the original cost paid less restocking fees charged by the vendor. New and unused Material transferred from the Joint Property may be credited at a price other than the price originally charged to the Joint Account provided such price is approved by the Parties owning such Material, pursuant to Section 1.6.A (*General Matters*). All refurbishing costs required or necessary to return the Material to original condition or to correct handling, transportation, or other damages will be borne by the divesting property. The Joint Account is responsible for Material preparation, handling, and transportation costs for new and unused Material charged to the Joint Property either through a direct purchase or transfer. Any preparation costs incurred, including any internal or external coating and wrapping, will be credited on new Material provided these services were not repeated for such Material for the receiving property.

(2) Condition "B" – Used Material in sound and serviceable condition and suitable for reuse without reconditioning shall be priced by multiplying the price determined in Sections IV.2.A (*Pricing*), IV.2.B (*Freight*), and IV.2.C (*Taxes*) by seventy-five percent (75%).

Except as provided in Section IV.2.D(3), all reconditioning costs required to return the Material to Condition "B" or to correct handling, transportation or other damages will be borne by the divesting property.

If the Material was originally charged to the Joint Account as used Material and placed in service for the Joint Property, the Material will be credited at the price determined in Sections IV.2.A (*Pricing*), IV.2.B (*Freight*), and IV.2.C (*Taxes*) multiplied by sixty-five percent (65%).

Unless otherwise agreed to by the Parties that paid for such Material, used Material transferred from the Joint Property that was not placed in service on the property shall be credited as charged without gain or loss.

(3) Condition "C" – Material that is not in sound and serviceable condition and not suitable for its original function until after reconditioning shall be priced by multiplying the price determined in Sections IV.2.A (*Pricing*), IV.2.B (*Freight*), and IV.2.C (*Taxes*) by fifty percent (50%).

The cost of reconditioning may be charged to the receiving property to the extent Condition "C" value, plus cost of reconditioning, does not exceed Condition "B" value.

(4) Condition "D" – Material that (i) is no longer suitable for its original purpose but useable for some other purpose, (ii) is obsolete, or (iii) does not meet original specifications but still has value and can be used in other applications as a substitute for items with different specifications, is considered Condition "D" Material. 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. 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. For other items, the price used should result in the Joint Account being charged or credited with the value of the service rendered or use of the Material, or as agreed to by the Parties pursuant to Section 1.6.A (*General Matters*).

(5) Condition "E" – Junk shall be priced at prevailing scrap value prices.

E. OTHER PRICING PROVISIONS

(1) Preparation Costs

Subject to Section II (*Direct Charges*) and Section III (*Overhead*) of this Accounting Procedure, costs incurred by the Operator in making Material serviceable including inspection, third party surveillance services, and other similar services will be charged to the Joint Account at prices which reflect the Operator's actual costs of the services. Documentation must be provided to the Non-Operators upon request to support the cost of service. New coating and/or wrapping shall be considered a component of the Materials and priced in accordance with Sections IV.1 (*Direct Purchases*) or IV.2.A (*Pricing*), as applicable. No charges or credits shall be made for used coating or wrapping. Charges and credits for inspections shall be made in accordance with COPAS MFI-38 ("Material Pricing Manual").

(2) Loading and Unloading Costs

Loading and unloading costs related to the movement of the Material to the Joint Property shall be charged in accordance with the methods specified in COPAS MFI-38 ("Material Pricing Manual").

1 **3. DISPOSITION OF SURPLUS**

2

3 Surplus Material is that Material, whether new or used, that is no longer required for Joint Operations. The Operator may purchase, but  
4 shall be under no obligation to purchase, the interest of the Non-Operators in surplus Material.

5

6 Dispositions for the purpose of this procedure are considered to be the relinquishment of title of the Material from the Joint Property to  
7 either a third party, a Non-Operator, or to the Operator. To avoid the accumulation of surplus Material, the Operator should make good  
8 faith efforts to dispose of surplus within twelve (12) months through buy/sale agreements, trade, sale to a third party, division in kind, or  
9 other dispositions as agreed to by the Parties.

10

11 Disposal of surplus Materials shall be made in accordance with the terms of the Agreement to which this Accounting Procedure is  
12 attached. If the Agreement contains no provisions governing disposal of surplus Material, the following terms shall apply:

13

14 • The Operator may, through a sale to an unrelated third party or entity, dispose of surplus Material having a gross sale value that  
15 is less than or equal to the Operator's expenditure limit as set forth in the Agreement to which this Accounting Procedure is  
16 attached without the prior approval of the Parties owning such Material.

17

18 • If the gross sale value exceeds the Agreement expenditure limit, the disposal must be agreed to by the Parties owning such  
19 Material.

20

21 • Operator may purchase surplus Condition "A" or "B" Material without approval of the Parties owning such Material, based on  
22 the pricing methods set forth in Section IV.2 (*Transfers*).

23

24 • Operator may purchase Condition "C" Material without prior approval of the Parties owning such Material if the value of the  
25 Materials, based on the pricing methods set forth in Section IV.2 (*Transfers*), is less than or equal to the Operator's expenditure  
26 limitation set forth in the Agreement. The Operator shall provide documentation supporting the classification of the Material as  
27 Condition C.

28

29 • Operator may dispose of Condition "D" or "E" Material under procedures normally utilized by Operator without prior approval  
30 of the Parties owning such Material.

31

32 **4. SPECIAL PRICING PROVISIONS**

33

34 **A. PREMIUM PRICING**

35

36 Whenever Material is available only at inflated prices due to national emergencies, strikes, government imposed foreign trade  
37 restrictions, or other unusual causes over which the Operator has no control, for direct purchase the Operator may charge the Joint  
38 Account for the required Material at the Operator's actual cost incurred in providing such Material, making it suitable for use, and  
39 moving it to the Joint Property. Material transferred or disposed of during premium pricing situations shall be valued in accordance  
40 with Section IV.2 (*Transfers*) or Section IV.3 (*Disposition of Surplus*), as applicable.

41

42 **B. SHOP-MADE ITEMS**

43

44 Items fabricated by the Operator's employees, or by contract laborers under the direction of the Operator, shall be priced using the  
45 value of the Material used to construct the item plus the cost of labor to fabricate the item. If the Material is from the Operator's  
46 scrap or junk account, the Material shall be priced at either twenty-five percent (25%) of the current price as determined in Section  
47 IV.2.A (*Pricing*) or scrap value, whichever is higher. In no event shall the amount charged exceed the value of the item  
48 commensurate with its use.

49

50 **C. MILL REJECTS**

51

52 Mill rejects purchased as "limited service" casing or tubing shall be priced at eighty percent (80%) of K-55/J-55 price as determined in  
53 Section IV.2 (*Transfers*). Line pipe converted to casing or tubing with casing or tubing couplings attached shall be priced as K-55/J-  
54 55 casing or tubing at the nearest size and weight.

55

56

57

**V. INVENTORIES OF CONTROLLABLE MATERIAL**

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59

60 The Operator shall maintain records of Controllable Material charged to the Joint Account, with sufficient detail to perform physical inventories.

61

62 Adjustments to the Joint Account by the Operator resulting from a physical inventory of Controllable Material shall be made within twelve (12)  
63 months following the taking of the inventory or receipt of Non-Operator inventory report. Charges and credits for overages or shortages will be  
64 valued for the Joint Account in accordance with Section IV.2 (*Transfers*) and shall be based on the Condition "B" prices in effect on the date of  
65 physical inventory unless the inventorying Parties can provide sufficient evidence another Material condition applies.

66

1 1. DIRECTED INVENTORIES

2  
3 Physical inventories shall be performed by the Operator upon written request of a majority in working interests of the Non-Operators  
4 (hereinafter, "directed inventory"); provided, however, the Operator shall not be required to perform directed inventories more frequently  
5 than once every five (5) years. Directed inventories shall be commenced within one hundred eighty (180) days after the Operator receives  
6 written notice that a majority in interest of the Non-Operators has requested the inventory. All Parties shall be governed by the results of  
7 any directed inventory.

8  
9 Expenses of directed inventories will be borne by the Joint Account; provided, however, costs associated with any post-report follow-up  
10 work in settling the inventory will be absorbed by the Party incurring such costs. The Operator is expected to exercise judgment in keeping  
11 expenses within reasonable limits. Any anticipated disproportionate or extraordinary costs should be discussed and agreed upon prior to  
12 commencement of the inventory. Expenses of directed inventories may include the following:

- 13  
14 A. A per diem rate for each inventory person, representative of actual salaries, wages, and payroll burdens and benefits of the personnel  
15 performing the inventory or a rate agreed to by the Parties pursuant to Section 1.6.A (*General Matters*). The per diem rate shall also  
16 be applied to a reasonable number of days for pre-inventory work and report preparation.  
17  
18 B. Actual transportation costs and Personal Expenses for the inventory team.  
19  
20 C. Reasonable charges for report preparation and distribution to the Non-Operators.  
21

22 2. NON-DIRECTED INVENTORIES

23  
24 A. OPERATOR INVENTORIES

25  
26 Physical inventories that are not requested by the Non-Operators may be performed by the Operator, at the Operator's discretion. The  
27 expenses of conducting such Operator-initiated inventories shall not be charged to the Joint Account.  
28

29 B. NON-OPERATOR INVENTORIES

30  
31 Subject to the terms of the Agreement to which this Accounting Procedure is attached, the Non-Operators may conduct a physical  
32 inventory at reasonable times at their sole cost and risk after giving the Operator at least ninety (90) days prior written notice. The  
33 Non-Operator inventory report shall be furnished to the Operator in writing within ninety (90) days of completing the inventory  
34 fieldwork.  
35

36 C. SPECIAL INVENTORIES

37  
38 The expense of conducting inventories other than those described in Sections V.1 (*Directed Inventories*), V.2.A (*Operator*  
39 *Inventories*), or V.2.B (*Non-Operator Inventories*), shall be charged to the Party requesting such inventory; provided, however,  
40 inventories required due to a change of Operator shall be charged to the Joint Account in the same manner as described in Section  
41 V.1 (*Directed Inventories*).  
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