

NMOCD Examiner Hearing September 16, 2010  
Docket 3110 Case 14541  
Exhibit 6

Westland Park 1 & 2

A.A.P.L. FORM 610-1982

## MODEL FORM OPERATING AGREEMENT

### OPERATING AGREEMENT

#### DATED

July 1, 20 10,

OPERATOR MERRION OIL & GAS CORPORATION

CONTRACT AREA Township 29 North, Range 13 West, NMPM

Section 18: N/2

DEPTHS: Surface to base of Pictured Cliffs formation

COUNTY OR PARISH OF San Juan STATE OF New Mexico

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A.A.P.L. FORM 610 - MODEL FORM OPERATING AGREEMENT - 1982

OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between Merrion Oil & Gas Corporation  
610 Rellly Avenue, Farmington, New Mexico 87401, hereinafter designated and  
referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein  
as "Non-Operator", and collectively as "Non-Operators".

WITNESSETH:

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

NOW, THEREFORE, it is agreed as follows:

ARTICLE I  
DEFINITIONS

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

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

B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land  
lying within the Contract Area which are owned by the parties to this agreement.

C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the  
Contract Area which are owned by parties to this agreement.

D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be  
developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests  
are described in Exhibit "A".

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

F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.

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

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

Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the  
singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II  
EXHIBITS

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

☒ A. Exhibit "A", shall include the following information:

- (1) Identification of lands subject to this agreement,
- (2) Restrictions, if any, as to depths, formations, or substances,
- (3) Percentages or fractional interests of parties to this agreement,
- (4) Oil and gas leases and/or oil and gas interests subject to this agreement,
- (5) Addresses of parties for notice purposes.

☐ B. ~~Exhibit "B", Form of Lease.~~

☒ C. Exhibit "C", Accounting Procedure.

☒ D. Exhibit "D", Insurance.

☒ E. Exhibit "E", Gas Balancing Agreement.

☐ F. ~~Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.~~

☐ G. ~~Exhibit "G", Tax Partnership.~~

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

**ARTICLE III.**  
**INTERESTS OF PARTIES**

**A. Oil and Gas Interests:**

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

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

Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties as their interests are set forth in Exhibit "A". In the same manner, the parties shall also own all production of oil and gas from the Contract Area subject to the payment of royalties to the extent of Actual Royalties as referenced in leases which shall be borne as hereinafter set forth.

Regardless of which party has contributed the lease(s) and/or oil and gas interest(s) hereto on which royalty is due and payable, each party entitled to receive a share of production of oil and gas from the Contract Area shall bear and shall pay or deliver, or cause to be paid or delivered, to the extent of its interest in such production, the royalty amount stipulated hereinabove and shall hold the other parties free from any liability therefor. No party shall ever be responsible, however, on a price basis higher than the price received by such party, to any other party's lessor or royalty owner, and if any such other party's lessor or royalty owner should demand and receive settlement on a higher price basis, the party contributing the affected lease shall bear the additional royalty burden attributable to such higher price.

Nothing contained in this Article III.B. shall be deemed an assignment or cross-assignment of interests covered hereby.

**C. Excess Royalties, Overriding Royalties and Other Payments:**

Unless changed by other provisions, if the interest of any party in any lease covered hereby is subject to any royalty, overriding royalty, production payment or other burden on production in excess of the amount stipulated in Article III.B., such party so burdened shall assume and alone bear all such excess obligations and shall indemnify and hold the other parties hereto harmless from any and all claims and demands for payment asserted by owners of such excess burden.

**D. Subsequently Created Interests:**

If any party should hereafter create an overriding royalty, production payment or other burden payable out of production attributable to its working interest hereunder, or if such a burden existed prior to this agreement and is not set forth in Exhibit "A", or was not disclosed in writing to all other parties prior to the execution of this agreement by all parties, or is not a jointly acknowledged and accepted obligation of all parties (any such interest being hereinafter referred to as "subsequently created interest" irrespective of the timing of its creation and the party out of whose working interest the subsequently created interest is derived being hereinafter referred to as "burdened party"), and:

1. If the burdened party is required under this agreement to assign or relinquish to any other party, or parties, all or a portion of its working interest and/or the production attributable thereto, said other party, or parties, shall receive said assignment and/or production free and clear of said subsequently created interest and the burdened party shall indemnify and save said other party, or parties, harmless from any and all claims and demands for payment asserted by owners of the subsequently created interest; and,
2. If the burdened party fails to pay, when due, its share of expenses chargeable hereunder, all provisions of Article VII.B. shall be enforceable against the subsequently created interest in the same manner as they are enforceable against the working interest of the burdened party.

**ARTICLE IV.**  
**TITLES**

**A. Title Examination:**

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and/or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and/or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including federal lease status reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of the title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

- ☐ Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be a part of the administrative overhead as provided in Exhibit "C", and shall not be a direct charge, whether performed by Operator's staff attorneys or by outside attorneys.

**ARTICLE IV**  
**continued**

1 Ex Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys or examiners for title examination  
2 (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties  
3 in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Ex-  
4 hibit "A". Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above  
5 functions.

6  
7 Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection  
8 with leases or oil and gas interests contributed by such party. Operator shall be responsible for the preparation and recording of pooling  
9 designations or declarations as well as the conduct of hearings before governmental agencies for the securing of spacing or pooling orders.  
10 This shall not prevent any party from appearing on its own behalf at any such hearing.

11  
12 No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above  
13 provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to par-  
14 ticipate in the drilling of the well.

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16 **B. Loss of Title:**

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18 1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a  
19 reduction of interest from that shown on Exhibit "A", the party contributing the affected lease or interest shall have ninety (90) days  
20 from final determination of title failure to acquire a new lease or other instrument curing the entirety of the title failure, which acquisi-  
21 tion will not be subject to Article VIII.B., and failing to do so, this agreement, nevertheless, shall continue in force as to all remaining oil  
22 and gas leases and interests; and,

23 (a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be  
24 entitled to recover from Operator or the other parties any development or operating costs which it may have theretofore paid or incurred,  
25 but there shall be no additional liability on its part to the other parties hereto by reason of such title failure;

26 (b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has  
27 been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has oc-  
28 curred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract  
29 Area by the amount of the interest lost;

30 (c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract Area is  
31 increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such in-  
32 terest (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such  
33 well;

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

37 (e) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be  
38 borne by the party or parties whose title failed in the same proportions in which they shared in such prior production; and,

39 (f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest  
40 claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in  
41 connection therewith.

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

54 (a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost interest, on an acreage basis,  
55 up to the amount of unrecovered costs;

56 (b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an acreage basis, of that portion of  
57 oil and gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such lease  
58 termination, would be attributable to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said  
59 portion of the oil and gas to be contributed by the other parties in proportion to their respective interest; and,

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

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63 3. Other Losses: All losses of title incurred other than those set forth in Articles IV.B.1. and IV.B.2. above, shall be joint losses  
64 and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of  
65 the Contract Area.

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ARTICLE V.  
OPERATOR

A. Designation and Responsibilities of Operator:

Merrion Oil & Gas Corporation

shall be the

Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

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

1. Resignation or Removal of Operator. Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest hereunder in the Contract Area, or is no longer capable of serving as Operator, Operator shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator. Upon the resignation or removal of Operator, a successor Operator shall be selected by the parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. The successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A"; provided, however, if an Operator which has been removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

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

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.  
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the 31<sup>st</sup> day of December, 20 11, Operator shall commence the drilling of a well for oil and gas at the following location:

T29N - R13W, Sec 18; N/2  
San Juan County, NM

and shall thereafter continue the drilling of the well with due diligence to a depth sufficient to test the Fruitland Coal Formation.

unless granite or other practically impenetrable substance or condition in the hole, which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.

ARTICLE VI  
continued

1 If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the  
2 well as a dry hole, the provisions of Article VI.E.1. shall thereafter apply.

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5 **B. Subsequent Operations:**

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7 1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided  
8 for in Article VI.A., or to rework, deepen or plug back a well producing in paying quantities or a well jointly-owned by all  
9 the parties / and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the  
10 other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective forma-  
11 tion and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice  
12 within which to notify the party wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drill-  
13 ing rig is on location, notice of a proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be  
14 limited to forty-eight (48) hours, exclusive of Saturday, Sunday, and legal holidays. Failure of a party receiving such notice to reply within  
15 the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or  
16 response given by telephone shall be promptly confirmed in writing.

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20 If all parties elect to participate in such a proposed operation, Operator shall, within <sup>one hundred eighty (180)</sup> / ninety (90) days after expiration of the notice  
21 period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period when a drilling rig is on loca-  
22 tion, as the case may be), actually commence the proposed operation and complete it with due diligence at the risk and expense of all par-  
23 ties hereto; provided, however, said commencement date may be extended upon written notice of same by Operator to the other parties,  
24 for a period of up to <sup>one hundred eighty (180)</sup> / thirty (30) additional days if, in the sole opinion of Operator, such additional time is reasonably necessary to obtain  
25 permits from governmental authorities, surface rights (including rights-of-way) or appropriate drilling equipment, or to complete title ex-  
26 amination or curative matter required for title approval or acceptance. Notwithstanding the force majeure provisions of Article XI, if the  
27 actual operation has not been commenced within the time provided (including any extension thereof as specifically permitted herein) and  
28 if any party hereto still desires to conduct said operation, written notice proposing same must be resubmitted to the other parties in ac-  
29 cordance with the provisions hereof as if no prior proposal had been made.

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33 2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VII.D.1. (Option  
34 No. 2) elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this Article, the party or parties  
35 giving the notice and such other parties as shall elect to participate in the operation shall, within <sup>one hundred eighty (180)</sup> / ninety (90) days after the expiration of  
36 the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period when a drilling rig is  
37 on location, as the case may be) actually commence the proposed operation and complete it with due diligence. Operator shall perform all  
38 work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is  
39 a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed opera-  
40 tion for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Con-  
41 senting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and con-  
42 ditions of this agreement.

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46 If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable  
47 notice period, shall advise the Consenting Parties of the total interest of the parties approving such operation and its recommendation as  
48 to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours  
49 (exclusive of Saturday, Sunday and legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit par-  
50 ticipation to such party's interest as shown on Exhibit "A" or (b) carry its proportionate part of Non-Consenting Parties' interests, and  
51 of (c) carry its proportionate part (determined as provided in (b) of Non-Consenting Parties' interests together with all or a portion  
52 of its proportionate part of any Non-Consenting Parties' interests that any Consenting Party did not elect to take. Any interest of Non-  
53 Consenting Parties that is not carried by a Consenting Party shall be deemed to be carried by the party proposing the operation if such  
54 party does not withdraw its proposal.  
55 / failure to advise the proposing party shall be deemed an election under (a). In the event a drilling rig is on location, the time permitted for  
56 such a response shall not exceed a total of forty-eight (48) hours <sup>exclusive</sup> /of Saturday, Sunday and legal holidays). The proposing party,  
57 at its election, may withdraw such proposal if there is insufficient participation and shall promptly notify all parties of such decision.

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59 The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have  
60 elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such  
61 operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties.  
62 If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well and restore the surface location at their  
63 sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a pro-  
64 ducer of oil and/or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk,  
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ARTICLE VI  
continued

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3 and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties  
4 in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties,  
5 and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting  
6 Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or  
7 applicable ad valorem taxes, production taxes, severance taxes, excise taxes  
8 and gathering fees  
9 market value thereof if such share is not sold, (after deducting / production taxes, excise taxes, royalty, / overriding royalty and other in-  
10 terests not excepted by Article III.D. payable out of or measured by the production from such well accruing with respect to such interest  
11 until it reverts) shall equal the total of the following:

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

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21  
22 (b) 300 % of that portion of the costs and expenses of drilling, reworking, deepening, plugging back, testing and completing,  
23 after deducting any cash contributions received under Article VIII.C., and 100 % of that portion of the cost of newly acquired equip-  
24 ment in the well (to and including the wellhead connections), which would have been chargeable to such Non-Consenting Party if it had  
25 participated therein.

26  
27  
28 An election not to participate in the drilling or the deepening of a well shall be deemed an election not to participate in any re-  
29 working or plugging back operation proposed in such a well, or portion thereof, to which the initial Non-Consent election applied that is  
30 conducted at any time prior to full recovery by the Consenting Parties of the Non-Consenting Party's recoupment account. Any such  
31 reworking or plugging back operation conducted during the recoupment period shall be deemed part of the cost of operation of said well  
32 and there shall be added to the sums to be recouped by the Consenting Parties one hundred percent (100%) of that portion of the costs of  
33 the reworking or plugging back operation which would have been chargeable to such Non-Consenting Party had it participated therein. If  
34 such a reworking or plugging back operation is proposed during such recoupment period, the provisions of this Article VLB. shall be ap-  
35 plicable as between said Consenting Parties in said well.

36  
37  
38 During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the  
39 proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, excise, / gathering and other  
40 taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production not excepted by Ar-  
41 ticle III.D.

42  
43  
44 In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free  
45 of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon  
46 abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such equip-  
47 ment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.

48  
49  
50 Within <sup>ninety (90)</sup> ~~sixty (60)~~ days after the completion of any operation under this Article, the party conducting the operations for the  
51 Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an  
52 itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its  
53 option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly bill-  
54 ings. Each <sup>quarter</sup> ~~month~~ thereafter, during the time the Consenting Parties are being reimbursed as provided above, the party conducting the  
55 operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities in-  
56 curred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds  
57 realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas  
58 produced during any month, Consenting Parties shall use industry accepted methods such as, but not limited to, metering or periodic  
59 well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation  
60 which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs  
61 of the work done and of the equipment purchased in determining when the interest of such Non-Consenting Party shall revert to it as  
62 above provided; and if there is a credit balance, it shall be paid to such Non-Consenting Party.

63  
64  
65 Notwithstanding any provision to the contrary in this or any other agreement, a non-consenting party, upon notice in writing to  
66 Operator and/or any party carrying all or part of the non-consenting interest, shall have to right at all times and from time to time for  
67 any calendar year within the twenty-four (24) month period following the end of such calendar year to audit Operator's and/or  
68 carrying party's accounts and records relating to or connected with its operations on the Contract Area, regardless of when such  
69 operations were conducted.



**ARTICLE VI**  
continued

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5  
6 If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above,  
7 the relinquished interests of such Non-Consenting Party shall automatically revert to it, and, from and after such reversion, such Non-  
8 Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production  
9 therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, reworking, deepening or plugging  
10 back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of  
11 the operation of said well in accordance with the terms of this agreement and the Accounting Procedure attached hereto.

12  
13  
14 Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent of all parties, no wells shall  
15 be completed in or produced from a source of supply from which a well located elsewhere on the Contract Area is producing, unless such  
16 well conforms to the then-existing well spacing pattern for such source of supply.

17  
18  
19 The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A.  
20 except (a) as to Article VII.D.1. (Option No. 2), if selected, or (b) as to the reworking, deepening and plugging back of such initial well  
21 after if it has been drilled to the depth specified in Article VI.A. if it shall thereafter prove to be a dry hole or, if initially completed for pro-  
22 duction, ceases to produce in paying quantities.

23  
24  
25 3. **Stand-By Time:** When a well which has been drilled or deepened has reached its authorized depth and all tests have been  
26 completed, and the results thereof furnished to the parties, stand-by costs incurred pending response to a party's notice proposing a  
27 reworking, deepening, plugging back or completing operation in such a well shall be charged and borne as part of the drilling or deepening  
28 operation just completed. Stand-by costs subsequent to all parties responding, or expiration of the response time permitted, whichever  
29 first occurs, and prior to agreement as to the participating interests of all Consenting Parties pursuant to the terms of the second gram-  
30 matical paragraph of Article VI.B.2., shall be charged to and borne as part of the proposed operation, but if the proposal is subsequently  
31 withdrawn because of insufficient participation, such stand-by costs shall be allocated between the Consenting Parties in the proportion  
32 each Consenting Party's interest as shown on Exhibit "A" bears to the total interest as shown on Exhibit "A" of all Consenting Par-  
33 ties.

34  
35  
36 4. **Sidetracking:** Except as hereinafter provided, those provisions of this agreement applicable to a "deepening" operation shall  
37 also be applicable to any proposal to directionally control and intentionally deviate a well from vertical so as to change the bottom hole  
38 location (herein called "sidetracking"), unless done to straighten the hole or to drill around junk in the hole or because of other  
39 mechanical difficulties. Any party having the right to participate in a proposed sidetracking operation that does not own an interest in the  
40 affected well bore at the time of the notice shall, upon electing to participate, tender to the well bore owners its proportionate share (equal  
41 to its interest in the sidetracking operation) of the value of that portion of the existing well bore to be utilized as follows:

42  
43  
44 (a) If the proposal is for sidetracking an existing dry hole, reimbursement shall be on the basis of the actual costs incurred in  
45 the initial drilling of the well down to the depth at which the sidetracking operation is initiated.

46  
47  
48 (b) If the proposal is for sidetracking a well which has previously produced, reimbursement shall be on the basis of the well's  
49 salvable materials and equipment ~~remaining in the hole~~ and salvable surface equipment used in connection with such sidetracked well  
50 incurred during such extended response period. If more than one party elects to take such additional time to respond to the notice, stand  
51 by costs shall be allocated between the parties taking additional time to respond on a day-to-day basis in the proportion each electing party's  
52 interest as shown on Exhibit "A" bears to the total interest as shown on Exhibit "A" of all the electing parties. In all other in-  
53 stances the response period to a proposal for sidetracking shall be limited to thirty (30) days.

54  
55  
56 In the event that notice for a sidetracking operation is given while the drilling rig to be utilized is on location, the response period  
57 shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday and legal holidays; provided, however, any party may request and  
58 receive up to eight (8) additional days after expiration of the forty-eight (48) hours within which to respond by paying for all stand-by time  
59 incurred during such extended response period. If more than one party elects to take such additional time to respond to the notice, stand  
60 by costs shall be allocated between the parties taking additional time to respond on a day-to-day basis in the proportion each electing party's  
61 interest as shown on Exhibit "A" bears to the total interest as shown on Exhibit "A" of all the electing parties. In all other in-  
62 stances the response period to a proposal for sidetracking shall be limited to thirty (30) days.

63  
64  
65 C. **TAKING PRODUCTION IN KIND:**  
66 Each party shall <sup>have the right to</sup> take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area,  
67 exclusive of production which may be used in development and producing operations and in preparing the treating oil and gas for  
68 marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any  
69 party of its proportionate share of the production shall be borne by such party. Any party taking its share of production in kind shall be  
70

ARTICLE VI  
continued

1 required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

2  
3 Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from  
4 the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment directly from the purchaser thereof for  
5 its share of all production.

6  
7 In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of  
8 the oil produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not  
9 the obligation, to purchase such oil or sell it to others at any time and from time to time, for the account of the non-taking party at the  
10 best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the  
11 owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil not previously  
12 delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil shall be only for such reasonable periods of  
13 time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess  
14 of one (1) year.

15  
16 In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and/or  
17 deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to  
18 be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with / any gas balancing  
19 agreement between the parties hereto, ~~whether such an agreement is attached as Exhibit "E."~~ <sup>the</sup> ~~or is a separate agreement.~~

20 Notwithstanding any provision to the contrary in this or any other agreement, each party shall have the right at all times and from  
21 time to time, upon written notice, to audit all of the taking party and/or Operator's records and accounts related to or in connection  
22 with production or allocation of production from the contract area. Auditing of settlement records shall also be applicable if taking  
23 party and/or Operator distributes proceeds to auditing party.

24 **D. Access to Contract Area and Information:**

25 Each party shall have access to the Contract Area at all reasonable times, at its sole cost and risk to inspect or observe operations,  
26 and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books  
27 and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with  
28 governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of  
29 each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of  
30 gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that re-  
31 quests the Information.

32  
33 **E. Abandonment of Wells:**

34  
35 1. Abandonment of Dry Holes: Except for any well drilled or deepened pursuant to Article VI.B.2., any well which has been  
36 drilled or deepened under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned  
37 without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply  
38 within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of notice of the proposal to plug and abandon  
39 such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in  
40 accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling or deepening  
41 such well. Any party who objects to plugging and abandoning such well shall have the right to take over the well and conduct further  
42 operations in search of oil and/or gas subject to the provisions of Article VI.B.

43  
44 2. Abandonment of Wells that have Produced: Except for any well in which a Non-Consent operation has been conducted  
45 hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has been completed as a  
46 producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall  
47 be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within  
48 thirty (30) days after receipt of notice of the proposed abandonment of any well, all parties do not agree to the abandonment of such well,  
49 those wishing to continue its operation from the interval(s) of the formation(s) then open to production shall tender to each of the other  
50 parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of  
51 Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. / Each abandoning party shall assign  
52 the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and  
53 material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the in-  
54 terval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and  
55 gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or in-  
56 tervals of the formation or formations then open to production, for a term of one (1) year and so long thereafter as oil and/or gas is pro-  
57 duced from the interval or intervals of the formation or formations covered thereby, ~~such lease to be on the form attached as Exhibit~~

58  
59  
60  
61 \* Failure of a party to make an explicit election within thirty (30) days will be deemed to be an agreement by that party to abandon the  
62 well.

**ARTICLE VI**  
**continued**

1 "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the  
2 assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentage of participation in the  
3 Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of  
4 interests in the remaining portion of the Contract Area.

5  
6 Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from  
7 the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon re-  
8 quest, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges con-  
9 templated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned  
10 well. Upon proposed abandonment of the producing interval(s) assigned or leased, the assignor or lessor shall then have the option to  
11 repurchase its prior interest in the well (using the same valuation formula) and participate in further operations therein subject to the pro-  
12 visions hereof.

13  
14 3. Abandonment of Non-Consent Operations: The provisions of Article VI.E.1. or VI.E.2 above shall be applicable as between  
15 Consenting Parties in the event of the proposed abandonment of any well excepted from said Articles; provided, however, no well shall be  
16 permanently plugged and abandoned unless and until all parties having the right to conduct further operations therein have been notified  
17 of the proposed abandonment and afforded the opportunity to elect to take over the well in accordance with the provisions of this Article  
18 VI.E.

**ARTICLE VII**  
**EXPENDITURES AND LIABILITY OF PARTIES**

19  
20  
21 **A. Liability of Parties:**

22  
23 The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and  
24 shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted  
25 among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor  
26 shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.  
27  
28

29  
30 **B. Liens and Payment Defaults:**

31  
32 Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share  
33 of oil and/or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon  
34 at the rate provided in Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the  
35 state, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the ob-  
36 taining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien  
37 rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share  
38 of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from  
39 the sale of such Non-Operator's share of oil and/or gas until the amount owed by such Non-Operator, plus interest, has been paid. Each  
40 purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien  
41 and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.

42  
43 If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by  
44 Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that  
45 the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain  
46 reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.

47  
48 **C. Payments and Accounting:**

49  
50 Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development  
51 and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective propor-  
52 tionate shares upon the expense basis provided in Exhibit "C". Operator shall keep an accurate record of the joint account hereunder,  
53 showing expenses incurred and charges and credits made and received.

54  
55 Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance  
56 of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding  
57 month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together  
58 with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted  
59 on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within  
60 fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount  
61 due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual ex-  
62 pense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

63  
64 **D. Limitation of Expenditures:**

65  
66 1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened  
67 pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling or deepening shall include:  
68  
69  
70

**ARTICLE VII**  
continued

X Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and equipping of the well, including necessary tankage and/or surface facilities.

Y Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its authorized depth, and all tests have been completed, and the results thereof furnished to the parties, Operator shall give immediate notice to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion attempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, including necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less than all parties.

2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agreement. <sup>Of Article X.V.A. (Consolidation of Formations)</sup> Consent to the reworking or plugging back of a well shall include all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage and/or surface facilities.

3. Other Operations: Without the consent of all parties, Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Fifty Thousand and NO/100 Dollars (\$50,000.00) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares an authority for expenditure (AFE) for its own use, Operator shall furnish any Non-Operator so requesting an information copy thereof for any single project costing in excess of (any amount) Dollars (\$ ) but less than the amount first set forth above in this paragraph.

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

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

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

**F. Taxes:**

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

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

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

**ARTICLE VII**  
continued

**G. Insurance:**

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

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

**ARTICLE VIII.**

**ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST**

**A. Surrender of Leases:**

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

However, should any party desire to surrender its interest in any lease or in any portion thereof, and the other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not consenting to such surrender. If the interest of the assigning party is or includes an oil and gas interest, the assigning party shall execute and deliver to the party or parties not consenting to such surrender an oil and gas lease covering such oil and gas interest for a term of one (1) year and so long thereafter as oil and/or gas is produced from the land covered thereby, ~~such lease to be on the form attached hereto as Exhibit "B"~~. Upon such assignment or lease, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the interest assigned or leased and the operation of any well attributable thereto, and the assigning party shall have no further interest in the assigned or leased premises and its equipment and production other than the royalties retained in any lease made under the terms of this Article. The party assignee or lessee shall pay to the party assignor or lessor the reasonable salvage value of the latter's interest in any wells and equipment attributable to the assigned or leased acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. If the assignment or lease is in favor of more than one party, the interest shall be shared by such parties in the proportions that the interest of each bears to the total interest of all such parties.

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

**B. Renewal or Extension of Leases:**

If any party secures a renewal of any oil and gas lease subject to this agreement, all other parties shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area.

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this agreement.

The provisions in this Article shall also be applicable to extensions of oil and gas leases.

**C. Acreage or Cash Contributions:**

While this agreement is in force, if any party contracts for a contribution of cash towards the drilling of a well or any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions

## ARTICLE VIII

## continued

said Drilling Parties shared the cost of drilling the well. Such acreage shall become a separate Contract Area and, to the extent possible, be governed by provisions identical to this agreement. Each party shall promptly notify all other parties of any acreage or cash contributions it may obtain in support of any well or any other operation on the Contract Area. The above provisions shall also be applicable to optional rights to earn acreage outside the Contract Area which are in support of a well drilled inside the Contract Area.

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

**D. Maintenance of Uniform Interests:**

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or
2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement and shall be made without prejudice to the right of the other parties.

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

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

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

**F. Preferential Right to Purchase:**

~~Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which any one party owns a majority of the stock.~~

## ARTICLE IX.

## INTERNAL REVENUE CODE ELECTION

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provision herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected 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 1986, as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected 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 of the returns, statements, and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall 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. No such party shall 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 Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1986, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from operations hereunder can be adequately determined without the computation of partnership taxable income.

ARTICLE X.  
CLAIMS AND LAWSUITS

Operator may settle any single uninsured third party damage claim or suit arising from operations hereunder if the expenditure does not exceed Twenty-Five Thousand and NO/100 Dollars (\$25,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expenses of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties participating in the operation from which the claim or suit arises. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, such party shall immediately notify all other parties, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

ARTICLE XI  
FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspending during, but no longer than, the continuance of the force majeure. The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

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

The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

ARTICLE XII  
NOTICES

All notices authorized or required between the parties and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by mail or telegram, postage or charges prepaid, or by telex or telecopier and addressed to the parties to whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed, and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the mail or with the telegraph company, with postage or charges prepaid, or sent by telex or telecopier. Each party shall have the right to change its address at any time, and from time to time, by giving written notice thereof to all other parties.

ARTICLE XIII  
TERM OF AGREEMENT

This agreement shall remain in full force and effect as to the oil and gas leases and/or oil and gas interests subject hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any lease or oil and gas interest contributed by any other party beyond the term of this agreement.

☐ Option No. 1: So long as any of the oil and gas leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal, or otherwise.

☒ Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and/or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of 180 days days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling, reworking, deepening, plugging back, testing or attempting to complete a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and/or gas from the Contract Area, this agreement shall terminate unless drilling, deepening, plugging back or reworking operations are commenced within 180 days days from the date of abandonment of said well.

It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

A.A.P.L. FORM 610 - MODEL FORM OPERATING AGREEMENT - 1982

ARTICLE XIV.

COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

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

B. Governing Law:

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

C. Regulatory Agencies:

Nothing herein contained shall grant, or be construed to grant, Operator the right or authority to waive or release any rights, privileges, or obligations which Non-Operators may have under federal or state laws or under rules, regulations or orders promulgated under such laws in reference to oil, gas and mineral operations, including the location, operation, or production of wells, on tracts offsetting or adjacent to the Contract Area.

With respect to operations hereunder, Non-Operators agree to release Operator from any and all losses, damages, injuries, claims and causes of action arising out of, incident to or resulting directly or indirectly from Operator's interpretation or application of rules, rulings, regulations or orders of the Department of Energy or predecessor or successor agencies to the extent such interpretation or application was made in good faith. Each Non-Operator further agrees to reimburse Operator for any amounts applicable to such Non-Operator's share of production that Operator may be required to refund, rebate or pay as a result of such an incorrect interpretation or application, together with interest and penalties thereon owing by Operator as a result of such incorrect interpretation or application.

Non-Operators authorize Operator to prepare and submit such documents as may be required to be submitted to the purchaser of any crude oil sold hereunder or to any other person or entity pursuant to the requirements of the "Crude Oil Windfall Profit Tax Act of 1980", as same may be amended from time to time ("Act"), and any valid regulations or rules which may be issued by the Treasury Department from time to time pursuant to said Act. Each party hereto agrees to furnish any and all certifications or other information which is required to be furnished by said Act in a timely manner and in sufficient detail to permit compliance with said Act.

ARTICLE XV.

OTHER PROVISIONS:

XV.A COMMINGLING OF FORMATIONS (ATTACHED.....Pages 14a-14g)



**ARTICLE XV. A  
COMMINGLING OF FORMATIONS**

The entire costs, risk and expenses involved in drilling, testing, completing, equipping, reworking, deepening, plugging back and operating a well located on the Contract Area, in the event such well is completed in or proposed to be completed in two or more formations in which the working interest ownership differs, or in plugging and abandoning such well in one or more formations, shall be governed by the following provisions:

**A. Definitions**

- "Objective Formation" - the interval consisting of a zone, formation or horizon to be tested in a proposed operation, as stated in the AFE or notice whereby such operation was proposed.
- "Participating Interest" - the percentage of the costs and risks of conducting an operation under the applicable operating agreement that a Participating Party agrees, or is otherwise obligated, to pay and bear.
- "Participating Party" - with respect to a given formation, a Party that has approved a proposed operation or otherwise agreed, or become liable, to pay and bear a share of the costs and risks of conducting such operation under the applicable operating agreement.

References herein to multiple completion wells shall mean wells which are completed in, or proposed to be completed in, two or more formations regardless of whether such formations are produced through separate tubing strings or commingled downhole.

**B. Formula for Allocation of Drilling, Completing and Equipping Costs**

Whenever in this Agreement it is provided that costs will be borne by the Parties in accordance with this Section B, the following procedures will be used:

At the time a Party proposes the drilling of a well having two or more Objective Formations in which the working interest ownership differs, the proposing Party shall submit to the other Parties who are entitled to participate in the proposed operation, an estimate of the total costs of drilling, testing, completing and equipping said well to, and including, the wellhead in all Objective Formations. In a like manner, a Party which proposes to conduct a reworking, deepening, or plugging back operation on a well involving two or more formations in which the working interest ownership differs, shall submit to the other Parties entitled to participate in the proposed operation, an estimate of the total cost of the operation. The estimated costs shall be divided into the following categories:

- (a.) Costs to be incurred from the surface to the base of the shallowest Objective Formation, including pre-drilling costs that benefit all Objective Formations, but excluding those costs set forth in subsection B (4) hereof;
- (b.) Costs to be incurred from the base of the shallowest Objective Formation to the base of the next (second) shallowest Objective Formation, excluding those set forth in subsection B (4) hereof;
- (c.) Costs to be incurred from the base of the second shallowest Objective Formation to the base of the next (third) shallowest Objective Formation, excluding those set forth in subsection B (4) hereof;

- (d.) Costs incurred from the base of the second deepest Objective Formation to total depth;
- (e.) Costs attributable to logging, testing, perforating, treating, stimulating, completing and abandoning each formation and the cost of equipping the well with respect to equipment that is used solely in connection with one formation; and
- (f.) Costs attributable to equipping the well beyond the wellhead, with respect to equipment that serves more than one formation.

The actual costs of drilling, testing, completing, and equipping the well will be apportioned among the Objective Formations, in accordance with the categories set forth above in this Section B, as follows:

- (1) Except as provided in Subsection B (4), pre-drilling costs that benefit all Objective Formations (including, but not limited to site surveys, site preparation, right-of-way and surface damage payments) and costs incurred from the surface to the base of the shallowest Objective Formation shall be divided equally between all Objective Formations and charged to the Participating Parties therein, in accordance with their respective Participating Interest in such formations.
- (2) Except as provided in Subsection B (4), costs incurred from the base of the shallowest Objective Formation to the base of the next shallowest (second) Objective Formation shall be divided equally between the second Objective Formation and all other deeper Objective Formations and charged to the Participating Parties therein in accordance with their respective Participating Interest in such formation. In a like manner, costs incurred from the base of the second Objective Formation to the base of the next shallowest (third) Objective Formation, other than those set forth in Subsection B (4), shall be divided equally between the third Objective Formation and all other deeper Objective Formations and charged to the Participating Parties therein, in accordance with their respective Participating Interest in such formation.
- (3) Costs incurred from the base of the second deepest Objective Formation to total depth shall be charged to the Participating Parties in the deepest formation, in accordance with their respective Participating Interest in such formation.
- (4) Costs attributable to logging, testing, perforating, treating, stimulating, completing and abandoning a given formation shall be charged to the Participating Parties therein, in accordance with their respective Participating Interests in such formation. The cost of equipping the well, with respect to equipment that is used solely in connection with a given formation, shall be charged to the Participating Parties therein, in accordance with their respective Participating Interest in such formation.
- (5) The cost of drilling, production casing, and tubing that serves more than one Objective Formation shall be allocated to the Participating Parties of each respective Objective Formation, pursuant to Subsections (1), (2), and (3) of this Section B, on a footage basis as follows:

n = number of Objective Formations  
 $I_1$  = First, or shallowest Interval  
 $I_2$  = Second shallowest Interval  
 $I_3$  = Third shallowest Interval  
 $Base_x$  = Footage at the base of the x Interval

Cost allocated to I<sub>1</sub>:  
 $(1/n * \text{Base}_1) / \text{Total Depth}$

Cost allocated to I<sub>2</sub>:  
 $[(1/n * \text{Base}_1) + ((1/(n-1) * (\text{Base}_2 - \text{Base}_1)))] / \text{Total Depth}$

Cost allocated to I<sub>3</sub>:  
 $[(1/n * \text{Base}_1) + ((1/(n-1) * (\text{Base}_2 - \text{Base}_1)) + ((1/(n-2) * (\text{Base}_3 - \text{Base}_2)))] / \text{Total Depth}$

If there are more than three (3) Objective Formations, costs shall be allocated to such other formations in a like manner.

**C. Drilling and Completing Wells in All Objective Formations**

Costs of drilling, testing, completing, and equipping wells to, and including, the wellhead which are begun with the objective of multiple completions and which are completed in all Objective Formations shall be borne by the Participating Parties in each Objective Formation in accordance with the provisions of Section B. The material and equipment in the well and on the surface shall be owned by the Parties paying the cost thereof pursuant to Section B. As to any well which was begun with the objective of multiple completions, drilling overhead shall be charged as though the well were a single well to be drilled to test the deepest formation, and borne in accordance with Section B. The working interest owners shall own all oil and gas produced from their respective formations in accordance with the applicable operating agreement for such formation.

Upon abandonment of the well, if dry in all formations, the costs of plugging and abandoning shall be borne in accordance with the provisions of Section B.

**D. Completion of Well in Fewer than All Objective Formations**

In the event that a well begun with the objective of multiple completions is drilled to the deepest formation and results in discovery of oil and/or gas in paying quantities in one or more Objective Formations, but is dry in one or more Objective Formations, all costs of drilling, testing, and completing the well shall be borne by the Participating Parties in each Objective Formation in accordance with Section B. Likewise, all costs of equipping the well prior to the decision to abandon the dry formation(s) shall be borne by the Participating Parties in each Objective Formation in accordance with Section B. All costs of equipping the well subsequent to the decision to abandon the dry formation(s) shall be borne by the Participating Parties in the formation(s) being completed and if there are two or more formations being completed, the equipping costs shall be apportioned between such formations in accordance with Section B. Further, the Participating Parties as to the formation(s) being completed shall pay to the Participating Parties of the formation being abandoned the value of any salvable material and equipment paid for or furnished by such abandoning Parties which is used in connection with the formation being completed. Thereafter, the Participating Parties in the completed formation(s) shall own all materials and equipment acquired and installed in the drilling and completion of said well. The working interest owners in the completed formation(s) shall own all oil and gas produced from their respective formation in accordance with the applicable operating agreement, and shall bear all costs of operating, reworking, and plugging and abandoning the well which accrue thereafter. Notwithstanding anything to the contrary herein, the cost of abandoning the dry formation shall be borne by the working interest owners of the formation(s) being abandoned, in accordance with the applicable operating agreement. If the formation being abandoned is the deepest formation, the working interest owners in the deepest formation shall bear the cost of abandoning the entire portion of the well below the base of the second deepest formation, in accordance with the applicable operating agreement.

**E. Partial Abandonment After Completion of Well in Multiple Formations**

In the event that, after completion of a well in two or more formations, the working interest owners of a given formation should decide to abandon the well as to their formation, the Participating Parties in the formation open to production ("Producible Formation") shall pay to the working interest owners of the formation to be abandoned ("Abandoning Parties"), the salvage value of any materials or equipment belonging to the Abandoning Parties that are used in connection with the Producible Formation. If there is more than one Producible Formation, such payment shall be apportioned between the Producible Formations so as to be consistent with the ownership of material and equipment as set forth in Section B. Upon making such payment, the Participating Parties as to the Producible Formation(s) shall own all of such materials and equipment. The working interest owners in the Producible Formation(s) shall own all oil and gas produced from their respective formation in accordance with the applicable operating agreement, and shall bear all cost of operating, reworking, and plugging and abandoning the well which accrue thereafter. Notwithstanding anything to the contrary herein, the cost of abandoning the formation to be abandoned shall be borne by the Abandoning Parties, in accordance with the applicable operating agreement. If the formation being abandoned is the deepest formation, the Abandoning Parties in the deepest formation shall bear the cost of abandoning the entire portion of the well below the base of the second deepest formation, in accordance with the applicable operating agreement.

**F. Adding Completions and Commingling**

Operations to deepen the well or recomplete the well at a shallower depth for the purpose of completing additional formations shall be proposed and approved by the Parties entitled to participate in the proposed completion attempt in accordance with the applicable operating agreement. Before any well which is completed in one or more formations may be deepened or recompleted at a shallower depth for the purpose of completing the well in an additional formation, such operation must have non-objection by Participating Parties owning an aggregate of at least seventy five percent (75%) Participating Interest in each formation that is then capable of producing in paying quantities in such well. (In other words, such deepening or recompletion operations shall be prevented in the event that Participating Parties owning an aggregate of more than twenty five percent (25%) Participating Interest in any formation that is capable at that time of producing in paying quantities object to said operations.) Failure of a Party owning an interest in a formation capable of producing in paying quantities to respond to a request for non-objection to a proposed deepening or recompletion within thirty (30) days after receipt of such request shall be deemed non-objection to such deepening or recompletion. Any Party owning a Participating Interest in a formation which is entitled to participate in the proposed deepening or recompletion shall have an election whether or not to participate in such deepening or recompletion operation that is separate from its non-objection to use of the wellbore. If the operation should result in an impairment of production from, or a loss of, the existing well, the provisions of Subsections H (4), (5) and (6) shall govern unless otherwise agreed.

As compensation for the use of the equipment, the Participating Parties in the additional completion shall pay to said Participating Parties in each formation then capable of producing in paying quantities their proportionate share of the current salvage value of the equipment to be shared as provided for in Section B.

As compensation for use of the wellbore, the Participating Parties in the additional completion shall pay to said Participating Parties in each such formation then capable of producing in paying quantities ("Producing Parties") an amount calculated as set forth hereinbelow ("Wellbore Compensation"). Such Wellbore Compensation shall be equal to that portion of the Current Drilling Costs, depreciated as provided below, which the Participating Parties would have borne if they had originally participated in the drilling of the well under the terms of this Agreement. The Current Drilling Costs would be the estimated cost to drill and case the well as of the date of the proposed recompletion. The applicable

Current Drilling Costs shall be depreciated on a straight-line depreciation basis over a twenty (20) year period commencing as of the original completion date of the subject wellbore until the commencement date of operations for the additional completion.

If the estimated cost of commingling formations exceeds the Operator's expenditure limit under the Operating Agreement, the proposing Party shall submit an authority for expenditure to the Participating Parties in the formations proposed to be commingled. Notwithstanding anything to the contrary in the Operating Agreement, failure to respond to a proposal to commingle that does not include other operations in the well, within thirty (30) days after receipt of the proposal, shall be deemed approval of such commingling. The cost of the commingling operation shall be borne by the formations being completed as set forth in Section B.

**G. Allocation of Operating and Maintenance Costs**

After completion of a well in two or more formations, the costs of producing operations shall be borne by the Participating Parties as to such formations as follows:

- (1) Notwithstanding anything to the contrary in the Accounting Procedure, each active completion which is not commingled downhole shall be treated as a separate well for producing well overhead, if the Operator is required by the working interest owners or any governmental agency to separately account for such completions. Such expense shall be borne by the Participating Parties of the respective formations as a separate cost allocable to their interest. Active completions that are commingled downhole or are not required by the working interest owners or any governmental agency to be separately accounted for shall be treated as one well for the purpose of charging producing well overhead and such charge shall be allocated equally to all such completions.
- (2) The Participating Parties as to each formation shall bear all costs of routine producing operations including costs of labor, repairs, maintenance and replacement of equipment attributable solely to such formation. All costs of operations performed for the joint benefit of two or more formations shall be borne equally by the formations benefiting from such operations and charged to the Participating Parties in each such formation in accordance with their respective Participating Interest in such formation.

**H. Allocation of Cost of Workover Operations**

After completion of a well in two or more formations, a proposed workover, repair or other operation, excluding routine repair or maintenance work, must be approved by Parties owning an aggregate of at least seventy five (75%) Participating Interest in each formation which is capable of producing in paying quantities, whether or not such formations are to undergo the proposed workover, repair or other operation. (In other words, such operations shall be prevented in the event that Participating Parties owning an aggregate of more than twenty five percent (25%) Participating Interest in any formation that is capable at that time of producing in paying quantities object to said operations.) Failure of a Party owning an interest in a formation capable of producing in paying quantities to respond to a request for non-objection to a proposed deepening or recompletion within thirty (30) days after receipt of such request shall be deemed non-objection to such deepening or recompletion. Any Party owning a Participating Interest in a formation which is entitled to participate in the proposed workover or repair shall have an election whether or not to participate in such workover or repair operation that is separate from its non-objection to use of the wellbore.

The costs and risk of any workover, repair or other operations on such well shall be borne by the Participating Parties in such workover, repair or other operation as follows:

- (1) The costs and risk of any workover, repair or other operation which is directly related to one formation, including but not limited to operations such as re-perforating the casing or stimulating the formation, shall be borne by the Participating Parties in the formation for which the workover, repair or other operation is performed.
- (2) All costs and risk of any workover, repair, or other operation not directly related to one formation, including but not limited to repair and correction of leaks which may result in communication between formations within the well bore shall be borne equally by the formations benefiting from such work, and charged to the owners of each such formation in accordance with their respective Participating Interests.
- (3) Any material and equipment acquired by any such expenditures provided for in Subsection H(1) and H(2) above shall be owned by the Participating Parties of the respective formations so as to be consistent with the ownership of the material and equipment as set forth in Section B.
- (4) The working interest owners of the formation undergoing the workover, repair or other operation shall not be liable to the working interest owners of the formation(s) not being worked upon for cessation of production during such operations for a period of time not exceeding a cumulative total of sixty (60) days. In the event cessation of production during such operations is for a longer period of time, the Parties participating in such workover, repair, or other operation, hereinafter referred to as Remedial Owners, shall pay to the Participating Parties as to the formation not being worked upon, hereinafter referred to as Damaged Owners, damages in such amount as shall be proposed by the Operator and approved jointly by Remedial Owners and Damaged Owners representing an aggregate of at least seventy five percent (75%) Participating Interest in each of the respective formations for loss of production occurring for each day in excess of such sixty (60) cumulative day period until such production is restored. If the Parties owning an aggregate of at least seventy five percent (75%) Participating Interest in each formation do not approve the proposed damages within one hundred eighty (180) days after written request for damage payments, the matter shall be referred to mediation, pursuant to Section K.
- (5) If the producing capacity of the formation not undergoing the workover, repair or other operation is reduced in excess of twenty percent (20%) as a result of such workover, repair or other operation, damages will be deemed to have occurred. If damages have occurred, the Remedial Owners shall pay to the Damaged Owners, damages in such amount as shall be proposed by the Operator and approved jointly by Remedial Owners and Damaged Owners representing an aggregate of at least seventy five percent (75%) Participating Interest in each of the respective formations for loss of producing capacity. (In other words, approval of damages shall be prevented if Parties owning an aggregate of more than twenty five percent (25%) in any formation do not accept the proposal). If the proposal for damages is not approved by the Parties owning an aggregate of at least seventy five percent (75%) in each formation within one hundred eighty (180) days after written request for damage payments, the matter shall be referred to mediation, pursuant to Section K.
- (6) It is understood, however, that liability for loss or damages under Subsections H(4) and H(5) shall not accrue hereunder if: (1) such loss or damage existed prior to actual commencement of the operations or prior to penetration by workover equipment of the damaged formation, and (2) the evidence is conclusive that the loss or damage resulted solely from the

previously existing poor mechanical condition of the well. In no event shall Remedial Owners be required to pay Damaged Owners an amount greater than the cost of drilling and completing a replacement well.

**I. Payments**

If the amount of any payment due by working interest owners of one formation to the working interest owners of another formation(s), pursuant to Sections D, E, F, or H above, is agreed to by Parties having at least seventy five percent (75%) Participating Interest in each of the respective formations, such agreement shall be binding on all Parties. Within thirty (30) days after agreement as to the amount of payment due, Operator shall invoice the working interest owners owing such payment. Within thirty (30) days after receipt of the invoice, each Party owing such payment shall send its payment to the Operator. The Operator will distribute the payments so received, along with any payment owed by the Operator, to the owners of the formation to whom payment is due within sixty (60) days after the invoice is issued. The Operator shall make a good faith effort to collect any such payments owed by the non-operators. If any non-operator fails to make a payment due hereunder, the Operator may, after making a good faith effort to collect, turn over the responsibility for collecting the payment to the Party to whom it is owed, and the Operator will have no further liability with regard to such payment.

**J. Non-Consent Wells**

Any payments made by owners of one formation to the owners of another formation(s) pursuant to Sections D, E, F, or H above, that would have been received by a Non-Consenting Party had it not relinquished its interest in the well, shall be credited against the total unreturned costs of the non-consent operation in determining when the interest of such Non-Consenting Party shall revert to it as provided in the applicable Operating Agreement; and if there is a credit balance, it shall be paid to such Non-Consenting Party. Likewise, any payments made by owners of a formation to owners of another formation(s) pursuant to Sections D, E, F or H above, that would have been made by a Non-Consenting Party had it not relinquished its interest in the well shall be deemed to be part of the cost of the non-consent operation and shall be added to the sums to be recouped by the Consenting Parties as provided in the applicable Operating Agreement.

**K. Dispute Resolution**

If a dispute arises between the Parties under this Agreement and is not resolved by negotiation, the dispute shall be submitted to mediation before any Party resorts to litigation. In such event, promptly following one Party's written request for mediation, the Parties to the dispute shall choose a mutually acceptable mediator and share the costs of mediation services equally. The Parties to the dispute shall each have present at the mediation at least one individual who has authority to settle the dispute. The Parties shall make reasonable efforts to ensure that the mediation commences within sixty (60) days of the date of the mediation request. Notwithstanding the above, any Party may file a complaint (1) if the Parties are unable after reasonable efforts to commence mediation within sixty (60) days of the date of the mediation request, (2) for statute of limitations reasons, or (3) to seek a preliminary injunction or other provisional judicial relief, if in its sole judgment an injunction or other provisional relief is necessary to avoid irreparable damage or to preserve the status quo. Despite such actions, the Parties shall continue to try to resolve the dispute by negotiation or mediation as necessary.

A.A.P.L. FORM 610 - MODEL FORM OPERATING AGREEMENT - 1982

ARTICLE XVI  
MISCELLANEOUS

OPERATING AGREEMENT DATED..... July 1, 2010 (Westland Park 1 & 2)

OPERATOR: Merrion Oil & Gas Corporation

CONTRACT AREA: Township 29 North, Range 13 West, NMPM, N/2 Section 18, San Juan County, NM

Depth Limited: Surface to base of Pictured Cliffs formation

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

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

IN WITNESS WHEREOF, this agreement shall be effective as of 1<sup>st</sup> day of February, 2008.

Merrion Oil & Gas Corp. Land Dept., who has prepared and circulated this form for execution, represents and warrants that the form was printed from and with the exception listed below, is identical to the AAPL Form 610-1982 Model Form Operating Agreement, as published in diskette form by Forms On-A-Disk, Inc. No changes, alternations, or modifications, other than those in Article DELETIONS APPEAR AS STRIKE-OUTS; INSERTIONS APPEAR IN BOLD TYPE, have been made to the form.

OPERATOR

MERRION OIL & GAS CORPORATION

By: 

T. Greg Merrion, President

NON-OPERATORS

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

Name: \_\_\_\_\_

Title: \_\_\_\_\_



## **EXHIBIT "A"**

Attached to and made a part of that certain Operating Agreement, dated July 1, 2010, by and between  
Merrion Oil & Gas Corporation, as Operator, and Non-Operator(s).

### **LANDS SUBJECT TO THIS AGREEMENT**

Township 29 North, Range 13 West, NMPM

Section 18: N/2

Containing 250.15 acres, more or less

San Juan County, New Mexico

### **OPERATING AGREEMENT DEPTH OR FORMATION RESTRICTIONS**

Surface to base of Pictured Cliffs formation

### **PARTIES TO THIS AGREEMENT**

**Operator:**

Merrion Oil & Gas Corporation  
610 Reilly Avenue  
Farmington, NM 87401

**Non-Operator(s):**

XTO Energy, Inc.  
810 Houston Street  
Fort Worth, TX 76102

Synergy Operating LLC  
P.O. Box 1317  
Aztec, NM 87410

### **PROPOSED WELLS**

**Westland Park 1 & 2**

Township 29 North, Range 13 West, NMPM  
Section 18: N/2  
Proposed Formation: Fruitland Coal  
San Juan County, New Mexico

**There is no Exhibit "B" contained in this Operating Agreement.**

EXHIBIT "C"

Attached to and made a part of \_\_\_\_\_ that certain Operating Agreement dated 7-1-2010 by and among MERRION OIL & GAS CORPORATION, as Operator, and Non-Operators.

ACCOUNTING PROCEDURE  
JOINT OPERATIONS

I. GENERAL PROVISIONS

1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

2. Statement and Billings

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

3. Advances and Payments by Non-Operators

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

B. Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the prime rate in effect at The Chase Manhattan Bank on the first day of the month in which delinquency occurs plus <sup>2%</sup> 4% or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts.

4. Adjustments

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

1 5. Material

2  
3 Material purchased or furnished by Operator for use on the Joint Property as provided under Section IV. Only such  
4 Material shall be purchased for or transferred to the Joint Property as may be required for immediate use and is  
5 reasonably practical and consistent with efficient and economical operations. The accumulation of surplus stocks shall be  
6 avoided.

7  
8 6. Transportation

9  
10 Transportation of employees and Material necessary for the Joint Operations but subject to the following limitations:

11  
12 A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be  
13 made to the Joint Account for a distance greater than the distance from the nearest reliable supply store where like  
14 material is normally available or railway receiving point nearest the Joint Property unless agreed to by the Parties.

15  
16 B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint  
17 Account for a distance greater than the distance to the nearest reliable supply store where like material is normally  
18 available, or railway receiving point nearest the Joint Property unless agreed to by the Parties. No charge shall be  
19 made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the  
20 Parties.

21  
22 C. In the application of subparagraphs A and B above, the option to equalize or charge actual trucking cost is  
23 available when the actual charge is \$400 or less excluding accessorial charges. The \$400 will be adjusted to the  
24 amount most recently recommended by the Council of Petroleum Accountants Societies.

25  
26 7. Services

27  
28 The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph  
29 10 of Section II and Paragraph i, ii, and iii, of Section III. The cost of professional consultant services and contract  
30 services of technical personnel directly engaged on the Joint Property if such charges are excluded from the overhead  
31 rates. The cost of professional consultant services or contract services of technical personnel not directly engaged on the  
32 Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.

33  
34 8. Equipment and Facilities Furnished By Operator

35  
36 A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate  
37 with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating  
38 expense, insurance, taxes, depreciation, and interest on gross investment less accumulated depreciation not to  
39 exceed Twelve percent (12.0%) per annum. Such rates shall not exceed average commercial  
40 rates currently prevailing in the immediate area of the Joint Property.

41  
42 B. In lieu of charges in Paragraph 8A above, Operator may elect to use average commercial rates prevailing in the  
43 immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates  
44 published by the Petroleum Motor Transport Association.

45  
46 9. Damages and Losses to Joint Property

47  
48 All costs or expenses necessary for the repair or replacement of Joint Property made necessary because of damages or  
49 losses incurred by fire, flood, storm, theft, accident, or other cause, except those resulting from Operator's gross  
50 negligence or willful misconduct. Operator shall furnish Non-Operator written notice of damages or losses incurred as  
51 soon as practicable after a report thereof has been received by Operator.

52  
53 10. Legal Expense

54  
55 Expense of handling, investigating and settling litigation or claims, discharging of liens, payment of judgments and  
56 amounts paid for settlement of claims incurred in or resulting from operations under the agreement or necessary to  
57 protect or recover the Joint Property, except that no charge for services of Operator's legal staff or fees or expense of  
58 outside attorneys shall be made unless previously agreed to by the Parties. All other legal expense is considered to be  
59 covered by the overhead provisions of Section III unless otherwise agreed to by the Parties, except as provided in Section  
60 I, Paragraph 3.

61  
62 11. Taxes

63  
64 All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof,  
65 or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties. If the ad  
66 valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then  
67 notwithstanding anything to the contrary herein, charges to the Joint Account shall be made and paid by the Parties  
68 hereto in accordance with the tax value generated by each party's working interest.

12. Insurance

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

13. Abandonment and Reclamation

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

14. Communications

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

15. Other Expenditures

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

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

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

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

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

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

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

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

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

A. Overhead - Fixed Rate Basis

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

Drilling Well Rate \$ 5,000  
(Prorated for less than a full month)

Producing Well Rate \$ 500

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

(a) Drilling Well Rate

(1) Charges for drilling wells shall begin on the date the well is spudded and terminate on the date the drilling rig, completion rig, or other units used in completion of the well is released, whichever

is later, except that no charge shall be made during suspension of drilling or completion operations for fifteen (15) or more consecutive calendar days.

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

(b) Producing Well Rates

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

B. Overhead - Percentage Basis

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

(a) Development

\_\_\_\_\_ Percent (\_\_\_\_\_ %) of the cost of development of the Joint Property exclusive of costs provided under Paragraph 10 of Section II and all salvage credits.

(b) Operating

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

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

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

2. Overhead - Major Construction

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint

Account for overhead based on the following rates for any Major Construction project in excess of \$ 100,000.

A. 5 % of first \$100,000 or total cost if less, plus

B. 2 % of costs in excess of \$100,000 but less than \$1,000,000, plus

C. 1 % of costs in excess of \$1,000,000.

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

### 3. Catastrophe Overhead

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

A. 5 % of total costs through \$100,000; plus

B. 2 % of total costs in excess of \$100,000 but less than \$1,000,000; plus

C. 1 % of total costs in excess of \$1,000,000.

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

### 4. Amendment of Rates

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

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

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

### 1. Purchases

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

### 2. Transfers and Dispositions

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

#### A. New Material (Condition A)

##### (1) Tubular Goods Other than Line Pipe

(a) Tubular goods, sized 2 3/8 inches OD and larger, except line pipe, shall be priced at Eastern mill published carload base prices effective as of date of movement plus transportation cost using the 80,000 pound carload weight basis to the railway receiving point nearest the Joint Property for which published rail rates for tubular goods exist. If the 80,000 pound rail rate is not offered, the 70,000 pound or 90,000 pound rail rate may be used. Freight charges for tubing will be calculated from Lorain, Ohio and casing from Youngstown, Ohio.

(b) For grades which are special to one mill only, prices shall be computed at the mill base of that mill plus transportation cost from that mill to the railway receiving point nearest the Joint Property as provided above in Paragraph 2.A.(1)(c). For transportation cost from points other than Eastern mills, the 30,000

1 pound Oil Field Haulers Association interstate truck rate shall be used.

2  
3 (c) ~~Special and finish tubular goods shall be priced at the lowest published out of stock price, f.o.b. Houston,~~  
4 ~~Texas, plus transportation cost, using Oil Field Haulers Association interstate 30,000 pound truck rate,~~  
5 ~~to the railway receiving point nearest the Joint Property.~~

6  
7 (d) ~~Macaroni tubing (size less than 2 3/8 inch OD) shall be priced at the lowest published out of stock prices~~  
8 ~~f.o.b. the supplier plus transportation costs, using the Oil Field Haulers Association interstate truck rate~~  
9 ~~per weight of tubing transferred, to the railway receiving point nearest the Joint Property.~~

10  
11 (2) Line Pipe

12  
13 (a) ~~Line pipe movements (except size 24 inch OD and larger with walls 1/4 inch and over) 30,000 pounds or~~  
14 ~~more shall be priced under provisions of tubular goods pricing in Paragraph A.1)(a) as provided above.~~  
15 ~~Freight charges shall be calculated from Lorain, Ohio.~~

16  
17 (b) ~~Line Pipe movements (except size 24 inch OD) and larger with walls 1/4 inch and over) less than 30,000~~  
18 ~~pounds shall be priced at Eastern mill published carload base prices effective as of date of shipment,~~  
19 ~~plus 20 percent, plus transportation costs based on freight rates as set forth under provisions of tubular~~  
20 ~~goods pricing in Paragraph A.1)(a) as provided above. Freight charges shall be calculated from Lorain,~~  
21 ~~Ohio.~~

22  
23 (c) ~~Line pipe 24 inch OD and over and 1/4 inch wall and larger shall be priced f.o.b. the point of~~  
24 ~~manufacture at current new published prices plus transportation cost to the railway receiving point~~  
25 ~~nearest the Joint Property.~~

26  
27 (d) ~~Line pipe, including fabricated line pipe, drive pipe and conduit not listed on published price lists shall~~  
28 ~~be priced at quoted prices plus freight to the railway receiving point nearest the Joint Property or at~~  
29 ~~prices agreed to by the Parties.~~

30  
31 (3) ~~All~~ Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable  
32 supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the  
33 railway receiving point nearest the Joint Property.

34  
35 (4) Unused new Material, except tubular goods, moved from the Joint Property shall be priced at the current  
36 new price, in effect on date of movement, as listed by a reliable supply store nearest the Joint Property, or  
37 point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint  
38 Property. Unused new tubulars will be priced as provided above in Paragraph 2.A.1) and (2).

39  
40 B. Good Used Material (Condition B)

41  
42 Material in sound and serviceable condition and suitable for reuse without reconditioning:

43  
44 (1) Material moved to the Joint Property

45  
46 At seventy-five percent (75%) of current new price, as determined by Paragraph A.

47  
48 (2) Material used on and moved from the Joint Property

49  
50 (a) At seventy-five percent (75%) of current new price, as determined by Paragraph A, if Material was  
51 originally charged to the Joint Account as new Material or

52  
53 (b) At sixty-five percent (65%) of current new price, as determined by Paragraph A, if Material was  
54 originally charged to the Joint Account as used Material

55  
56 (3) Material not used on and moved from the Joint Property

57  
58 At seventy-five percent (75%) of current new price as determined by Paragraph A.

59  
60 The cost of reconditioning, if any, shall be absorbed by the transferring property.

61  
62 C. Other Used Material

63  
64 (1) Condition C

65  
66 Material which is not in sound and serviceable condition and not suitable for its original function until  
67 after reconditioning shall be priced at fifty percent (50%) of current new price as determined by  
68 Paragraph A. The cost of reconditioning shall be charged to the receiving property, provided Condition  
69 C value plus cost of reconditioning does not exceed Condition B value.



(2) Condition D

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

(a) Casing, tubing, or drill pipe used as line pipe shall be priced as Grade A and B seamless line pipe of comparable size and weight. Used casing, tubing or drill pipe utilized as line pipe shall be priced at used line pipe prices.

(b) Casing, tubing or drill pipe used as higher pressure service lines than standard line pipe, e.g. power oil lines, shall be priced under normal pricing procedures for casing, tubing, or drill pipe. Upset tubular goods shall be priced on a non upset basis.

(3) Condition E

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

D. Obsolete Material

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

E. Pricing Conditions

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

(2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

3. Premium Prices

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

4. Warranty of Material Furnished By Operator

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

V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

Adjustments to the Joint Account resulting from the reconciliation of a physical inventory shall be made within six months following the taking of the inventory. Inventory adjustments shall be made by Operator to the Joint Account for

1 overages and shortages, but, Operator shall be held accountable only for shortages due to lack of reasonable diligence.  
2

3 3. Special Inventories  
4

5 Special inventories may be taken whenever there is any sale, change of interest, or change of Operator in the Joint  
6 Property. It shall be the duty of the party selling to notify all other Parties as quickly as possible after the transfer of  
7 interest takes place. In such cases, both the seller and the purchaser shall be governed by such inventory. In cases  
8 involving a change of Operator, all Parties shall be governed by such inventory.  
9

10 4. Expense of Conducting Inventories  
11

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

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

B. The Operator shall reply in writing to an audit report within 180 days after receipt of such report.

6. Approval By Non-Operators

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

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. Ecological and Environmental

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

2. Rentals and Royalties

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

3. Labor

A. (1) Salaries and wages of Operator's field employees directly employed on the Joint Property in the conduct of Joint Operations.

(2) Salaries of First level Supervisors in the field.

(3) Salaries and wages of Technical Employees directly employed on the Joint Property if such charges are excluded from the overhead rates.

(4) Salaries and wages of Technical Employees either temporarily or permanently assigned to and directly employed in the operation or the Joint Property if such charges are excluded from the overhead rates.

B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II. Such costs under this Paragraph 3B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 3A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.

C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II.

D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II.

4. Employee Benefits

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

## **EXHIBIT "D"**

Attached to and made a part of that certain Operating Agreement dated July 1, 2010, by and between Merrion Oil & Gas Corporation, as Operator, and Non-Operator(s).

### **INSURANCE**

Operator shall at all times during the term of this Agreement or an extension thereof, and at all times relative thereto, carry insurance to protect the parties hereto as follows:

- (a) Statutory Workmen's Compensation Insurance as may be required in the state or states where work under this Agreement, or activities relative thereto, will be performed, plus Workmen Compensation Insurance as may be required by Federal Law, if applicable, plus Employers Liability Insurance.
- (b) Public Liability Insurance with bodily injury limits of not less than \$1,000,000 for death or injury to one person, or not less than \$1,000,000 for death or injury to more than one person in any one accident and property damage liability insurance with a limit of not less than \$1,000,000 for any one accident, for loss or destruction of or damage to property.
- (c) Automobile Liability Insurance with bodily injury policy limits of not less than \$1,000,000 for death or injury to one person, or not less than \$1,000,000 for death or injury to more than one person in any one accident and property damage liability insurance with a limit of not less than \$1,000,000 for any one accident, for loss or destruction of or damage to property.
- (d) Operator shall require its contractors and subcontractors working or performing services on the contract area covered hereby to carry insurance in the types and amounts as set out in subsections (a), (b), and (c) hereinabove.

Operator agrees to furnish Non-Operator, upon request, acceptable certificates from the major drilling contractors, the contract pumper, and from the Operator, showing the effectiveness of the foregoing insurance coverage at least five (5) days before the commencement of actual drilling operations, such to contain a statement that such insurance shall not be materially changed or canceled without at least fifteen (15) days prior written notice to Non-Operator.

## Exhibit "E"

Attached to and made a part of that certain Operating Agreement dated July 1, 2010, by and between Merriam Oil & Gas Corporation, as Operator, and Others (see Exhibit "A") as Non-Operator. Township 29 North, Range 13 West, N/2 Section 18

### Gas Balancing Agreement

#### ARTICLE I

##### Definitions

- 1.01 For the purposes of this Agreement, the terms set forth below shall have the meanings herein ascribed to them.
- (a) "Balance" is the condition existing when a Party has disposed of a cumulative volume of Gas from a Well which is equal to such Party's Percentage Ownership of the total cumulative volume of Gas disposed of by all Parties from such Well. For purposes of Balancing, references herein to price, value and volume shall be adjusted or calculated on a Btu basis.
  - (b) "Btu" is one British thermal unit, which is the amount of heat required to raise the temperature of one pound of water one degree Fahrenheit from 58.5° Fahrenheit to 59.5° Fahrenheit at 14.73 pounds per square inch absolute. The term "MMBtu" refers to one million (1,000,000) Btu's.
  - (c) "FERC" refers to the Federal Energy Regulatory Commission, or any similar or successor agency, state or federal.
  - (d) "Gas" includes all hydrocarbons produced or producible from a Well, whether a Well is classified as an oil Well or gas Well by the regulatory agency having jurisdiction in such matters, which are or may be made available at the Measurement Point for sale or separate disposition by the Parties, excluding oil, condensate and other liquids separated upstream from the Measurement Point. "Gas" does not include gas used for joint operations, or gas which is vented or lost, prior to delivery at the Measurement Point. Reference herein to the right to "dispose of" Gas or Gas "disposed of" includes all methods of disposition of Gas, including taking in kind, delivering in kind to a Lessor, sales to a Party or third party or an affiliate or gas used by a Party for purposes other than joint operations.
  - (e) "Imbalance" refers to either the Overproduction of an Overproduced Party or the Underproduction of an Underproduced Party, as applicable.
  - (f) "Make-up Gas" refers to that incremental volume of Gas, up to but not exceeding fifty percent (50%) of the Percentage Ownership of an Overproduced Party in the gas which can be produced from a Well which the Underproduced Party is entitled to dispose of in accordance with this Agreement in order to make up its imbalance.
  - (g) "Mcf" means the quantity of Gas occupying a volume of one thousand (1,000) cubic feet at a temperature of sixty degrees Fahrenheit (60°F) and a pressure of fourteen and seventy-three hundredths pounds per square inch absolute (14.73 psia).
  - (h) "Measurement Point" refers to the outlet side of the jointly owned production facilities, or such other point mutually agreeable where Gas from a Well is measured after the separation of oil, condensate or other liquids and custody of the gas is transferred to a pipeline.
  - (i) "Operator" refers to the Operator under the terms of the Operating Agreement.
  - (j) "Overproduced" is the condition existing when a Party has disposed of a greater cumulative volume of Gas from a Well than its Percentage Ownership of the total cumulative volume of Gas disposed of by all Parties from such Well.
  - (k) "Party" means any party subject to the Operating Agreement. "Parties" mean all parties subject to the Operating Agreement.
  - (l) The "Percentage Ownership" of each Party is equal to that Party's percentage or fractional interest in a Well, as determined under the terms of the Operating Agreement.
  - (m) "Underproduced" is the condition existing when a Party has disposed of a lesser cumulative volume of Gas from a Well than its Percentage Ownership of the total cumulative volume of Gas disposed of by all Parties from such Well.
  - (n) The terms "Underproduction" and "Overproduction" refer to that lesser or greater incremental volume of Gas which a Party would have disposed of from a Well, on a monthly or cumulative basis, if it had disposed of its Percentage Ownership of Gas from that well.
  - (o) "Well" means a well drilled on the Contract Area covered by the Operating Agreement and capable of producing Gas. If a single Well is completed in two or more reservoirs, such Well will be considered a separate Well with respect to, but only to, each reservoir from which the Gas production is not commingled in the wellbore. If this Agreement covers a fieldwide unit, "Well" for the purposes of this Agreement shall refer to gas production from the unit separately accounted for by NGPA category.
- 1.02 Unless the context clearly indicates to the contrary, words used in the singular include plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine,

#### ARTICLE II

##### Scope and Term of Agreement

- 2.01 This Agreement establishes a separate gas balancing agreement for each Well covered by The Operating Agreement to the same extent as if a separate Gas Balancing Agreement had been executed for each such Well.
- 2.02 The Agreement shall terminate, separately as to each Well, the earlier of (a) when the oil and gas lease(s) covering the Well terminate, or (b) when production from such Well permanently ceases and the Gas accounts for such Well are brought into Balance pursuant to this Agreement.

### **ARTICLE III**

#### **Right to Produce and Ownership of Gas**

- 3.01 Subject to the rights of an Underproduced Party to produce and dispose of Make-up Gas pursuant to this Agreement, each Party shall own and be entitled to produce and dispose of its Percentage Ownership of Gas which can be produced from a Well. During any month when a Party does not dispose of its entire Percentage ownership of such gas, the other Parties shall be entitled to produce and dispose of all or any portion of such Gas; provided, that to the extent such Parties desire to dispose of more Gas than is available, they shall share in such Gas in the proportion that each such Party's Percentage Ownership bears to the combined Percentage Ownership of all Parties desiring to dispose of such Gas.
- 3.02 As between the Parties hereto, each Party shall own and be entitled to the Gas disposed of by such Party for its sole account, and the proceeds thereof, including constituents contained therein that are recovered downstream from the Measurement Point. If at any time, and from time to time, a Party is Underproduced with respect to a Well. Its Underproduction shall be deemed to be in storage in the Well, subject to the right of such Party to produce and dispose of such Gas at a later time.

### **ARTICLE IV**

#### **Make-Up Gas**

- 4.01 In order to make up an Imbalance, each Underproduced Party in a Well shall have the right, after twenty (20) days written notice to all parties, to produce and dispose of Make-Up Gas, subject to the following rules:
- (a) An Overproduced Party shall not be required to furnish Make-Up Gas unless an Underproduced Party is first taking or disposing of its full Percentage Ownership of Gas from a Well; and
  - (b) An Overproduced Party may but shall not be required under any circumstances to reduce its takes to less than its Percentage Ownership of Gas which can be produced from a Well during the months of January, February, and December of a calendar year; and
  - (c) An Overproduced Party may but shall not be required under any circumstances to reduce its takes to less than fifty percent (50%) of such Overproduced Party's Percentage Ownership of Gas which can be produced from a well; and
  - (d) Once an Underproduced Party elects and begins to take Make-Up Gas such make-up shall continue in consecutive months until the Underproduced Party is brought back into Balance, except as provided in 4.01 (b) above.
  - (e) If there is more than one Overproduced Party, the Make-Up Gas will be taken from the Overproduced Parties in the proportion that each Overproduced Party's Percentage Ownership in a Well bears to the total Percentage Ownership of all Overproduced Parties in that Well; and
  - (f) If there is more than one Underproduced Party who desires and is able to dispose of Make-Up Gas in a month, each Underproduced Party will share in the Make-Up Gas in the proportion which its Percentage Ownership in a Well bears to the total Percentage Ownership of all Underproduced Parties in that Well disposing of Make-Up Gas that month.
- 4.02 The provisions of this Article IV shall constitute an Underproduced Party's exclusive rights and an Overproduced Party's exclusive obligations with regard to the right of an Underproduced Party to require an Overproduced Party to furnish Make-Up Gas.
- 4.03 Nothing herein shall be construed to deny any Party the right from time to time to produce and deliver its full Percentage Ownership of Gas in a Well for the purpose of conducting deliverability tests pursuant to its gas purchase contracts.

### **ARTICLE V**

#### **Balancing of Gas Accounts**

- 5.01 The Operator shall have the right of controlling production and deliveries of Gas and administering the provisions of this Agreement. The Operator shall use its best efforts to cause Gas to be delivered at the Measurement Point in such a manner and at such rates as may be required, from time to time, to give effect to the intent that any Imbalances shall be brought into Balance in accordance with the provisions hereof. The Operator shall only be liable for its failure to make deliveries of Gas in accordance with the terms of this Agreement if such failure is due to its gross negligence or willful misconduct.
- 5.02 During periods of Imbalance hereunder, the Operator will maintain a separate Gas account for each Party and Well. The Operator will furnish each Party quarterly a report showing the total MMBtu of gas delivered to the Measurement Point from each Well, the MMBtu of Gas disposed of by each Party, each Party's Overproduction or Underproduction for each month during the preceding calendar quarter, and the cumulative imbalance of all Parties in each Well at the end of each month during such quarter. In the event that production from each Well is not separately measured at the Measurement Point, then the Operator will allocate production to each Well on the basis of periodic test, check meters, or such other methods as are commonly used and accepted in the industry.
- 5.03 Each Party shall retain all data, information and records pertaining to the Gas taken and disposed of by such Party in a Well during periods of Imbalance hereunder, including, but not limited to, records pertaining to the volumes of Gas disposed of, and the information utilized to adjust volumes on a Btu basis, for a period expiring two (2) years after the termination of this Agreement as to such Well.
- 5.04 During the term of this agreement, subject to the terms of the operating agreement, each Party shall have the right to request Information from and to audit the records of the Operator and any other Party as to all matters concerning volumes, Btu adjustments, and disposition of Gas from a Well. These rights for each Well shall extend until two (2) years after the termination of this Agreement as to that Well. Any audit shall be conducted at the expense of the Party or Parties desiring such audit, and shall be conducted, after reasonable notice, during normal business hours in the office of the Party whose records are being audited. If more than one party desires to audit the records of another Party, then all such Parties shall cooperate with each other in order that only one audit shall be conducted in any twelve (12) month period.

### **ARTICLE VI**

#### **Cash Settlement of Imbalance**

- 6.01 "Upon (i) approval of all parties owning a working interest in the well to plug and abandon the well or (ii) when production from a well permanently ceases, the Operator shall render its final account of the cumulative imbalance of all Parties for that well within sixty (60) days after receiving the information requested as hereafter provided. Within thirty (30) days of Operator's request, each Overproduced Party shall provide information to Operator sufficient for the preparation of such statements and each Underproduced Party shall submit to Operator such data and information evidencing its payment of all royalties, overriding royalties, production burdens and taxes on its Underproduction which it was obligated to pay. Each Overproduced Party shall account to and pay each Underproduced Party within sixty (60) days of Operator's final account a sum of money equal to the

Settlement Price on the Underproduction which an Underproduced Party was entitled to receive from an Overproduced Party. All past due payments due Underproduced Parties shall bear interest at the prime rate of interest in effect from time to time of Chemical Bank of N.Y. plus 2-percent (%), from date due until date paid. Net price for cash settlements herein shall be determined in accordance with Paragraph 6.02.

- 6.02 The "Settlement Price" for cash settlements (without interest) under this Article VI shall be the Index Price (\$/MMBtu) published in Inside FERC's Gas Market Report on or about the first day of the month of the month (i) when approval of all parties owning a working interest in the well to plug and abandon the well is received or (ii) when production from a well permanently ceases, under the heading "Prices of Spot Gas Delivered to Pipelines" for the appropriate pipeline and producing region. In the event the referenced Index Price ceases to be available, the Operator shall designate another Index Price that is representative of the price for gas of equal quality and relative location.
- 6.03 If any portion of the price which is to be paid to an Underproduced Party is subject to refund under order, rule or regulation of the FERC, then the Overproduced Party shall withhold the increment of price subject to refund until the price is fully approved, unless the Underproduced Party furnishes a corporate undertaking satisfactory to the Overproduced Party guaranteeing the return of the increment in price attributable to such refund, including interest, if any, which is required to be paid with such refund. In addition, if FERC or any other governmental agency having jurisdiction requires that an Overproduced Party make a refund with respect to any portion of a price used to make payment under this Article VI, then the Underproduced Party(ies) shall reimburse the Overproduced Party(ies) for such refund, including any interest required to be paid with respect thereto. This Paragraph 6.03 shall survive the termination of this Agreement until the period has passed for which a refund may be required.
- 6.04 In the event an overproduced party sells, assigns, or otherwise transfers any of its interest in the leases to which this agreement applies, it shall promptly notify the other parties and upon written request from Underproduced parties proceed to make a cash settlement with Underproduced parties as provided herein, provided that a cash settlement may not be demanded by such Underproduced party solely because an Overproduced party has mortgaged its interests, or disposed of its interest by merger, reorganization, consolidation, or sale of substantially all of its assets to a subsidiary or parent company, or to any company in which any one party owns a majority of the stock.
- 6.05 Nothing herein contained shall be construed as precluding cash balancing at any time as negotiated between parties.

## **ARTICLE VII**

### **Costs and Ownership of Liquids**

- 7.01 All operating risks, expenses and liabilities shall be borne and paid by the Parties in accordance with the provisions of the Operating Agreement, or other agreement, rule or order if there is not an Operating Agreement, regardless of whether the Gas is being taken or disposed of from a Well at any given time in proportion to the Percentage Ownership of the Parties in the Well. Liquid hydrocarbons of a Well separated from the Gas prior to delivery at the Measurement Point shall be owned by all Parties in accordance with their Percentage Ownership in the Well, and each of the Parties shall be entitled to own and market their liquid hydrocarbons separated prior to the Measurement Point in accordance with their Percentage Ownership in the Well and the operating agreement, irrespective of the fact that one or more of the Parties may not be disposing of Gas from the Well.

## **ARTICLE VIII**

### **Indemnity**

- 8.01 Each Party hereby indemnifies and agrees to hold the other Parties harmless from all claims which may be asserted by any third party arising out of the operation of this Agreement and the performance of the indemnifying Party of its obligations hereunder. Such indemnity shall extend to and include all costs of investigation and defense (including reasonable attorneys fees), and all judgments and damages incurred or sustained, as a result of any such claim.

## **ARTICLE IX**

### **Payment of Lease Burden**

- 9.01 Unless otherwise required by provisions of a lease agreement or statute, rule, regulation or order of any governmental authority having jurisdiction, and regardless of who is actually taking or disposing of Gas from a Well, each Party shall be responsible for and shall pay or cause to be paid any and all royalties, overriding royalties, production payments and similar encumbrances on production due to its full Percentage Ownership of Gas production from a Well and shall hold the other Parties free from any liability therefore. The Party or Parties actually taking and disposing of Gas from a Well shall be responsible for and shall pay all production severance or similar taxes, fees or levies on such production.

## **ARTICLE X**

### **Notice**

- 10.01 Any notices or other communications required or permitted hereunder shall be in writing and shall be deemed given only when received by the Party to whom the same is directed at the addresses and in the manner then provided under the Operating Agreement.