Unit Operating Agreement

OIL CONSERVATION DIVISION

CASE NUMBER

EXHIBIT NUMBER 3

THIS IS A PHOTOSTATIC COPY OF THE

ORIGINAL INSTRUMENT

OPERATING AGM'T

UNIT OPERATING AGREEMENT
FOR THE DEVELOPMENT AND OPERATION
OF THE COTTON DRAW UNIT AREA
EDDY AND LEA COUNTIES, NEW MEXICO

I N D E X

UNIT OPERATING AGREEMENT
FOR THE DEVELOPMENT AND OPERATION
OF THE COTTON DRAW UNIT AREA
EDDY AND LEA COUNTIES, NEW MEXICO

NO. _____

THIS AGREEMENT, made and entered into this the _____ day of _____, 1958, by and between The Texas Company, a corporation with offices at Fort Worth, Texas, hereinafter referred to as "Unit Operator", and the undersigned as owners of working interests in the unitized substances within the unit area subject to the unit agreement hereinafter referred to as may subscribe to this agreement and become parties hereto, which owners are hereinafter referred to as "Working Interest Owners", or as "Non-Operators",

WITNESSETH:

WHEREAS, the parties hereto have concurrently herewith as of the date hereof, entered into a certain Unit Agreement for the development and operation of the Cotton Draw Unit Area, hereinafter referred to as the "Unit Agreement", and which said agreement embraces the following described land situated in Eddy and Lea Counties, New Mexico, hereinafter referred to as the "unit area":

NEW MEXICO PRINCIPAL MERIDIAN, NEW MEXICO

T. 24 S., R. 31 E.

Sec. 13: All
Sec. 14: S½
Secs. 23, 24, 25, 26: All
Sec. 34: E½
Secs. 35 and 36: All

T. 24 S., R. 32 E.

Secs. 7, 8, 9: All
Secs. 16, 17, 18, 19, 20, 21: All
Sec. 27: W½, SE¼
Secs. 28, 29, 30, 31, 32, 33 and 34: All

T. 25 S., R. 31 E.

Secs. 1 and 2: All
Sec. 3: E½
Sec. 10: E½
Secs. 11, 12, 13, 14: All
Sec. 15: E½, E½W½
Sec. 22: E½, E½W½, SW¼NW¼, NW¼SW¼
Secs. 23 and 24: All
Sec. 25: N½
Sec. 26: N½

T. 25 S., R. 32 E.

Secs. 3, 4, 5, 6, 7, 8, 9, 10: All
Secs. 15, 16, 17, 18, 19, 20, 21, 22: All
Sec. 27: N½
Sec. 28: N½
Sec. 29: N½
Sec. 30: N½

Situated in Eddy and Lea Counties, and containing 35,144.36 acres, more or less.

WHEREAS, the parties hereto enter into this agreement pursuant to Section 7 of the Unit Agreement.

NOW THEREFORE, it is mutually agreed between the parties hereto as follows:

ARTICLE I

1. UNIT PLAN CONFIRMED: The aforesaid unit agreement and all exhibits attached thereto are hereby confirmed and made a part of this agreement.

ARTICLE II

MANAGEMENT OF UNIT

2.1 UNIT OPERATOR AND EMPLOYEES: The Texas Company, a corporation, with offices at Fort Worth, Texas, the party hereto named as Unit Operator of the unit area under the provisions of the unit agreement, or its duly appointed successor Unit Operator, shall have the exclusive right to develop and operate the unit area subject to the provisions of this agreement and the unit agreement. All individuals employed by Unit Operator in the conduct of operations hereunder shall be the employees of Unit Operator alone and their working hours, rates of compensation and all other matters relating to their employment shall be determined solely by Unit Operator.

2.2 UNIT OPERATOR - DUTIES: Unit Operator shall in the conduct of operations hereunder:

(a) Conduct the operations in a good and workmanlike manner, and in the exercise of its judgment and discretion, acting in good faith;

(b) Consult freely with Working Interest Owners concerning unit operations, and keep Working Interest Owners informed of all matters arising during the operation of the Unit Area which Unit Operator, in the exercise of its best judgment, considers important;

(c) Keep full and accurate records of all costs incurred, rentals and royalties paid, and controllable materials and equipment, which records, receipts and vouchers in support thereof, shall be available for inspection by authorized representatives of the Working Interest Owners at reasonable intervals during usual business hours, at the office of the Unit Operator;

(d) Permit each of the Working Interest Owners, through its duly authorized representatives, but at its sole risk and expense, to have access to the Unit Area at all times, and to the derrick floor of each well drilled or being drilled hereunder, for the purpose of observing operations conducted hereunder and inspecting jointly owned materials, equipment and other property, and to have access at reasonable times to information and data in the possession of Unit Operator concerning the Unit Area;

(e) Furnish to each of the other parties who makes timely written request therefor, copies of Unit Operator's authorization for expenditures or itemizations thereof in excess of One Thousand Dollars ($1,000), and copies of all drilling reports, well logs, basic engineering data, tank tables, gauge reports and run tickets, and reports of stock on hand at the first of each month, if available, and samples of cores or cuttings taken from wells drilled hereunder, containers therefor to be furnished by the party requesting such samples;

(f) Comply with the terms and conditions of the Unit Agreement and all valid applicable Federal and State laws and regulations;

(g) Keep the land in the Unit Area free from liens and encumbrances occasioned by its operations, except such liens as the Working Interest Owners elect to contest, and save only the lien granted the Unit Operator under this agreement.

2.3 UNIT OPERATOR - RESTRICTIONS: The Unit Operator shall not do any of the following things without the consent of the Working Interest Owners obtained as herein provided:

(a) Locate, drill, deepen, or plug back any well or let any contract therefor. The approval of the drilling, deepening or plugging back of any well shall be construed to mean and include the approval of any necessary expenditures for the drilling, deepening or plugging back, and completing and equipping of such well, including the necessary lines, separators and necessary tankage if a producer, and if a dry hole, the plugging and abandonment thereof, except as otherwise provided in Article IV hereof;

(b) Make any expenditures in excess of Five Thousand Dollars ($5,000) for any one single item.

(c) Make any expenditure for expert technical advice, including any extra services, rendered by Unit Operator's technical staff, not contemplated by the provisions of Exhibit "C" attached hereto, and not covered by the overhead, district and camp expenses therein authorized, which overhead in Exhibit "C" is intended to cover only normal development and operations;

(d) Make any partial relinquishment of the rights of the Unit Operator;

(e) Abandon any well or wells or dispose of any major items of surplus material or equipment other than junk, having an original cost of One Thousand Dollars ($1,000) or more (any

such item or items of less cost may be disposed of without such approval), except as may otherwise be provided herein;

(f) Enter into any plans for development of the Unit Area or any participating area or amendment thereof, or any expansion or contraction of the Unit Area or any designation or enlargement of a participating area;

(g) Drill or abandon any injection wells or convert any well into an injection well;

(h) Determine whether to drill a demanded offset well or pay compensatory royalty;

(i) Determine the basis of investment adjustment and the adjusted basis of prorated future development and operating costs and readjust percentages of participation on enlargement or reduction of the Unit Area or enlargement of any participating area or on elimination of acreage for failure of title;

(j) Make any arrangement for repressuring, cycling or pressure maintenance, or approve or disapprove any change in the existing method of operation;

(k) Contest any encumbrance or lien;

(l) Determine not to pay the annual rental, advance rental, or delay rental under any lease.

In case of blowout, explosion, fire, flood or other sudden emergency, Unit Operator may take such steps and incur such expense as, in its opinion, are required to deal with the emergency and to safeguard life and property; provided that Unit Operator shall, as promptly as possible, report the emergency to the other parties and shall endeavor to secure any sanction that might otherwise have been required.

Subject to the provisions of this agreement, Unit Operator shall have full control of the premises subjected hereto and shall conduct and manage the development and operation of unitized lands for the production of unitized substances there-

from for the account or the parties hereto.

2.4 CONSENT OF WORKING INTEREST OWNERS: On matters on which the consent of working interest owners is required, each working interest owner shall have a vote equal to the proportionate or fractional acreage interest owned by him in the participating area or individual lease if there is no participating area involved in any determination to be made, or in the unit area where the determination concerns any matters affecting the unit area as a whole. Except as otherwise specified herein or in the unit agreement, an affirmative vote of 65% of the voting power of the working interest owners involved shall constitute the decision of the working interest owners, which decision shall be binding upon all; provided, however, that should any working interest owner own as much as 65%, but less than 100%, voting interest in the participating area or individual lease involved in the determination, his vote must be supported by the affirmative vote of at least one additional working interest owner, and where any working interest owner owns as much as 65%, but less than 100%, voting interest in the unit area where the determination concerns any matters affecting the unit area as a whole, his vote must be supported by the affirmative vote of at least two additional working interest owners; and provided, further, that if any party owns 35% or more voting interest, but less than 50%, the vote of such party shall not serve to defeat or disapprove any matters approved by the majority (over 50%) unless supported by at least one additional voting interest where the determination to be made concerns any matters pertaining to a participating area or individual lease and by at least two additional voting interests where the determination concerns any matters affecting the unit area as a whole.

The Working Interest Owners shall meet in regular or special meetings for the purpose of discussing unit business and

of voting on the matters set out in Section 2.3 hereof, and of exercising any other powers by this agreement or by the Unit Agreement committed to the Working Interest Owners. Each Working Interest Owner shall designate a representative and an alternate to represent him at such meeting, who shall have such powers as are conferred on him by his principal, which powers shall be sufficiently broad to enable the representative to vote on matters coming before said meeting. Notices of meetings and place of holding same and other notices shall be served on such representative by the Unit Operator. The representative of the Unit Operator shall act as Chairman at all meetings. Each Working Interest Owner shall have the right, from time to time, on notice to the Unit Operator, to change the representative or the alternate. It shall be sufficient for the Unit Operator to poll all of the affected Working Interest Owners on all such matters without calling a meeting and any vote so taken pursuant to such poll shall be as binding on the Working Interest Owners as if done at a regular or special meeting at which a quorum was present.

2.5 UNIT OPERATOR - LIABILITIES: Unit Operator shall not be liable to any of the Working Interest Owners for anything done or omitted to be done by it in the conduct of operations hereunder while acting in compliance with Section 2.2 (a) hereof. The provisions of this section shall not relieve Operator of its duty to obtain the consent of the Working Interest Owners in accordance with the provisions of Section 2.3.

2.6 UNAVOIDABLE DELAY: The obligations of Unit Operator shall be suspended to the extent that, and only so long as performance thereof is prevented by fire, action of the elements, strikes or other differences with workmen, acts of civil or military authorities, acts of the public enemy, acts of God, restrictions or restraints imposed by law or by regulation or order

of Governmental authority, whether Federal, state or local, inability to obtain necessary rights of access, unavoidable accidents, uncontrollable delays in transportation, inability to obtain necessary materials in the open market or other matters beyond the reasonable control of Unit Operator, whether or not similar to any cause above enumerated.

ARTICLE III
COST OF OPERATIONS

3.1 HOW KEPT: The actual cost to the Unit Operator of performing its obligations as Unit Operator hereunder shall be kept separately for each participating area, and in each area such cost shall be apportioned to each tract in the same ratio as that defined in the Unit Agreement for the allocation of production in that area, and among the Working Interest Owners in each tract in proportion to their comparative interest therein, and as so allocated shall be paid as hereinafter provided by the several Working Interest Owners, unless otherwise provided by separate agreement, and as nearly as may be done, all costs shall be charged directly to each participating area and the operations served. The cost of other separate operations shall likewise be separately kept and charged to the Working Interest Owners affected. All materials, equipment and other property, whether real or personal, charged as a part of cost of operations hereunder shall be owned by the Working Interest Owners in the same proportion that they were charged therefor. All such costs, expenses, credits and related matters and the method of handling the accounting with respect thereto shall be in accordance with the provisions of the Accounting Procedure attached hereto, made a part hereof and marked for identification as Exhibit "C".

3.2 CONFLICT OF INSTRUMENTS: In the event of any conflict between the provisions contained either in the body of this instrument or in the Unit Agreement and those contained i

the Accounting Procedure, the provisions of the Unit Agreement shall govern to the extent of such conflict. The term "Operator" as used in Exhibit "C" shall be deemed to refer to the Unit Operator, and the term "Non-Operators" as used in Exhibit "C" shall be deemed to refer to the Working Interest Owners herein.

3.3 OPERATOR'S LIEN: Unit Operator is hereby granted a prior lien on the rights and interest of each Working Interest Owner in the Unit Area and the unitized substances allocated to each such Working Interest Owner, and the material and equipment thereon, to secure the payment of its proportionate part of the said costs and expenses. Should any Working Interest Owner fail to pay its proportionate part of said costs and expenses within thirty (30) days after being billed therefor as provided in the referred to Accounting Procedure, Exhibit "C", Unit Operator shall have the right at its option at any time thereafter, such default continuing to foreclose said lien on the respective interests of such Working Interest Owners. In lieu of or in addition to such remedy, the parties hereto agree that in the event of default, except in cases of a bona fide dispute, the Unit Operator may notify the purchaser of the defaulting party's share of unitized substances and such purchaser shall pay all proceeds accruing on account thereof to Unit Operator until said obligation is extinguished without any liability to the defaulting party. In lieu of or in addition to the remedy above specified for such default, Unit Operator may have any other remedy afforded by law or equity against the defaulting party for such default.

Likewise, Non-Operators are hereby granted a prior lien on the rights and interests of the Unit Operator as a working interest owner in the unit area and unitized substances and upon the interest of the Unit Operator in all materials and equipment to secure the payment of any amounts which may become due and owing from Unit Operator to any of the Non-Operators, which lien

shall be subject to all of the terms and conditions provided for in the preceding paragraph.

3.4 ADVANCES: Unit Operator, at its election, may require each Working Interest Owner hereto to advance its respective portion of development costs hereunder in accordance with an estimate by Unit Operator to be made not less than ten (10) days in advance of the month in which the costs and expenses are to be incurred. Adjustment between estimates and actual costs shall be made by the Unit Operator at the close of each calendar month and the accounts of the Working Interest Owners adjusted accordingly.

3.5 TAXES: All of the jointly owned personal property within the Unit Area shall be rendered by the Operator for ad valorem taxes if necessary. The Operator shall pay all ad valorem taxes rendered or assessed against said properties and all such amounts so paid by the Operator shall be charged to the joint account of the parties hereto. All other taxes which may be levied upon or against the respective leasehold interests or measured by the production of unitized substances allocated to the respective tracts under the terms of the unit agreement and this agreement shall be paid by the respective Working Interest Owners having interests in such tracts.

3.6 INSURANCE: Unit Operator shall carry insurance in the following amounts to cover its operations pursuant to the terms of this Agreement:

(a) Workmen's compensation insurance meeting the requirements of the State of New Mexico;

(b) General public liability insurance with limits of not less than $100,000 for any one person injured in any one accident, and not less than $200,000 for more than one person injured in any one accident; and not less than $50,000 for property damage per accident;

(c) As to all cars, trucks and other automotive equipment owned and operated for the benefit of the joint account not covered by any insurance, Operator shall act as a self-insurer and assume all liability in the event any such equipment is involved in an accident, and shall save, hold and protect Non-Operators harmless from all liability with respect thereto.

Unit Operator shall require its contracts or subcontractors to carry insurance in the following amounts to cover drilling operations for the production of oil, gas and other hydrocarbon substances from the lands subject to this Agreement:

(a) Workmen's compensation insurance meeting the requirements of the laws of the State of New Mexico;

(b) Contractor's public liability insurance of not less than $50,000 for injuries to one person; $100,000 for injuries in one accident; and $25,000 for surface property damage;

(c) Automobile public liability and property damage insurance for not less than $25,000 for injuries to one person; $50,000 for injuries in one accident; and $10,000 for property damage.

All premiums paid for insurance carried by Operator as herein provided shall be charged to the joint account as operating expenses and shall be paid by the parties hereto in the same manner as other operating expenses are to be paid.

ARTICLE IV
WELLS

4.1 INITIAL TEST WELL: Within six months after the effective date of the Unit Agreement, Unit Operator shall commence operations upon the initial test well to be drilled pursuant to the provisions of Section 9 of the Unit Agreement (unless such well should be commenced prior to the effective date of said Unit Agreement). Said well shall be drilled in compliance with

Section 9 of the Unit Agreement and shall also be drilled in accordance with the applicable regulations of the Secretary of the Interior and the New Mexico Oil Conservation Commission. The working interest owners subject hereto as "non-operators" shall be responsible for only such portion of the cost of drilling, completing and plugging said well as they may have expressly agreed to in writing other than by this agreement. In the event said well should be plugged and abandoned, the working interest owners who shall have participated in the cost of drilling the same shall own all casing, materials and other equipment which may be salvaged in connection therewith in the same proportion that they participated in the cost of drilling said well. In the event said well should be completed as a well capable of producing unitized substances in paying quantities, the participating area shall be designated in accordance with the provisions of Section 9 of the Unit Agreement and there shall be an investment adjustment between the owners of the working interests affected in accordance with the provisions of Article V hereof.

4.2 OTHER TEST WELLS: In the event it is decided to drill any additional wells other than the well provided for in Section 4.1 hereof prior to establishing a participating area or prior to the establishing of an additional participating area, such wells shall be drilled by the Unit Operator except as otherwise may be provided by this agreement. The basis of contribution to the cost of such wells and the final adjustment or disposition of such costs and the basis of unitized substances attributable to the Working Interest Owners shall be made the subject of a special agreement between the Unit Operator and the Working Interest Owners desiring to participate in the cost thereof.

4.3 MODIFICATION OF DRILLING REQUIREMENTS OF UNIT AGREEMENT: The Unit Operator may apply for and obtain a modification of the drilling requirements of said unit agreement or an extension or extensions of time within which to comply therewith as provided by the terms of said unit agreement and any such application or applications may be made without the consent of any of the Working Interest Owners subscribing hereto as parties of the second part.

4.4 WELL CONTRACTS: All wells drilled in the unit area by Unit Operator after the effective date of this agreement shall be drilled on a competitive contract basis at the usual rates prevailing in the region of the unit area. Unit Operator, if it so desires, may employ its own tools and equipment in the drilling of such wells but in such event, the charge therefor shall not exceed the competitive prevailing rate charged by independent contractors doing work of a similar nature. If the parties who are to participate in the cost of drilling any well are unable to mutually agree on the competitive contract price, Operator shall obtain bids from at least three responsible drilling contractors who are ready, able and willing to drill a well of the type contemplated by the parties hereto on lease acreage covered hereby; and said competitive contract price shall be the lowest acceptable bid received which will result in the most economical drilling of said well. All drilling, whether by Operator or others, shall be under contracts approved by the parties hereto, which contract shall contain appropriate provisions that any well drilled on the joint leases when completed shall not deviate in excess of 5 degrees from perpendicular.

4.5 WELLS WITHIN PARTICIPATING AREAS: All wells drilled within the boundaries of participating areas to the productive formation or formations therein shall be drilled at the cost, risk and expense of all of the Working Interest Owners

within the respective participating areas as provided in Section 3 hereof and on authorization as set out in Section 2.3 hereof.

4.6 EXTENSION WELLS OUTSIDE OF PARTICIPATING AREAS: The Unit Operator may drill any well within the unit area but outside the boundaries of any established participating area with the object of completing the same in the formation for which the participating area was established, which well is herein referred to as an "extension well", for the account and at the sole risk and expense of all of the Working Interest Owners within the participating area only after obtaining consent as provided in Section 2.3 hereof. Such "extension wells" may also be drilled as provided by Section 4.8 hereof.

4.7 WELLS TO TEST UNTESTED FORMATIONS: Wells to test theretofore untested formations may be drilled either pursuant to the provisions of Section 4.6 hereof, or at the expense of the parties owning interests within a participating area as though it was a well drilled under Section 4.5 hereof. If any such well is completed as a well capable of producing unitized substances in such quantities that it may properly be included in a participating area, such participating area shall be established or enlarged in accordance with the provisions of the unit agreement to include such well and thereafter, the same shall be operated by the Unit Operator in accordance with the terms of the Unit Agreement and this agreement.

4.8 EXTENSION WELLS BY WORKING INTEREST OWNERS: In addition to the method provided in Section 4.6 hereof, "extension wells" may be drilled by a single Working Interest Owner on his own lease as provided in Section 13 of the Unit Agreement, unless the owners of the leases within a participating area elect to drill the same as provided in Section 4.6 hereof. In the event there is more than one Working Interest Owner having an interest in the lease on which the well is desired to be

drilled, the same may be drilled on the authority of the majority in interest of the Working Interest Owners in and to said tract. Such wells may be drilled by the Unit Operator for the account of the parties financing the same.

If any party or parties hereto elect to drill a well or wells in accordance with the provisions of Section 13 of the Unit Agreement, the basis of contribution to the cost thereof and the final adjustment or disposition of such costs shall be by separate agreement between the parties financing said well. If such well is completed as a well capable of producing unitized substances in paying quantities, the party or parties participating in the cost thereof shall be entitled to reimbursement out of the entire working interest portion of the production from such well to the extent and in the manner provided by Section 4.9 hereof. If such well is completed as a well capable of producing unitized substances but not in paying quantities, the same shall be operated and produced by the party or parties drilling the same in accordance with the provisions of said Section 13 of the Unit Agreement.

4.9 NON-CONSENT OF WORKING INTEREST OWNERS TO DRILLING OF WELLS: In the event any party does not desire to participate in the cost of drilling any well which is to be drilled in accordance with the provisions of Sections 4.5, 4.6 or 4.7 or in the cost of deepening, plugging back or reworking any non-commercial well drilled in accordance with the provisions of said sections (if such deepening, plugging back or reworking will cost more than $5,000) and such party has notified the Unit Operator of such desire in writing prior to the commencement of operations therefor and such operations result in the completion of a well capable of producing unitized substances in paying quantities, the entire working interest portion of the production from such well shall be allocated to the working interest owners who

participated in the cost and expense of drilling, completing and equipping the same, or the cost of deepening, plugging back, reworking, completing and equipping the same (including tanks, separators, and flow lines) as the case may be in proportion to their contribution to the cost thereof until such time as each such working interest owner shall have received from the proceeds thereof an amount equal to 150% of the costs incurred if such well is within a participating area drilled in accordance with Section 4.5, and 200% of the costs incurred if drilled pursuant to the provisions of Sections 4.6, 4.7 or 4.8 plus 100% of the amount paid by each participating party for operating costs in connection therewith, such costs to be determined in accordance with the provisions of the accounting procedure attached hereto as Exhibit "C". If the operation involves deepening, plugging back or reworking, any non-commercial well, the participating party or parties shall pay to the non-participating party or parties a sum equal to the proportionate value (determined in accordance with Exhibit "C" after deducting the cost of recovery) of the equipment and reclaimable casing and tubing on and in any well in which said deepening, plugging back or reworking operations are to be conducted, and the amount so paid shall constitute a part of the cost of deepening, plugging back or reworking such well for which the participating parties shall be entitled to reimbursement out of production on the basis above provided. If any such well should fail to produce or should cease to produce in paying quantities before the receipt of the reimbursement hereinabove provided for, the well shall be plugged and abandoned at the sole risk, cost and expense of the participating party or parties and such parties shall be entitled to all salvage value derived from the well to the extent necessary to complete the reimbursement as above provided plus the cost of plugging and abandoning such well. After the parties who shall have participated in the

cost of drilling, completing, equipping, deepening, plugging back or reworking any well as the case may be have been reimbursed to the extent above provided, said well shall be operated by the Unit Operator for the joint account of all Working Interest Owners who normally would have participated in the cost thereof and from and after such time, the unitized substances and all pipe and other equipment installed in such well or thereon shall be owned by said parties in proportion to their respective participating interests.

4.10 PAYING WELLS - DRY HOLES - MARGINAL WELLS. In the event any well drilled under the provisions of this Article IV encounters production in quantities sufficient to justify the same being included in a participating area or the creation of a new participating area as the case may be there shall be an investment adjustment between the owners of the working interest affected in accordance with the provisions of Article V hereof. In the event any such well is a dry hole, it shall be plugged and abandoned at the sole risk, cost and expense of the Working Interest Owners responsible for the drilling of the well. If any such well obtains production in insufficient quantities or of such poor quality to justify the inclusion of the spacing or proration unit on which the well is located in an existing participating area or the creation or a new participating area, the same shall be operated for the account of the Working Interest Owners who participated in the cost of drilling the well in accordance with the third paragraph of Section 13 of the Unit Agreement.

No well shall be included in an existing participating area or shall be used as a basis for the creation of a new participating area unless such well is capable of producing oil or gas in paying quantities; that is, quantities sufficient to repay the cost of drilling and producing operations with a

reasonable profit and if any party [illegible] by the inclusion of a well in an existing participating [illegible] or the creation of a new participating area objects to any such well being used as a basis for the inclusion of the land comprising the spacing or proration unit upon which such well is located in a participating area or the creation of a new participating area, such lands shall not be included in such participating area or used as the basis of a new participating area until after said well has been on production for a period of ninety (90) days after which a determination shall be made by the parties affected as to whether said land should be included in an existing participating area or a new participating area as the case may be on account thereof. Such determination shall be based upon the performance of said well during said period and all pertinent geological information available. During such test period the working interest production from said well shall be allocated to the parties who shall have participated in the cost of drilling and completing the same in proportion to their percentage of participation. The Unit Operator shall give notice to all Working Interest Owners having interests which may be affected by the inclusion of said well in an existing participating area or the creation of a new participating area based thereon so that all such Working Interest Owners will have access to all information obtained from the test of said well.

4.11 FORCED WELLS: (a) In the event Unit Operator is required to drill an extension well upon any regular well spacing unit adjacent to the boundaries of any participating area or any development well within a participating area by governmental order (including any Federal or State Agency), or demand, whether such order or demand is initiated by the Government independent of its consideration of any plan of development, or is issued as a required alteration of a plan

of development, the cost of drilling and completing said well if a producer, and of plugging and abandoning the well if a dry hole, shall be borne by all of the Working Interest Owners in said participating area in proportion to their interest therein, except as otherwise may be provided by separate agreement.

(b) Should Unit Operator be required by governmental order (including Federal or State agency), or demand; whether such order or demand is initiated by the Government independent of its consideration of any plan of development to drill an offset well to any well drilled outside of the boundaries of the unit area, or to test previously untested portions of the unit area which are one-half mile or more from the boundaries of any established participating area, the cost of drilling and equipping such well if a producer, and plugging and abandoning the same if a dry hole, shall be borne by the parties hereto having leasehold interests within the drilling unit upon which said well is drilled. In such case, a drilling unit shall be formed for the drilling of such well consisting of the 160-acre legal subdivision upon which the well is located and each of the adjoining 160-acre legal subdivisions so that the drilling unit will consist insofar as practicable of a square composed of nine 160-acre legal subdivisions. In the event the location of the well to be drilled is near the boundaries of the unit area only so much of the lands within the drilling unit as are located within the unit area shall be included in such drilling unit. All of the parties hereto owning working interests within the drilling unit shall pay the cost of drilling, completing and equipping said well if a producer or plugging and abandoning the same if a dry hole in the proportion that the leasehold interest of each party on an acreage basis bears to the total number of acres included in the drilling unit. In the event such well is completed as a well capable of producing unitized substances in paying quantities and a participating area is created

or any existing participating area is extended to include said well, there shall be an investment adjustment of tangible and intangible costs in accordance with the provisions of Article V hereof.

4.12 ABANDONMENT OF WELLS: If the affected Working Interest Owners determine to abandon any well or wells, as provided in Section 2.3 (e) hereof, but any other party or parties object thereto, then such party or parties not desiring to abandon the same shall, within ten days thereafter, notify the other parties of their desire to take over and operate said well and shall tender to the other affected Working Interest Owner or Owners a sum equal to the last named parties' proportionate share in the salvage of the material and equipment in said well or wells determined in accordance with the Accounting Procedure Exhibit "C" attached hereto, and on receipt of said sum, the said parties having any interest in the well, and wishing to abandon said well, shall within twenty-five (25) days thereafter, assign without warranty to the other Working Interest Owners their rights in the well and well property as to the producing formation only in the land on which said well is situated, and their interest in the leasehold estate in a tract surrounding said well of an area equal to that prescribed by the spacing rule of State or Federal authority, but if there is no such established rule, then said assignment shall cover the working interest and leasehold estate in the producing formation only in 40 acres surrounding said well, if an oil well, or 160 acres if a gas well, said well may thereafter be operated by the Unit Operator for the separate account of the remaining Working Interest Owners. Proper bills of sale and division orders shall be executed by the assigning parties to accomplish the purposes hereof. The percentage of participation of the parties under the Unit Agreement and this agreement as to all other wells then or thereafter drilled and as to the other land and leasehold rights under this agreement and the Unit Agreement shall be unaffected by this transfer.

ARTICLE V
INVESTMENT ADJUSTMENT

5.1 ON ESTABLISHMENT OF PARTICIPATING AREAS: In the event any test well or wells drilled shall encounter unitized substances in quantity sufficient to justify the establishment of a participating area for the formation encountered, such participating area shall be formed as provided in Section 11 of the Unit Agreement, and there shall be those investment adjustments hereinafter provided, and thereafter the costs incurred and benefits derived from the operation of the well shall be borne by and inure to the benefit of the Working Interest Owners in the participating area, and the working interests attributable to the non-participating portion of the Unit Area shall thereafter be liable for no part of the costs and entitled to no part of the benefits derived therefrom, in the absence of a subsequent enlargement of the participating area.

(a) Investment Adjustment of Intangibles: On the establishment of the participating area, there shall be a retroactive adjustment of the actual intangible cost incurred in drilling, completing, equipping for production the said producing test well or wells until the effective date of the establishment of the participating area to the end that the owners of working interests in the participating area established shall, in proportion to their respective percentages of participating in the participating area, reimburse without interest the party or parties who paid for said intangible cost and expense of drilling, completing, equipping for production the producing well or wells, it being understood that interests in intangibles shall be exchanged only for interests in intangibles or for cash in order to effect said adjustment.

(b) Investment Adjustment of Tangibles: On the establishment of the participating area, there shall be a separate retroactive investment adjustment as to the tangible property in

and appurtenant to said producing well or wells, tankage, pipe lines, camps, separators, and without limitation all other structures, facilities, appliances and property employed in the drilling, completion, equipping and operation of said well, to the end that the owners of working interests in the participating area established shall reimburse without interest the Working Interest Owners who purchased and paid for said equipment for the actual cost thereof to the end that all of said property shall be owned by the Working Interest Owners in the participating area by undivided interests in proportion to their respective percentages of participation in the participating area, and to the end that the former owners thereof shall be reimbursed for their expenditures on the basis herein set out, it being understood that interests in tangibles shall be exchanged for interests in tangibles or for cash in order to effect said adjustment.

Separate participating areas for different formations may be established and any participating area may be diminished on account of failure of title or may be enlarged all as provided by the Unit Agreement and this agreement. If any payments are required to be made on such investment adjustment on behalf of lands in which there are undivided interests, some of which are carried working interests, payments on behalf or such lands shall be made by the parties required to make the same and shall be recovered from the other parties all as may be provided by the separate agreement creating the carried working interests.

5.2 ENLARGEMENT OF PARTICIPATING AREA: On the enlargement of any participating area as provided in the Unit Agreement, there shall be investment adjustments between the Working Interest Owners in the enlarged participating area who are parties hereto and the Working Interest Owners in the former participating area who are parties hereto, to the end that costs and investments within the enlarged participating area shall be paid for by the

affected Working Interest Owners in the enlarged participating area proportionate to the interest of each of the enlarged participating area, and also to the end that the parties who have previously paid said costs shall be reimbursed on the basis hereinafter set forth, and otherwise as set forth in Section 5.1 hereof, except:

The affected Working Interest Owners in the participating area before its enlargement and those who paid for intangibles in the area to be admitted to the enlarged participating area, shall receive credit for the intangible cost of drilling, completing and equipping for production all wells capable of producing the unitized substances within said enlarged participating area. The costs to be so credited shall be measured by the average cost of drilling, completing and equipping for production wells of like character and depth in the participating area in a good and workmanlike manner at the time when said wells were drilled. Credits for tangibles in the participating area before enlargement and in the area to be included in the enlargement shall be given in accordance with a classification and appraisal thereof by the Working Interest Owners or a committee thereof, valued in accordance with the method set out in Section V of Exhibit "C" attached hereto, or otherwise as agreed to by the Working Interest Owners. If the enlargement of the participating area was caused by the drilling of a well under the provisions of Section 4.7 hereof in making the adjustments, due consideration shall be given to the rights of the parties who may have participated in the cost of such well so that their rights under Section 4.7 will be preserved and will not conflict with the provisions of this section. The sum total of said credits shall be apportioned to the enlarged participating area, and separate cash adjustment of tangibles and intangibles as set forth in Section 5.1 shall be made among the Working Interest Owners through the Unit Operator. No credit shall be given for

the previous cost of operating any wells or for the intangible cost of repairing or maintaining other property, nor shall there be any debit for and on account of production taken from wells prior to the effective date of the enlargement of the participating area.

ARTICLE VI
RENTALS, ROYALTIES AND PRODUCTION

6.1 RENTALS: The Working Interest Owners in each tract shall pay all rentals, advance rentals or delay rentals due under the lease thereon and shall concurrently submit to the Unit Operator evidence of payment. If the Working Interest Owners in any tract determine not to pay any such rental, they shall notify Unit Operator at least sixty (60) days before the due date and they shall thereupon assign to all other Working Interest Owners in the unit area proportionable to their interests, all of their right, title and interest under said lease; provided, however, all such assignments shall be subject to all obligations with respect to reassignments, if any, of the parties making such assignments theretofore created in favor of parties who are not parties to this agreement. In the event of failure of any Working Interest Owner to make proper payment of any delay rental through mistake or oversight where such rental is required to continue the lease in force, there shall be no money liability on the part of the party failing to pay such rental, but such party shall make a bona fide effort to secure a new lease covering the same interest and commit such lease to the Unit Agreement, and in the event of failure to secure a new lease within a reasonable time, the interest of the parties hereto shall be revised so that the party failing to pay any such rental shall not be credited with the ownership of any lease on which rental was required but was not paid. The Unit Operator shall incur no liability for failure to pay any rental due under the terms of any lease committed to said

Unit Agreement; however, in the event any rentals are paid by Unit Operator, the same shall be charged and billed to the party responsible for the payment of the same. In the event of loss of title to a lease for failure to pay rental, all loss occasioned thereby shall be that of the Working Interest Owners who should have paid the same.

6.2 ROYALTIES AND COMPENSATORY ROYALTIES: The Working Interest Owners shall be responsible for and shall pay all royalties which may become due and payable on account of the allocation of unitized substances to their respective leases committed to the Unit Agreement, and if any of said leases are burdened with any overriding royalties, payments out of production or any other charges in addition to the usual royalty, the owners of such leases shall bear and assume the same out of the unitized substances allocated thereto.

In cases where the affected Working Interest Owners determined to pay compensatory royalty or damages in lieu of drilling a demanded offset well, such compensatory royalty shall be paid by the Unit Operator and charged on the joint account to the affected Working Interest Owners. Compensatory royalty for drainage of lands within any participating area shall be apportioned to all the Working Interest Owners having interests therein in proportion to their respective interests. Compensatory royalty for drainage of lands outside any participating area shall be apportioned to those Working Interest Owners having interests in such lands.

6.3 DISPOSAL OF PRODUCTION: Each of the parties hereto shall own and, at its own expense, shall take in kind and separately dispose of its proportionate part of all the unitized substances produced and saved from the lease acreage covered hereby, exclusive of the production that the Unit Operator may use in developing and producing operations and in preparing and treating oil for market purposes and of production unavoidably lost; provided that

each of the parties shall pay or secure the payment of the royalty interest on its proportionate part of the production. At such time or times as a Working Interest Owner shall fail or refuse to take in kind or separately dispose of its proportionate part of said production, Operator shall have the authority, revocable by Working Interest Owner at will, to sell all or part of such production to others at the same price which Operator receives for its own portion of the production. All such sales by Operator of Working Interest Owner's production shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the circumstances, but in no event shall any such sale be for a period in excess of one (1) year.

ARTICLE VII
TITLES TO UNITIZED INTERESTS

7.1 TITLE EXAMINATION - INITIAL TEST WELLS: Each Working Interest Owner hereby represents that it is now the owner of the interests in tracts of land in the Unit Area as set out in Exhibit "B" attached to the Unit Agreement. On the execution of this agreement, the Working Interest Owners on each and every lease covering land, any part of which is situated within a 640-acre area surrounding the test wells location in such an outline as may be delineated by the Working Interest Owners in the Unit Area, shall furnish the Unit Operator with: (a) up-to-date abstracts of title, (b) copies of all title opinions and title documents in its possession, and (c) in addition, for lands of the United States or of Indian tribes or restricted Indians, acceptable up-to-date reports as to the status of said lands as appears from the records of the Department of the Interior, and (d) in addition, for State lands, an acceptable report or transceipt showing the status of lands as appears on the records of the State Land Office. The Working Interest Owners within the 640-acre area shall by majority vote promptly appoint a title

committee who shall examine or cause to be examined all of said titles and have title opinions prepared and copies thereof distributed to all of the aforesaid Working Interest Owners. All expenses of and in connection with said title examination shall be charged to the Working Interest Owners within the area of the title examination in proportion to the acreage ownership, and each Working Interest Owner shall severally pay the cost of all curative work on its own titles. The Working Interest Owners within the 640-acre area shall by vote as provided in Section 2.4 hereof, accept or disapprove all titles. In the event that title to any tract or interest therein shall be disapproved, such tract or interest shall be eliminated from the Unit Agreement and this agreement, unless the true owner shall commit said interests to said agreements.

7.2 TITLE EXAMINATION - SUBSEQUENT WELLS: Prior to the drilling of any additional well hereunder, title shall in like manner be examined and accepted as above described covering all leases, any part of which are within a 640 acre area surrounding the proposed well in such an outline as may be delineated by the Working Interest Owners, except as to titles previously accepted as above set out.

The Working Interest Owners in any participating area affected may by vote as provided in Section 2.4 hereof waive or modify the requirements of this section to meet special conditions as they may arise, or may require the examination of title to additional lands.

7.3 LOSS OF TITLE: Any loss of title, whether partial or complete, as to any lease committed to the Unit Agreement, shall be borne entirely by such Working Interest Owner and such party's interest shall be reduced in proportion to any such loss and the effect of such loss shall be determined pursuant to the provisions of Section 29 of the Unit Agreement, and in the event

of the failure of title of any Working Interest Owner at any time after a participating area shall have been established in conformity with the terms of the Unit Agreement, there shall be an appropriate adjustment of the percentage of the participation of the parties having working interests committed to such participating area. It is provided, however, that such adjustment shall not be retroactive as to the operating costs and expenses incurred or as to revenues on production obtained prior to such date.

ARTICLE VIII
CHANGE OF OWNERSHIP

8.1 ASSIGNMENTS: Any Working Interest Owner may, at any time, transfer or assign all or any part of his working interest to any other Working Interest Owner who is then a party to the Unit Agreement and to this agreement, or to any other person, association or corporation, when such assignment is made expressly subject to the terms of the Unit Agreement and the terms of this agreement, and wherein the assignee shall accept and agree to perform all duties, obligations and liabilities thereof. On the making of such assignment, the assignor shall thereupon be relieved of all future duties, obligations and liabilities of a Working Interest Owner under this agreement and under the Unit Agreement, to the extent of the interest assigned. No assignment made under the provisions of this section shall be binding upon the Unit Operator until a certified copy of said assignment has been delivered to Unit Operator. The terms of this agreement shall be deemed to be covenants running with the land and the leasehold estates and interests therein of the parties hereto, and shall be binding upon and inure to the benefit of the parties hereto, their heirs, personal representatives, successors and assigns.

8.2 WITHDRAWAL OF PARTY: If any party hereto so desires, it may withdraw from this agreement by conveying, assigning and transferring, without warranty, either express or implied, to the other parties hereto who do not desire to withdraw all of its right, title and interest in and under the leases included in the Unit Area, together with the withdrawing party's interest in all wells, casing, material, equipment, fixtures and other personal property belonging to the joint account, but such conveyance or assignment shall not relieve said party from any obligation or liability accruing or incurred prior to the date thereof. The interest so conveyed and assigned shall be held and owned by the assignees in the proportion set out in applicable percentage participation schedules and thereupon the withdrawing party shall be relieved from all obligations and liabilities thereafter to accrue under this contract, and the right of such party to any benefits subsequently accruing hereunder shall cease; but assignees shall pay assignor for its interest in all casings, material, equipment, fixtures and other personal property owned by the joint account at the salvage value thereof computed in accordance with the Accounting Procedure, Exhibit "C", hereto attached. If all of the parties are not willing to accept the assignment of such interest, the assignment shall be made to those willing to accept such interest in the proportions that their respective interests bear to the aggregate of their interests in the unit area on an acreage basis.

8.3 SUBSEQUENT JOINDER: Prior to commencement of operations under the Unit Agreement, all owners of working interests in the Unit Area who have joined in the Unit Agreement shall be privileged to join in this agreement by subscribing to the Unit Agreement and this agreement. After commencement of operations under the Unit Agreement, however, subsequent joinder in the Unit Agreement and in this agreement by any party owning a

working interest in the Unit Area shall be on such reasonable terms and conditions as the parties who are then committed to the Unit Agreement and this agreement may require in view of the circumstances existing at the time such subsequent joinder is sought.

8.4 SURRENDER OR TERMINATION OF INTERESTS: No lease as to lands committed to the Unit Agreement shall be surrendered in whole or in part, unless the parties hereto mutually consent thereto. Should any party at any time desire to surrender any lease committed to said Unit Agreement and the other parties should not agree to consent to such surrender, the party desiring so to surrender shall assign, without express or implied warranty of title, subject to the approval of the Director of the Bureau of Land Management, Department of the Interior or the Commissioner of Public Lands as the case may be, if Federal or State lands are involved, all of such party's interest in such lease to the other parties hereto in proportion to the interest then severally held by them on an acreage basis in the Unit Area. If all of the parties are not willing to accept the assignment of such interest, the assignment shall be made to those willing to accept such interest in the proportions that their respective interests bear to the aggregate of their interests in the unit area on an acreage basis. Such assignment shall be free and clear of all liens and encumbrances and upon delivery thereof, the assigning party shall be relieved of all further obligations with respect to the lease or leases so assigned but such assignment shall not relieve the assigning party of any obligations to the joint account incurred with respect to such lease or leases prior to the assignment thereof.

Any Working Interest Owner shall have the right at any time while not in default of any of the provisions hereof or indebted to the joint account to be relieved of all further obliga-

tions on account of said Unit Agreement, and the provisions hereof, except the obligation to pay such party's proportionate part of the cost of any well then drilling under the provisions of the Unit Agreement of this agreement, by assigning, subject to the approval of the Director of the Bureau of Land Management, Department of the Interior of the Commissioner of Public Lands as the case may be, if Federal or State lands are involved, to the other parties hereto in proportion to the interest then severally held by them on an acreage basis, all of the interest of such party in all leases committed to the Unit Agreement. All such interests shall be assigned free and clear of all liens and encumbrances. In such event, the Unit Operator shall pay the Working Interest Owner desiring to be relieved of such further obligations for such party's proportionate interest in all casing, materials, equipment, fixtures and other personal property belonging to the joint account, the fair salvage value thereof determined as provided in Exhibit "C" attached hereto.

ARTICLE IX
MISCELLANEOUS PROVISIONS

9.1 FAIR EMPLOYMENT. In connection with the performance of work under this agreement, the operator shall not discriminate against any employee or applicant for employment because of race, religion, color or national origin. The aforesaid provisions shall include, but not be limited to, the following: employment, upgrading, demotion or transfer; recruitment or recruitment advertising, layoff, or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. The Operator agrees to post hereafter in conspicuous places, available for employees and applicants for employment, notices to be provided by the contracting officer setting forth the provisions of the non-discrimination clause.

The Operator agrees to insert the foregoing provisions in all sub-contracts hereunder, except sub-contracts for standard commercial supplies or raw materials.

Operator shall also comply with the terms and conditions of any Indian leases while engaged in operations thereon with respect to the employment of available Indian labor.

9.2 NOTICES: Except as herein otherwise expressly provided, all notices, reports or other communications required or permitted hereunder shall be deemed to have been properly given when sent by certified or registered mail or telegraph with all postage or charges fully prepaid, and addressed to the parties hereto, at the addresses set opposite their respective names, or such other addresses as may be thereafter furnished. The date of service by mail shall be the date on which such written notice or other communication is deposited in the United States Post Office, or sent as a telegram, addressed as above provided.

9.3 RELATION OF PARTIES: The rights, duties, obligations and liabilities of the parties hereto shall be several and not joint or collective, and nothing herein contained shall ever be construed as creating a partnership of any kind, joint venture, an association or a trust or as imposing upon any one or more of the parties hereto any partnership duty, obligation or liability. Each party hereto shall be individually responsible for only its obligations, as set out in this agreement.

9.4 INCOME TAX ELECTION, SUB-CHAPTER K, OF CHAPTER 1 SUB-TITLE A INTERNAL REVENUE CODE: Notwithstanding any provisions herein that the rights and liabilities of the parties hereunder are several and not joint or collective, or that this agreement and the operations hereunder shall not constitute a partnership, if for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, then each of the parties hereto hereby elects to be excluded from the application

of all of the provisions of Subchapter K, Chapter 1, Subtitle A, of the Internal Revenue Code of 1954, as permitted and authorized by Section 761 of said Code and the regulation promulgated thereunder. Operator is hereby authorized and directed to execute on behalf of each of the parties hereto such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all or the returns, statements, and data required by Federal Regulations 1.761-1 (a). Should there be any requirement that each party hereto further evidence this election, each party hereto agrees to execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. Each party hereto further agrees not to give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the property covered by this agreement is located, or any future income tax law of the United States, contain, or shall hereafter contain, provisions similar to those contained in Subchapter K, Chapter 1, Subtitle A, of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of said Subchapter K is permitted, each of the parties hereto hereby makes such election or agrees to make such election as may be permitted by such laws. In making this election, each of the parties hereto hereby states that the income derived by him from the operations under this agreement can be adequately determined without the computation of partnership taxable income.

In the event operator executes for and on behalf of the other parties hereto any election authorized under the provisions of this section, operator shall give notice of such election to the other parties hereto.

9.5 FORCE MAJEURE: In the event any party hereto is rendered unable, wholly or in part, by force majeure to carry out its obligations under this contract other than the obligation to make payments of amounts due hereunder, it is agreed that upon such party's giving notice and reasonably full particulars of force majeure in writing or by telegraph to the other parties hereto within a reasonable time after the occurrence of the cause relied upon, then the obligations of the party giving the notice, so far as they are affected by force majeure, shall be suspended during the continuance of any liability so caused, but for no longer period; and the cause of the force majeure shall, so far as possible, be remedied with all reasonable dispatch. The term "force majeure" as employed herein shall mean any cause not reasonably within the control of the party claiming suspension.

The settlement of strikes and lockouts shall be entirely within the discretion of the party having the difficulty and the above mentioned requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes and lockouts by acceding to the demands of opposing party when such course is inadvisable in the discretion of the party having the difficulty.

9.6 CONTRIBUTIONS TOWARD DRILLING: Any contribution, whether of money or property interest, toward the drilling of any well drilled on the unit area pursuant to the provisions of this agreement shall be shared in by the parties hereto in proportion to their participating interests in such well.

9.7 ASSIGNMENTS OF PARTIAL INTERESTS: Notwithstanding any of the provisions contained herein to the contrary, in executing any assignments pursuant to Sections 4.12, 8.1, 8.2 or 8.4 hereof where the interest to be assigned is only as to certain producing formations where federal and state lands are involved and if as to undivided interests where state lands are involved and where such assignments are not subject to approval by the Director of the

Bureau of Land Management or by the Commissioner of Public Lands of the State of New Mexico, the interest to be assigned shall be conveyed by appropriate operating agreements or by any other valid instrument that will carry out the intention of such provision or provisions or in case of a state lease or leases where undivided interests are to be assigned, the same may be assigned to the Unit Operator to be held in trust for the parties entitled to participation therein in proportion to their respective interests.

9.8 PROVISIONS CONFORMED WITH LAWS AND REGULATIONS: All of the provisions of this agreement are hereby expressly made subject to all applicable Federal or State laws, orders, rules and regulations, and in the event this contract or any provision hereof is found to be inconsistent with or contrary to any such law, order, rule or regulation the latter shall be deemed to control and this contract shall be regarded as modified accordingly and as so modified shall continue in full force and effect.

9.9 EFFECTIVE DATE AND TERM: This agreement shall become effective as of the effective date of the unit agreement and shall remain in full force and effect during the term of said unit agreement and any and all extensions or renewals thereof, and, in the event of the termination of the unit agreement for any reason, this agreement shall continue in full force and effect as to all wells which have not been plugged and abandoned as of the time of the termination of the unit agreement and the rights and interests of the parties hereto in such wells and their participation in the production therefrom and in the cost of the operation thereof, shall be governed by the provisions hereof and this agreement with respect thereto shall remain in full force and effect so long as any such well is capable of producing oil or gas in paying quantities.

9.10 COUNTERPARTS: This agreement may be executed in any number of counterparts, no one of which needs to be executed by the other parties hereto, and the same shall be binding upon

aid Unit parties who have executed such a counterpart, regardless whether the same shall have been executed by all of the parties owning oil and gas leasehold interests within the Unit Area, and such counterpart shall have the same force and effect as if all parties signing such counterparts had signed the same document.

IN WITNESS WHEREOF, this agreement is executed by the undersigned parties hereto as of the day and year first hereinabove written.

ATTEST:

Secretary

THE TEXAS COMPANY

By J. A. Hall
ATTORNEY-IN-FACT

Address P. O. Box 1720
Ft. Worth, Texas

ATTEST:

Secretary

UNIT OPERATOR AND WORKING INTEREST OWNER

E. L. Fauley

By Edwin W. Fauley

Address 717 N. Highland Ave.
~~Los Angeles 38, Calif.~~

ATTEST:

Secretary

E. R. T. Harrison

By

Address

ATTEST:

Secretary

CONTINENTAL OIL COMPANY

By
ATTORNEY-IN-FACT

Address 1216 FAIR BUILDING
FORT WORTH, TEXAS

ATTEST:

Secretary

By

Address 1813 Fair Building
Fort Worth 2, Texas

ATTEST:

Secretary

By

Address

ATTEST:

_____
Secretary

By _____

Address _____

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Secretary

By _____

Address _____

ATTEST:

_____
Secretary

By _____

Address _____

ATTEST:

_____
Secretary

By W. W. Sheffield

Address 1200 Ft Worth Nat'l Bk Bldg
Ft Worth, Texas

ATTEST:

_____
Secretary

By Lamar L. Fleming

Address 1200 Ft Worth Nat'l Bk Bldg
Ft Worth, Texas

J. M. Stanfield

Address 7363 Wilshire Blvd
Beverly Hills, Calif

R. L. Kerr

Address 436 San Pedro Rd
Pacific Palisades, Calif

12305 5th Helena

Address ~~Los Angeles 49, Calif~~

Address

Address

Address

Address

Address

Address

STATE OF _____ }
COUNTY OF _____ } ss.

The foregoing instrument was acknowledged before me this _____ day of _____, 1958, by _____ of the Texas Company, a _____ corporation, on behalf of said corporation.

_____
Notary Public

My Commission Expires:

_____

STATE OF Texas }
COUNTY OF Tarrant } ss.

The foregoing instrument was acknowledged before me this 22nd day of May, 1958, by G. T. PEARSON ATTORNEY IN FACT of CONTINENTAL Oil COMPANY a Delaware corporation, on behalf of said corporation.

Evelyn Pritchett
Notary Public

My Commission Expires:

June 1, 1959

STATE OF _____ }
COUNTY OF _____ } ss.

The foregoing instrument was acknowledged before me this _____ day of _____, 1958, by _____ of _____ a _____ corporation, on behalf of said corporation.

_____
Notary Public

My Commission Expires:

_____

STATE OF _____ }
COUNTY OF _____ } ss.

The foregoing instrument was acknowledged before me this _____ day of _____, 1958, by _____ of _____ a _____ corporation, on behalf of said corporation.

_____
Notary Public

My Commission Expires:

_____

STATE OF ____________ }
COUNTY OF ____________ } ss.

The foregoing instrument was acknowledged before me this ______ day of ______________, 1958, by ____________ of ____________ a ____________ corporation, on behalf of said corporation.

____
Notary Public

My Commission Expires:

____

STATE OF ____________ }
COUNTY OF ____________ } ss.

The foregoing instrument was acknowledged before me this ______ day of ______________, 1958, by ____________ of ____________ a ____________ corporation, on behalf of said corporation.

____
Notary Public

My Commission Expires:

____

STATE OF ____________ }
COUNTY OF ____________ } ss.

The foregoing instrument was acknowledged before me this ______ day of ______________, 1958, by ____________ of ____________ a ____________ corporation, on behalf of said corporation.

____
Notary Public

My Commission Expires:

____

STATE OF ____________ }
COUNTY OF ____________ } ss.

The foregoing instrument was acknowledged before me this ______ day of ______________, 1958, by ____________ of ____________ a ____________ corporation, on behalf of said corporation.

____
Notary Public

My Commission Expires:

____

STATE OF _____ }
COUNTY OF _____ } ss.

The foregoing instrument was acknowledged before me this _____ day of _____, 1958, by _____ and his wife _____.

_____
Notary Public

My Commission Expires:

_____

STATE OF _____ }
COUNTY OF _____ } ss.

The foregoing instrument was acknowledged before me this _____ day of _____, 1958, by _____ and his wife, _____.

_____
Notary Public

My Commission Expires:
My Commission Expires May 10, 1962

STATE OF Texas }
COUNTY OF TARRANT } ss.

The foregoing instrument was acknowledged before me this 5 day of June, 1958, by Stu Richardson and his wife, Perry R. Bass.

Delphia Cordin
Notary Public
DELPHIA CORDIN
NOTARY PUBLIC, TARRANT CO., TEXAS

My Commission Expires:
June 1 1959

STATE OF _____ }
COUNTY OF _____ } ss.

The foregoing instrument was acknowledged before me this 23rd day of May, 1958, by _____ and his wife, _____.

_____
Notary Public

My Commission Expires:
ELLIS ADAMS, Notary Public
My Commission Expires June 1, 1959

STATE OF CALIFORNIA }
COUNTY OF LOS ANGELES } ss.

The foregoing instrument was acknowledged before me this 21st day of April, 1958, by T. M. CARTWRIGHT and [illegible].

Notary Public

My Commission Expires:

3-14-59

STATE OF CALIFORNIA }
COUNTY OF LOS ANGELES } ss.

The foregoing instrument was acknowledged before me this 22nd day of April, 1958, by R. J. KERR and [illegible].

Notary Public

My Commission Expires:

3-14-59

STATE OF CALIFORNIA }
COUNTY OF LOS ANGELES } ss.

The foregoing instrument was acknowledged before me this 24th day of April, 1958, by W. R. PAGEN and EDWIN W. PAULEY and [illegible].

Notary Public

My Commission Expires:

3-14-59

STATE OF New Mexico }
COUNTY OF Bernalillo } ss.

The foregoing instrument was acknowledged before me this 24 day of April, 1958, by [illegible] and [illegible], his wife.

Notary Public

My Commission Expires:

Dec 29 1962

EXHIBIT "C" PASO-T-1971-J

Attached hereto and made a part of Unit Operating Agreement for the development and operation of the Cotton Draw Unit Area, in Rio Arriba and Eddy Counties, New Mexico

ACCOUNTING PROCEDURE
(UNIT AND JOINT LEASE OPERATIONS)

I. GENERAL PROVISIONS

1. Definitions

"Joint property" as herein used shall be construed to mean the subject area covered by the agreement to which this "Accounting Procedure" is attached.

"Operator" as herein used shall be construed to mean the party designated to conduct the development and operation of the subject area for the joint account of the parties hereto.

"Non-Operator" as herein used shall be construed to mean any one or more of the non-operating parties.

2. Statements and Billings

Operator shall bill Non-Operator on or before the last day of each month for its proportionate share of costs and expenditures during the preceding month. Such bills will be accompanied by statements reflecting the total costs and charges as set forth under Subparagraph C below.

A. Statement in detail of all charges and credits to the joint account.

B. Statement of all charges and credits to the joint account, summarized by appropriate classifications indicative of the nature thereof.

C. Statements as follows:

(1) Detailed statement of material ordinarily considered controllable by operators of oil and gas properties.

(2) Statement of ordinary charges and credits to the joint account summarized by appropriate classifications indicative of the nature thereof; and

(3) Detailed statement of any other charges and credits.

3. Payments by Non-Operator

Each party shall pay its proportion of all such bills within fifteen (15) days after receipt thereof. If payment is not made within such time, the unpaid balance shall bear interest at the rate of six percent (6%) per annum until paid.

4. Adjustments

Payment of any such bills shall not prejudice the right of Non-Operator to protest or question the correctness thereof. Subject to the exception noted in Paragraph 1 of this Section I, all statements rendered to Non-Operator by Operator during any calendar year shall conclusively be presumed to be true and correct after twenty-four (24) months following the end of any such calendar year, unless within the said twenty-four (24) month period Non-Operator takes written exception thereto and makes claim on Operator for adjustment. Failure on the part of Non-Operator to make claim on Operator for adjustment within such period shall establish the correctness thereof and preclude the filing of exceptions thereto or making of claims for adjustment thereon. The provisions of this paragraph shall not prevent adjustments resulting from physical inventory of property as provided for in Section VI, Inventories, hereof.

5. Audits

A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the accounting hereunder for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, that Non-Operator must take written exception to and make claim upon the Operator for all discrepancies disclosed by said audit within said twenty-four (24) month period. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct joint or simultaneous audits in a manner which will result in a minimum of inconvenience to the Operator.

II. DEVELOPMENT AND OPERATING CHARGES

Subject to limitations hereinafter prescribed, Operator shall charge the joint account with the following items:

1. Rentals and Royalties

Delay or other rentals when such rentals are paid by Operator for the joint account; royalties, when not paid directly to royalty owners by the purchaser of the oil, gas, casinghead gas or other products.

2. Labor

A. Salaries and wages of Operator's employees directly engaged on the joint property in the development, maintenance and operation thereof, including salaries or wages paid to geologists and other employees who are temporarily assigned to and directly employed on the joint property.

B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances applicable to the salaries and wages chargeable under Subparagraph 2 A and Paragraph 11 of this Section II. Costs under this Subparagraph 2 B may be charged on a "direct" and "paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable under Subparagraph 2 A and Paragraph 11 of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.

C. Costs of expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's labor cost of salaries and wages as provided under Subparagraphs 2 A, 2 B, and Paragraph 11 of this Section II.

3. Employee Benefits

Operator's current cost of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus and other benefit plans of a like nature, applicable to Operator's labor cost, provided that the total of such charges shall not exceed ten per cent (10%) of Operator's labor costs as provided in Subparagraphs A and B of Paragraph 2 of this Section II and in Paragraph 11 of this Section II.

4. Material

Material, equipment, and supplies purchased or furnished by Operator for use of the joint property. So far as it is reasonably practical and consistent with efficient and economical operation, only such material shall be purchased for or transferred to the joint property as may be required for immediate use; and the accumulation of surplus stocks shall be avoided.

5. Transportation

Transportation of employees, equipment, material and supplies necessary for the development, maintenance and operation of the joint property subject to the following limitations:

A. If material is moved to the joint property from vendor's or from the Operator's warehouse or other properties, no charge shall be made to the joint account for a distance greater than the distance from the nearest reliable supply store or railway receiving point where such material is available, except by special agreement with Non-Operator.

B. If surplus material is moved to Operator's warehouse or other storage point, no charge shall be made to the joint account for a distance greater than the distance from the nearest reliable supply store, or railway receiving point, except by special agreement with Non-Operator. No charge shall be made to the joint account for moving material to other properties belonging to Operator, except by special agreement with Non-Operator.

6. Service:

A. Outside Services:

The cost of contract services and utilities procured from outside sources.

B. Use of Operator's Equipment and Facilities:

Use of and service by Operator's exclusively owned equipment and facilities as provided in Paragraphs 3 of Section III entitled "Operator's Exclusively Owned Facilities."

7. Damages and Losses to Joint Property and Equipment:

All costs or expenses necessary to replace or repair damages or losses incurred by fire, flood, storm, theft, accident, or any other cause not controllable by Operator through the exercise of reasonable diligence. Operator shall furnish Non-Operator written notice of damages or losses incurred as soon as practicable after report of the same has been received by Operator.

8. Litigation Expense:

All costs and expenses of litigation or legal services otherwise necessary or expedient for the protection of the joint interests, including attorneys' fees and expenses as hereinafter provided, together with all judgments obtained against the parties or any of them on account of the joint operations under this agreement, and actual expenses incurred by any party or parties hereto in securing evidence for the purpose of defending against any action or claim prosecuted or urged against the joint account or the subject matter of this agreement.

A. If a majority of the interests hereunder shall so agree, actions or claims affecting the joint interests hereunder may be handled by the legal staff of one or more of the parties hereto, and a charge commensurate with cost of providing and furnishing such services rendered may be made against the joint accounts, but no such charge shall be made until approved by the legal departments or attorneys for the respective parties hereto.

B. Fees and expenses of outside attorneys shall not be charged to the joint account unless authorized by the majority of the interests hereunder.

9. Taxes:

All taxes of every kind and nature assessed or levied upon or in connection with the properties which are the subject of this agreement, the production therefrom or the operation thereof, and which taxes have been paid by the Operator for the benefit of the parties hereto.

10. Insurance and Claims:

A. The parties hereto shall insure their respective risks.

B. If the parties hereto or any of them shall insure their respective risks beyond the specific limits of insurance required to be carried by the Operator under the terms of the Agreement, the benefits of such insurance shall inure to the parties procuring and maintaining the same, and the cost of such insurance shall be borne by such parties, respectively, without reimbursement one from the other and without entering into the accounting hereunder.

[illegible] camps including housing facilities for [illegible] of the operations on the joint property and other properties operated in the same locality. The expense [illegible] of less any revenue from other facilities should be inclusive of depreciation or a fair monthly rental in lieu of depreciation on the investment of such [illegible]

12. Administrative Overhead:

district and camp expense and all expenses of all offices of the Operator, including salaries and expenses of personnel assigned to such offices.

Operator shall have the right to assess against the joint property covered hereby the following management and administrative overhead charges which shall be in lieu of all [illegible] except that salaries of geologists and other employees of Operator who are temporarily assigned to and directly serving on the joint property will be charged as provided in Section III, Paragraph 2, above. Salaries and expenses of other technical employees assigned to such offices will be considered as covered by overhead charges in this paragraph unless charges for such salaries and expenses are agreed upon between Operator and Non-Operator as a direct charge to the joint property.

WELL BASIS (Rate Per Well Per Month)

Well Depth	DRILLING WELL RATE: Each Well	Producing Well Rate (Upon Completion Depth): First Five	Next Five	All Wells Over Ten
Down to 8500'	$450.00	$75.00	$68.00	$50.00
Below 8500'	600.00	100.00	75.00	65.00

drilling operations are completed or the well

A. Overhead charges for drilling wells shall begin on the date each well is spudded and terminate on the date it is plugged or [illegible] as the case may be, except that no charge shall be made during the suspension of drilling operations for fifteen (15) or more consecutive days.

B. In connection with overhead charges, the status of wells shall be as follows:

(1) Injection wells for recovery operations, such as for repressure or water flood, shall be included in the overhead schedule the same as producing oil wells.

(2) Water supply wells utilized for water flooding operations shall be included in the overhead schedule the same as producing oil wells.

(3) Producing gas wells shall be included in the overhead schedule the same as producing oil wells.

(4) Wells permanently shut down on which plugging operations are deferred shall be charged from the overhead [illegible] shutdown is effected. When such wells are plugged, overhead shall be charged at the producing well rate [illegible] plugging operations.

(5) Wells being plugged back, drilled deeper, or converted to a source of input shall be included in the overhead [illegible] drilling wells.

(6) Temporarily shut-down wells (other than by governmental regulatory body) which are not produced or worked [illegible] calendar month shall not be included in the overhead schedules; however, wells shut in by governmental regulatory body shall be included in the overhead schedule only to the extent the allowable production is transferred to other wells on the same property. In the event the allowable [illegible] all wells capable of producing will be counted in determining the overhead charge.

(7) Wells completed in dual or multiple horizons shall be considered as two wells in the producing overhead schedule.

(8) Lease salt water disposal wells shall not be included in the overhead schedule unless such wells are used in a secondary recovery program on the joint property.

C. The above overhead schedule for producing wells shall be applied to the total number of wells operated under the Operating Agreement to which this accounting procedure is attached, irrespective of individual leases.

D. It is specifically understood that the above overhead rates apply only to drilling and producing operations and are not intended to cover the construction by Operator of additional facilities such as, but not limited to, gasoline plants, compressor plants, repressuring projects, salt water disposal facilities, and similar installations. If at any time any or all of these become necessary to the operation, a separate agreement will be reached relative to an overhead charge and allocation of district expense.

E. The above specific overhead rates may be amended from time to time by agreement between Operator and Non-Operator if, in practice, they are found to be insufficient or excessive.

12. Operator's Fully Owned Warehouse Operating and Maintenance Expense

(Describe fully the agreed procedure to be followed by the Operator.)

None

13. Other Expenditures

Any expenditure, other than expenditures which are covered and dealt with by the foregoing provisions of this Section II, incurred by the Operator for the necessary and proper development, maintenance, and operation of the joint property.

III. BASIS OF CHARGES TO JOINT ACCOUNT

1. Purchases

Material and equipment purchased and service procured shall be charged at price paid by Operator after deduction of all discounts actually received.

2. Material Furnished by Operator

Material required for operations shall be purchased for direct charge to joint account whenever practicable, except that Operator may furnish such material from Operator's stocks under the following conditions:

A. New Material (Condition "A")

(1) New material transferred from Operator's warehouse or other properties shall be priced f.o.b. the nearest reputable supply store or railway receiving point where such material is available, at current replacement cost of the same kind of material. This will include material such as tanks, pumping units, bucket rods, engines, and other major equipment. Tubular goods, two-inch (2") and over, shall be priced on carload basis effective at date of transfer and f.o.b. railway receiving point nearest the joint account operation, regardless of quantity transferred.

(2) Other material shall be priced on basis of Operator's preferential price (effective at date of transfer and f.o.b. the nearest reputable supply store or railway receiving point nearest the joint account operation where such material is available.

(3) Cash discount shall not be allowed.

B. Used Material (Condition "B" and "C")

(1) Material which is in sound and serviceable condition and is suitable for reuse without reconditioning shall be classed as Condition "B" and priced at seventy-five per cent (75%) of new price.

(2) Material which cannot be classified as Condition "B" but which

(a) After reconditioning will be further serviceable for original function as good secondhand material (Condition "B"), or

(b) Is serviceable for original function but substantially not suitable for reconditioning,

shall be classed as Condition "C" and priced at fifty per cent (50%) of new price.

(3) Material which cannot be classified as Condition "B" or Condition "C" shall be priced at a value commensurate with its use.

(4) Tanks, buildings, and other equipment involving erection costs shall be charged at applicable percentages of knocked-down new price.

3. Premium Prices

Whenever materials and equipment are not readily obtainable at the customary supply point and at prices specified in Paragraphs 1 and 2 of this Section III because of national emergencies, strikes or other unusual causes over which the Operator has no control, the Operator may charge the joint account for the required materials on the basis of the Operator's direct cost and expense incurred in procuring such materials, in making it suitable for use, and in moving it to the location, provided, however, that notice in writing is furnished to Non-Operator of the proposed charge prior to billing the Non-Operator for the material and/or equipment acquired pursuant to this provision, whereupon Non-Operator shall have the right by so electing and notifying Operator within 10 days after receiving notice from the Operator, to furnish in kind, or in tonnage as the parties may agree, at the location, nearest railway receiving point, or Operator's storage point within a comparable distance, all or part of his share of material and/or equipment suitable for use and acceptable to the Operator. Transportation costs on any such material furnished by Non-Operator, at any point other than at the location, shall be borne by such Non-Operator. If, pursuant to the provisions of this paragraph, any Non-Operator furnishes material and/or equipment in kind, the Operator shall make appropriate credits therefor to the account of said Non-Operator.

4. Warranty of Material Furnished by Operator

Operator does not warrant the material furnished beyond or back of the dealer's or manufacturer's guaranty; and in case of defective material, credit shall not be passed until adjustment has been received by Operator from the manufacturers or their agents.

5. Operator's Exclusively Owned Facilities

The following rates shall apply to service rendered to the joint account by facilities owned exclusively by Operator:

A. Water, fuel, power, compressor and other auxiliary services at rates commensurate with cost of providing and furnishing such service to the joint account but not exceeding rates currently prevailing in the field where the joint property is located.

B. Automotive equipment at rates commensurate with cost of ownership and operation. Such rates should generally be in line with the schedule of rates adopted by the Petroleum Motor Transport Association, or some other recognized organization, as recommended uniform charges against joint account operations and revised from time to time. Automotive rates shall include cost of oil, gas, repairs, insurance, and other operating expense, and depreciation, and charges shall be based on use in actual service by, or in connection with, the joint account operations. Truck and tractor rates may include wages and expenses of driver.

C. A fair rate shall be charged for the use of drilling and cleaning-out tools and for other items of Operator's fully owned machinery or equipment which shall be ample to cover maintenance, repairs, depreciation, and the services furnished the joint property; provided that such charges shall not exceed those currently prevailing in the field where the joint property is located. Pulling units shall be charged at hourly rates commensurate with the cost of ownership and operation, which shall include repairs and maintenance, operating supplies, insurance, depreciation, and taxes. Pulling unit rates may include wages and expenses of the operator.

D. A fair rate shall be charged for laboratory services performed by Operator for the benefit of the joint account, such as gas, water, core, and other analyses and tests; provided such charges shall not exceed those currently prevailing if performed by outside service laboratories.

E. Whenever requested, Operator shall inform Non-Operator in advance of the rates it proposes to charge.

F. Rates shall be revised and adjusted from time to time whenever found to be either excessive or insufficient.

IV. DISPOSAL OF LEASE EQUIPMENT AND MATERIAL

The Operator shall be under no obligation to purchase interest of Non-Operator in surplus new or secondhand material. The disposition of major items of surplus material, such as derricks, tanks, engines, pumping units, and tubular goods, shall be subject to mutual determination by the parties hereto; provided Operator shall have the right to dispose of normal accumulations of junk and scrap material either by transfer or sale from the joint property.

1. Material Purchased by the Operator or Non-Operator

Material purchased by either the Operator or Non-Operator shall be credited by the Operator to the joint account for the month in which the material is removed by the purchaser.

2. Division in Kind

Division of material in kind, if made between Operator and Non-Operator, shall be in proportion to their respective interests in such material. Each party will thereupon be charged individually with the value of the material received or receivable by each party, and corresponding credits will be made by the Operator to the joint account. Such credits shall appear in the monthly statements of operations.

3. Sales to Outsiders

Sales to outsiders of material from the joint property shall be credited by Operator to the joint account at the net amount collected by Operator from vendee. Any claims by vendee for defective material or otherwise shall be charged back to the joint account if and when paid by Operator.

V. BASIS OF PRICING MATERIAL TRANSFERRED FROM JOINT ACCOUNT

Material purchased by either Operator or Non-Operator or divided in kind, unless otherwise agreed, shall be valued on the following basis:

1. New Price Defined

New price as used in the following paragraphs shall have the same meaning and application as that used above in Section III, "Basis of Charges to Joint Account."

2. New Material

New material (Condition "A"), being new material procured for the joint account but never used thereon, at one hundred per cent (100%) of current new price (plus sales tax if any).

3. Good Used Material

Good used material (Condition "B"), being used material in sound and serviceable condition, suitable for reuse without reconditioning:

A. At seventy-five per cent (75%) of current new price if material was originally charged to the joint property at seventy-five per cent (75%) or more of new price.

B. At proportionately lower percentage of current new price if material was originally charged to the joint property at less than seventy-five per cent (75%) of new price.

4. Other Used Material

Used material (Condition "C"), at fifty per cent (50%) of current new price, being used material which:

A. After reconditioning will be further serviceable for original function as good secondhand material (Condition "B"), or

B. Is serviceable for original function but substantially not suitable for reconditioning.

5. Bad-Order Material

Material and equipment (Condition "D"), which is no longer usable for its original purpose without excessive repair cost but is further usable for some other purpose, shall be priced on a basis comparable with that of items normally used for that purpose.

6. Junk

Junk (Condition "E"), being obsolete and scrap material, at prevailing prices.

7. Temporarily Used Material

When the use of material is temporary and its service to the joint account does not justify the reduction in price as provided in Paragraph 3A above, such material shall be priced on a basis that will leave a net charge to the joint account consistent with the value of the service rendered.

VI. INVENTORIES

1. Periodic Inventories, Notice and Representation

At reasonable intervals, inventories shall be taken by Operator of the joint account material, which shall include all such material as is ordinarily considered controllable by operators of oil and gas properties.

Written notice of intention to take inventory shall be given by Operator at least thirty (30) days before any inventory is to begin so that Non-Operator may be represented when any inventory is taken.

Failure of Non-Operator to be represented at an inventory shall bind Non-Operator to accept the inventory taken by Operator, who shall in that event furnish Non-Operator with a copy thereof.

2. Reconciliation and Adjustment of Inventories

Reconciliation of inventory with charges to the joint account shall be made by Operator, and a list of overages and shortages shall be furnished to Non-Operator.

Inventory adjustments shall be made by Operator with the joint account for overages and shortages, but Operator shall be held accountable to Non-Operator only for shortages due to lack of reasonable diligence.

3. Special Inventories

Special inventories may be taken, at the expense of the party, whenever there is any sale or change of interest in the joint property; and it shall be the duty of the party selling to notify all other parties as quickly as possible after the transfer of interest takes place. In such cases, both the seller and the purchaser shall be represented and shall participate in the inventory so taken.