Case 1357 2

OPERATING AGREEMENT

This agreement, made and entered into this the 6th day of September 1957, by and between STANDARD OIL COMPANY OF TEXAS, a Delaware corporation hereinafter sometimes referred to as "Standard" or "Operator", and GULF OIL CORPORATION, a Pennsylvania corporation hereinafter sometimes called "Gulf"

W I T N E S S E T H :

WHEREAS, each of the parties hereto are the owners of certain oil and gas leases covering lands situated in Sections 2, 11 and 12, T-18-S, R-26-E, Eddy County, New Mexico; and

WHEREAS, in order to develop said leases in accordance with the rules and regulations of the governmental authorities having jurisdiction and to promote conservation, the parties hereto propose to create pooled units for such purposes and desire to enter into an operating agreement to provide for the development and operation of any such pooled unit, any such pooled unit being hereinafter sometimes referred to individually as the "Premises".

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants and agreements herein contained, the parties hereto agree as follows:

1. LANDS SUBJECT TO THIS AGREEMENT: No lands or leases lying in said sections 2, 11 and 12 shall be subject hereto except as to the portions thereof which are now or are hereafter included in a pooled unit created by the parties hereto. At the time any such pooled unit is created it shall immediately become subject to all of the terms and provisions of this agreement. This agreement shall apply separately to each pooled unit with the same force and effect as though the parties hereto had executed a separate agreement, in a form identical with this agreement, covering each pooled unit.

2. GENERAL DUTIES OF OPERATOR: Standard is hereby designated as Operator and shall have, subject to the terms, provisions and limitations herein contained, exclusive charge, control and supervision of all operations of every kind to be conducted on the Premises for the exploration, development and production of oil and gas therefrom as well as the payment of all royalties, taxes and other charges which may arise or become due or payable in connection with such operations except that, if Gulf desires, it may take payment for its share of unit production directly and may account to the royalty and other owners interested therein. Operator shall keep the Premises free from liens and encumbrances

occasioned by its operations hereunder, except such liens as the parties hereto elect to contest, and save only the lien granted to Operator under this agreement.

3. CHARGES TO JOINT ACCOUNT: Operator shall charge the joint account with all costs and expenses incurred in connection with the operation of the Premises as herein provided, charges to be made in accordance with the "Accounting Procedure" attached hereto as Exhibit "A" and made a part hereof for all purposes. Charges made to the joint account as provided herein shall be borne by the parties hereto in the proportion that the interest of each of the parties in the Premises bears to the total of the interests in the Premises. Separate accounts shall be maintained by Operator as to each pooled unit including costs and expenses incurred, receipts and disbursements and all matters of accounting arising hereunder.

Operator shall secure the written approval of Gulf before incurring against the joint account any item of expense, which item itself is in excess of $5,000, except in the drilling, equipping and completing of a well drilled for the joint account under the terms hereof. Provided, however, that in event of fire, blowout, explosion or other emergency endangering life of or injury to persons or loss of or damage to property, Operator may incur expenses for the joint account in excess of said sum for the purpose of overcoming such emergency but shall promptly advise Gulf of any such expense incurred and the reason therefor.

4. OWNERSHIP OF MATERIALS: All materials (which term, as herein used, shall include derricks, engines, tanks, separators, pumps, pipe and other machinery, equipment and materials of any kind) purchased for the joint account shall be owned by the parties in common in proportion to their respective obligations to bear the cost thereof. Jointly owned materials which Operator deems no longer required in operations hereunder shall be considered surplus and shall be disposed of by Operator at then prevailing prices for like articles in like condition, where the materials are located, Operator to have the right to purchase any part thereof for its own account, at such prices; however, at least ten (10) days before selling or purchasing for its own account any such surplus materials, Operator shall give Gulf written notice of intention so to do, describing the materials to be disposed of, and Gulf shall have the right to receive in kind its proportionate share of any of such materials which are susceptible of division in kind, provided written notice of election so to do is received by Operator within said ten-day period.

5. RECORDS: Operator shall keep an accurate record of the joint account hereunder showing the costs and expenses incurred and charges made and all credits and receipts made and received, which record shall be available at all reasonable times for the consideration, examination and inspection of Gulf and its duly authorized representatives.

6. MONTHLY STATEMENTS: Operator shall furnish to Gulf the statements and billings provided for in Exhibit "A" attached and Gulf shall pay its proportion thereof as more particularly set out in said Exhibit.

Gulf grants to Operator a lien on its interest in the Premises, the production therefrom and all fixtures, improvements and personal property now or hereafter located thereon to secure the payment of its proportionate part of all investments made for and costs and expenses against the joint account hereunder in operating and developing the Premises, which lien may be enforced as any other mortgage lien. Should Gulf fail to pay its proportionate part of all statements as herein provided and should such default continue for a period of 60 days, Operator shall have the right at its option at any time thereafter, such default continuing, to foreclose said lien. Provided, however, that each party hereto shall have the right to sell and dispose of its interest in the oil and gas and the products therefrom produced hereunder, free and clear of such lien and the purchaser thereof need not take notice thereof until default in payment in which event each party agrees, at any time when it shall be in arrears in payment hereunder, but only in such event, to execute, upon request, such additional instruments as may be necessary or desired to further evidence such lien and to provide for the prior discharge thereof.

7. PAYMENT OF DELAY RENTALS AND SHUT-IN WELL PAYMENTS: Any and all delay rentals and shut-in well payments required to be paid to maintain in force any lease, all or a portion of which is included in a pooled unit, shall be paid by the party contributing such lease, in advance of the due date thereof. Copies of receipts or other evidence of the payment thereof shall, on request, be furnished to the nonpaying party at such party's expense but the paying party shall not be liable for failure to pay, or improper payment of, any such rental and shut-in well payment, through clerical error, oversight, or otherwise, provided that the paying party shall have exercised good faith. However, any party desiring to cease payment of delay rental or shut-in well payment on any such

lease or leases may give the other party written notice thereof, adequately identifying each such lease, whereupon such party shall be relieved of obligation to make such payment falling due more than sixty (60) days after the giving of such notice, on the lease or leases identified in the notice, except that, after accrual of an obligation to drill or rework a well on land covered by any lease, notice of desire to cease payment of delay rental or shut-in well payment on such lease may not be given unless and until such obligation has been satisfied, it being intended that no party may be relieved of obligation to bear his or its proportionate share of the cost of performing every such obligation. Whenever any party gives notice of desire to cease payment of delay rental or shut-in well payment on any such lease or leases, as above provided, if the other party should make written request therefor within sixty (60) days after the giving of such notice, the party giving such notice shall assign to the other party all of its right, title and interest in and under that portion of the lease or leases identified in such notice and specified in such request, as are included in a pooled unit, such assignment to be made without warranty of title except as against the acts of the assigning party. The assigning party shall be reimbursed by the party receiving the assignment for its share of the salvage value of any jointly owned material located on the pooled unit, including pipe, tubing and other equipment in any well located thereon. Whenever all parties desire to cease payment of delay rental or shut-in well payment on any lease, they shall join in a proper instrument for the surrender thereof.

8. DRILLING, DEEPENING AND REWORKING FOR JOINT ACCOUNT: Operator shall not drill any well, unless expressly provided for in this agreement, or conduct deepening or reworking operations at the expense of the joint account, without first obtaining approval of Gulf. All such operations shall be performed on a competitive contract basis at not more than the usual rates prevailing in the area.

9. DRILLING, DEEPENING OR REWORKING OTHERWISE THAN FOR JOINT ACCOUNT:

(a) Whenever any party desires the drilling of a well on a pooled unit, other than a well specificially provided for herein, which can be drilled for the joint account only by mutual agreement and such party proposes to drill such well for its own account unless the other party agrees to the drilling thereof, such party may give the other party written notice thereof stating the

location at which and depth to which the well is to be drilled, naming the main objective horizon, and stating the estimated cost of the well, properly itemized. The party receiving such notice, if desiring to participate in the drilling of the well proposed in such notice, shall give written consent to the drilling of such well, within thirty (30) days after the giving of the initial notice, in which event the well shall be drilled by Operator for the joint account, but otherwise the party giving the initial notice shall have the right to drill such well at its sole cost, expense and risk provided that (1) operations for the drilling of the well are commenced in good faith within sixty (60) days after the giving of the initial notice of desire to drill; (2) such operations are prosecuted with reasonable diligence, and (3) the location of the well conforms to the spacing pattern adopted or generally being followed in the field, if a pattern has heretofore been adopted or established. If a well so drilled is not completed as a producer, the drilling party shall abandon and properly plug the well at its sole cost, expense and risk, but if the well is found to be productive of oil or gas in paying quantities, the well shall be completed and equipped for production by, and at the sole cost, expense and risk of the drilling party, whereupon the well shall at the option of such party be operated by it for its own account, or by Operator for the account of the drilling party, who shall be entitled (as against the non-drilling party) to all the production therefrom of the parties hereto until such time as the proceeds of such production (after deduction of royalties, overriding royalties and like interests payable in respect thereof, expenses incurred in operating the well up to such time, and any severance, production and like taxes paid or payable on the production from such well) shall equal one hundred fifty per cent (150%) of a sum which bears the same relation to the total amount expended in drilling, completing and equipping the well as the interest of the parties hereto bears to the total working interest; after such time the well and the production therefrom shall be owned by all parties hereto in proportion to their respective interests in the pooled unit and shall be operated for the joint account; provided, however, if such well is completed as a gas well, then the cost of equipping the well shall include only those items necessary for equipping an ordinary gas well and the drilling party shall receive only 100 per cent of the cost of any "additional" equipment and facilities. Additional facilities or equipment shall be deemed to include, but without limitation, low temperature units, compressors, dehydration

facilities, sour gas removal facilities, delivery pipe lines or gathering pipe line systems and any cost and expense attributable to or in connection with the installation thereof. If the well should cease to produce in paying quantities before receipt of the one hundred fifty per cent (150%) reimbursement above provided for, the well shall be abandoned and plugged at the sole cost, expense and risk of the drilling party, who shall be entitled to all salvage derived from the well to the extent necessary to complete the one hundred fifty per cent (150%) reimbursement, any excess to be credited to the joint account of all parties hereto.

(b) At least twenty-four (24) hours before undertaking to abandon and plug a well drilled for the joint account, but not completed as a producing well, Operator shall notify Gulf thereof by telephone or telegraph except that if such notice is received after 12 noon on any Friday, the effective time of receipt of such notice shall be 8 a.m. of the following Monday, and if such notice is received after 12 noon on any day immediately preceding a holiday, the effective time of receipt of such notice shall be 8 a.m. of the next regular working day. If Operator or Gulf desires to rework or deepen any such well, notice thereof shall be given to the other party by telephone or telegraph within said twenty-four hour period, whereupon the other party, if desiring to participate therein, must give notice of election so to do by telephone or telegraph within forty-eight (48) hours after the giving of the initial notice by Operator. If the other party elects to participate therein, the operation shall be performed by Operator for the joint account, but otherwise the party giving notice of desire to rework or deepen shall have the right to take over the well in its then condition provided the well is so taken over within twenty-four (24) hours after the expiration of said forty-eight (48) hour period and a good faith effort is made to perform the proposed operation. If the well is so taken over but not completed as a producer, the party taking over the well shall abandon and properly plug the well at its sole cost, expense and risk, but if the operations result in paying production, the well shall be completed and equipped for production by, and at the sole cost, expense and risk of such party, whereupon the well shall at the option of such party be operated by it for its own account, or by Operator for the account of such party, who shall be entitled (as against the other party hereto) to all production from such well until such time as the proceeds thereof (after deduction of royalties, overriding royalties and like interests payable thereon, the expense of operating the well up to such

time, and any severance, production and like taxes on such production) shall equal one hundred fifty per cent (150%) of a sum which bears the same relation to the total amount expended in deepening or reworking, and completing and equipping the well as the interest of the parties hereto bears to the total working interest; after such time the well and the production therefrom shall be owned by all parties hereto in proportion to their respective interests in the pooled unit and the well shall be operated by Operator for the joint account. If the well should cease to produce in paying quantities before receipt of such one hundred fifty per cent (150%) reimbursement, the well shall be abandoned and plugged at the sole cost, expense and risk of the party who took the well over who shall be entitled to all salvage derived from the well to the extent necessary to complete such one hundred fifty per cent (150%) reimbursement, any excess to be credited to the joint account.

(c) Whenever any party determines that a well completed as a producer for the joint account is no longer capable of producing in paying quantities, such party, if it wishes that such well be deepened or reworked, may give written notice thereof to the other party. If a party so notifies the other party that it desires that such well be deepened or reworked, then all of the terms and provisions of subsection (b) of this paragraph shall thereafter apply to such well and to such deepening, reworking, and other operations in connection therewith, except that the party receiving the notice shall have thirty (30) days after the giving of such notice (instead of forty-eight (48) hours) to advise the notifying party of its election to participate in such deepening or reworking, and except that the party electing to perform the work shall have ten (10) days after the expiration of said 30 day period to take over the well and thereafter make a good faith effort to deepen or rework same.

(d) If any operation carried on pursuant to the provisions of this section involves the deepening, plugging back or reworking of any noncommercial well, the participating party or parties shall pay to the non-participating party or parties a sum equal to the proportionate value (determined in accordance with Exhibit "A", after deducting the cost of recovery) of the equipment and reclaimable casing and tubing on and in any well in which said deepening, plugging back or reworking operations are to be conducted and the amount so paid shall constitute a part of the cost of the deepening, plugging back or reworking such well of which the participating party or parties shall be entitled to reimbursement out of production on the basis above provided.

10. ABANDONMENT OF PRODUCING WELLS: Whenever any party determines that a well completed as a producer for the joint account is no longer capable of producing in paying quantities, such party, if it wishes that such well be abandoned, may give written notice thereof to the other party who, if objecting to the abandonment of such well, must give to such party written notice of such objection within thirty (30) days after the giving of the initial notice. If such written objection is not made by the other party within said thirty-day period, Operator shall abandon and plug the well for the joint account, but otherwise the party making such written objection within said thirty-day period shall pay to the other party a sum equal to the interest of such other party in the salvage value of such well, whereupon such other party shall assign to the objecting party its interest in such well and in the lease or leases in the pooled unit covering the land on which the well is located, but only in so far as such lease or leases cover the formation or formations in the pooled unit from which the well is then producing. The "salvage value" of any such well shall be the fair market value, at the well site, of the salvageable materials comprised therein, less the estimated reasonable cost of salvaging the same. Each assignment made as above provided shall be made without warranty of title, except as against liens, encumbrances and transfers of interest created or made by the assignor.

11. HANDLING OF PRODUCTION: Each of the parties hereto shall always have the right to take in kind its share of the oil and gas produced and saved from the Premises and the right to personally sell such share. Such production accruing to Gulf's interest shall be delivered to Gulf into the pipe line or lines to which the well or wells may be connected or, at Gulf's election, into storage tanks furnished by Gulf. Gulf shall bear any extra expenses incurred by Operator in delivering in kind its portion of the production from the Premises or for its failure to remove said production when tendered.

At such times as Gulf does not personally take in kind or sell its share of such production, or in the event it fails to dispose of its share of said production, as tendered, Operator shall have the right, subject to revocation by Gulf at will, to market all oil and gas and other minerals produced; and upon the sale of same, the purchaser thereof shall pay to the respective parties hereto the proceeds of sale in proportion to each party's interest in such production; provided, however, should Gulf be in arrears in its payment to Operator as

herein provided, Operator shall have the right upon demand to receive from the purchaser of the production Gulf's portion of the proceeds and apply the proceeds on any amounts in arrears. In this connection each of the parties hereto will sign the usual customary division orders covering its respective portion of the production and warranting its title thereto. Any contract made by Operator for the sale of Gulf's share of the production shall be revocable at will by Gulf as to its share of the production.

12. GULF'S RIGHTS AND PRIVILEGES: Gulf shall have the following specific rights and privileges:

(a) Access to the Premises at all reasonable times to inspect the operations hereunder.

(b) The right to inspect the logs, samples and cuttings from any and all wells drilled hereunder and to receive samples and cuttings and copies of the logs.

(c) The right to inspect at all reasonable times the Operator's books, records and invoices pertaining to any matter of accounting arising hereunder.

13. LIABILITY OF PARTIES: The Premises shall not be operated hereunder as a partnership venture and the liability of the parties hereunder shall be several and not joint or collective. Each party shall be responsible only for its obligations as set out herein and shall be liable only for its proportionate share of the cost of operations hereunder. Nothing herein shall be construed as an assignment or transfer of the leases or interests therein as between the parties hereto. If any oil and gas lease covered hereby be subject to any overriding royalty, production payment, or other charge in addition to or other than the usual one eighth royalty, the party contributing such lease shall bear and discharge any such overriding royalty, production payment or other charge and such party's share of the production shall be subject thereto.

All individuals employed by Operator and engaged in operations hereunder shall be the employees of Operator alone and their working hours and rates of compensation shall be determined by Operator. In the conduct of operations hereunder Operator shall be obligated to use only the care and diligence customarily exercised by a prudent operator in the area in which said lands are located, and Operator shall not be liable for the result of any error of judgment or for the

loss of or damage to any joint property not resulting from the gross negligence or willful misconduct of Operator or its employees; nor shall Operator be liable for delay or loss resulting from fire, flood, action of the elements, strikes or other labor difficulties, acts or orders of civil or military authorities, restrictions or restraints imposed by law or ordinance, or by order or regulation of public authority, whether federal, state or local, inability to procure necessary materials or labor in the open market and on usual and lawful terms, or any other cause reasonably beyond the control of Operator. Operator shall not be responsible for the neglect or default of any drilling contractor or other independent contractor engaged by Operator in operations hereunder.

While each of the parties hereto recognizes that its rights and liabilities hereunder are several and not joint or collective, if, solely for Federal Income Tax purposes, and for no other reason, the parties should be regarded as partners or joint venturers, and the operations carried on under this agreement be required to be treated as a partnership as defined in Section 761 of the Internal Revenue Code of 1954 for Federal Income Tax purposes, each and all of the parties hereto do hereby elect to exclude such operations from the application of all of subchapter K of the Internal Revenue Code of 1954 as provided in Section 761(a) thereof. It shall be the responsibility of the Operator to make this election in a statement attached to a partnership return filed with the Internal Revenue Service of the United States in accordance with Regulations pertaining thereto, and to furnish a copy thereof to each Non-Operator.

Each party hereto represents to the other party hereto that such party owns and has good title to the interest in and to the oil and gas leases as to the portion thereof included in any pooled unit and in the event of loss or failure of title to such interest or leases, or any part thereof, agrees to hold the other party harmless from and shall indemnify it against all loss, cost, damage and expense which may result from or in any manner arise because of the delivery to such other party of production, if any, obtained hereunder from the portion of the lands covered by such lost or failed interest or lease or the payment, if any, to such other party out of the proceeds derived from the sale of any such production therefrom, prior to the date said loss or failure of title is finally determined and that such party's interest in and to the production obtained from the lands subject hereto shall be reduced in proportion to such loss or failure

of such party's title as of the date such loss or failure of title is finally determined; provided that such revision of ownership interest shall not be retroactive as to operating costs and expenses incurred or as to revenue or production obtained prior to such date.

14. PREFERENTIAL RIGHT TO PURCHASE: Should either party desire to sell all or any part of its interests in the Premises it shall promptly give written notice to the other party, 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 party shall then have an optional prior right, for a period of ten days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell. 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 of its assets, or a sale or transfer of its interests to a subsidiary or parent company, or subsidiary of a parent company, or to any company in which such party owns a majority of the stock.

15. RIGHT OF PARTIES TO WITHDRAW OR ASSIGN: This agreement shall be deemed a covenant running with the above described leases and/or mineral interests and shall be binding upon and inure to the benefit of the heirs, personal representatives, successors and assigns of the parties respectively, subject to the following provisions:

(a) Except as otherwise expressly provided for herein, and except with the written consent of the other party first obtained, no party hereto shall make any sale, mortgage, transfer, or other disposition of interest in the Premises and materials, unless the same covers either the entire interest of such party in the Premises and materials, or an undivided interest in the Premises and all the jointly owned materials. Every such sale, mortgage, transfer, or other disposition made by any party hereto shall be made expressly subject to this agreement and without prejudice to the rights of the other party hereto and any sale or transfer shall contain a provision (unless incorporated in a separate instrument) whereby the vendee or transferee expressly assumes all of the

obligations of the assigning party under this agreement with respect to the properties affected by such sale or transfer, or under any other agreement binding on all of the parties hereto. Any party making such sale or transfer shall remain liable for its obligations under this agreement with respect to the properties assigned or transferred until the following has been furnished Operator:

(i) Written notice of such sale or transfer, signed by both assignor and assignee, describing the properties and the interest conveyed, together with such other evidence of title as Operator may require, including abstracts of title down to date if requested by Operator; and

(ii) Evidence in writing that the Assignee assumes, and stating the effective date of such assumption, the obligations of the assigning party under this agreement with respect to such properties and under any other agreement binding on all of the parties hereto; and

(iii) The address of assignee to which notices, consents, and requests provided for herein may be given.

(b) Operator shall not assign its rights and duties as Operator hereunder and should Operator or any successor Operator hereunder dissolve, liquidate or terminate its corporate existence or sell or otherwise dispose of its interest in the Premises, it shall thereupon cease to be Operator hereunder. Should a sale be made by Operator of its rights and interests in the Premises, Gulf shall have the right and option to become Operator. If Gulf does not elect to become Operator, the transferee of the present Operator shall assume the duties of and act as Operator. In either case, the retiring Operator shall continue to serve as Operator, and discharge its duties in that capacity under this agreement, until its successor Operator begins to function but the present Operator shall not be obligated to continue the performance of its duties for more than 90 days after the sale of its rights and interests has been completed. Provided, however, should the then acting

operator hereunder transfers its entire interest in the Premises and materials to a corporation which is a parent or subsidiary of such party or owned by such party or affiliated with such party, the transferee of such party's interest shall become the Operator hereunder. Any successor operator shall assume the responsibilities and duties and have the rights prescribed for Operator by this Agreement.

Any party hereto, including parties, shall have the right at any time when it is not indebted in any amount to Operator under the provisions hereof and when there is not existing to any lessor or lessors or their successors in interest any obligation to do any further drilling upon the leases affected hereby, to be relieved of all unaccrued obligations under this agreement by assigning to the other party all of the interest in the Premises of the party desiring to be relieved of such unaccrued obligations, free and clear of all liens and encumbrances and relinquishing all of its rights hereunder. Should the other party desire not to accept an assignment, it shall join with the party desiring to relieve itself of unaccrued obligations in executing any necessary instruments for releasing the lease or leases involved and in terminating this agreement. In the event of any such assignment as aforesaid the party electing to accept such assignment shall promptly reimburse the assigning party for its interest in the personal property located upon the Premises in cash at its fair salvage value.

20. NOTICES: Except as otherwise expressly provided herein, each notice, consent or request herein provided for shall be deemed to have been properly given and delivered if and when deposited in the United States mail duly registered, with return receipt requested, or filed with a recognized telegraph company with charges fully prepaid and addressed to the parties respectively as follows:

Standard Oil Company of Texas
P. O. Box [illegible]
Houston, Texas

Gulf Oil Corporation
P. O. Drawer 2097
Roswell, New Mexico

The date a notice is given by mail or telegraph shall be the date on which such written notice is deposited in the United States Post Office addressed as above provided or the date on which the notice by telegraph is delivered to the telegraph company for transmission to the party addressed as above provided.

17. TERM: Unless terminated by agreement of all parties hereto, or as otherwise provided herein, this contract shall continue in force and effect as to any pooled unit as long as the unit and any extensions or renewals thereof remain in force and effect.

18. INSURANCE - COMPLIANCE WITH LAWS AND REGULATIONS: In conducting operations hereunder, Operator shall comply with the Fair Labor Standards Act and all other applicable federal and state laws and applicable rules and regulations of federal and state governmental agencies having or asserting jurisdiction. Operator shall carry for the joint account Workmen's Compensation and Employer's Liability Insurance on its employees engaged in the joint operations, as may be required by the laws of the state in which the Premises are located, provided, however, if Operator is a self-insurer and has qualified as such under laws, then it shall in such manner be liable for such coverage, and the provisions of Section 10 B of Article II of the Accounting Procedure attached hereto shall be applicable. Except as to claims arising under the Workmen's Compensation Act, or claims of less than $1,000.00 total, Operator will immediately give Non-Operators written notice of any injury to persons or damage to property which occurs in connection with its operations of the subject premises; and Non-Operators shall have the right to participate in the investigation, settlement, and defense of any claims arising therefrom. Operator shall make no settlement of any such claims without Non-Operators' consent.

EXECUTED as of the day and year first hereinabove written.

ATTEST:

By _____
Assistant Secretary

STANDARD OIL COMPANY OF TEXAS

By _____
Vice President

ATTEST:

By _____
Assistant Secretary
H. M. CRAIG

GULF OIL CORPORATION

By _____
~~Vice President~~ Attorney-in-Fact

Law
Contr
Exp.
Prod.

STATE OF TEXAS §
§
COUNTY OF HARRIS §

The foregoing instrument was acknowledged before me this 9th day of September, 1957, by W. L. Arnold, Vice President of STANDARD OIL COMPANY OF TEXAS, a Delaware corporation, on behalf of said corporation.

Dorothy Gunn
Notary Public

My Commission Expires 6-1-59,

STATE OF TEXAS

COUNTY OF TARRANT

The foregoing instrument was acknowledged before me this 17 day of October, 1957, by A. D. CORDRY, Attorney-in-Fact of GULF OIL CORPORATION, a Pennsylvania corporation, on behalf of said corporation.

Janice Rozier JANICE ROZIER
Notary Public

My Commission Expires 6-1-59.

EXHIBIT "A"

PASO-T-1955-2

Attached to and made a part of Operating Agreement between Standard Oil Company of Texas and Gulf Oil Corporation covering certain pooled units in Eddy County, New Mexico.

ACCOUNTING PROCEDURE

(UNIT AND JOINT LEASE OPERATIONS)

I. GENERAL PROVISIONS

1. Definitions

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

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

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

2. Statements and Billings

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

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

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

C. Statements as follows:

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

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

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

3. Payments by Non-Operator

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

4. Adjustments

Payment of any such bills shall not prejudice the right of Non-Operator to protest or question the correctness thereof. Subject to the exception noted in Paragraph 5 of this section I, all statements rendered to Non-Operator by Operator during any calendar year shall conclusively be presumed to be true and correct after twenty-four (24) months following the end of any such calendar year, unless within the said twenty-four (24) month period Non-Operator takes written exception thereto and makes claim on Operator for adjustment. Failure on the part of Non-Operator to make claim on Operator for adjustment within such period shall establish the correctness thereof and preclude the filing of exceptions thereto or making of claims for adjustment thereon. The provisions of this paragraph shall not prevent adjustments resulting from physical inventory of property as provided for in Section VI, Inventories, hereof.

5. Audits

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

II. DEVELOPMENT AND OPERATING CHARGES

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

1. Rentals and Royalties

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

2. Labor

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

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

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

3. Employee Benefits

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

4. Material

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

5. Transportation

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

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

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

6. Service

A. Outside Services:
The cost of contract services and utilities procured from outside sources.

B. Use of Operator's Equipment and Facilities:
Use of and service by Operator's exclusively owned equipment and facilities as provided in Paragraph 5 of Section III entitled "Operator's Exclusively Owned Facilities."

7. Damages and Losses to Joint Property and Equipment

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

8. Litigation Expense

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

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

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

9. Taxes

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

10. Insurance and Claims

A. Premiums paid for insurance required to be carried for the benefit of the joint account, together with all expenditures incurred and paid in settlement of any and all losses, claims, damages, judgments, and other expenses, including legal services, not recovered from insurance carrier.

B. If no insurance is required to be carried, all actual expenditures incurred and paid by Operator in settlement of any and all losses, claims, damages, judgments, and any other expenses, including legal services, shall be charged to the joint account.

11. District and Camp Expense (Field Supervision and Camp Expense)

A pro rata portion of the salaries and expenses of Operator's production superintendent and other employees serving the joint property and other properties of the Operator in the same operating area, whose time is not allocated directly to the properties, and a pro rata portion of the cost of maintaining and operating a production office known as Operator's Ward-Hobbs office located at or near Monahans, Texas (or a comparable office if location changed), and necessary suboffices (if any), maintained for the convenience of the above-described office, and all necessary camps, including housing facilities for employees if required. used in the conduct of the operations on the joint property and other properties operated in the same locality. The expense of, less any revenue from, these facilities should be inclusive of depreciation or a fair monthly rental in lieu of depreciation on the investment. Such charges shall be apportioned to all properties served on some equitable basis consistent with Operator's accounting practice.

12. Administrative Overhead

Operator shall have the right to assess against the joint property covered hereby the following management and administrative overhead charges, which shall be in lieu of all expenses of all offices of the Operator not covered by Section II, Paragraph 11, above, including salaries and expenses of personnel assigned to such offices, except that salaries of geologists and other employees of Operator who are temporarily assigned to and directly serving on the joint property will be charged as provided in Section II, Paragraph 2, above. Salaries and expenses of other technical employees assigned to such offices will be considered as covered by overhead charges in this paragraph unless charges for such salaries and expenses are agreed upon between Operator and Non-Operator as a direct charge to the joint property.

WELL BASIS (Rate Per Well Per Month)

	DRILLING WELL RATE	PRODUCING WELL RATE (Use Completion Depth)		
Well Depth	Each Well	First Five	Next Five	All Wells Over Ten
All depths	$250	$50 - All wells		

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

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

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

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

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

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

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

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

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

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

IV. DISPOSAL OF LEASE EQUIPMENT AND MATERIAL

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

1. Material Purchased by the Operator or Non-Operator

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

2. Division in Kind

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

3. Sales to Outsiders

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

V. BASIS OF PRICING MATERIAL TRANSFERRED FROM JOINT ACCOUNT

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

1. New Price Defined

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

2. New Material

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

3. Good Used Material

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

A. At seventy-five per cent (75%) of current new price if material was charged to joint account as new, or

B. At sixty-five per cent (65%) of current new price if material was originally charged to the joint property as secondhand at seventy-five per cent (75%) of new price.

4. Other Used Material

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

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

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

5. Bad-Order Material

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

6. Junk

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

7. Temporarily Used Material

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

VI. INVENTORIES

1. Periodic Inventories, Notice and Representation

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

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

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

2. Reconciliation and Adjustment of Inventories

Reconciliation of inventory with charges to the joint account shall be made by each party at interest, and a list of overages and shortages shall be jointly determined by Operator and Non-Operator.

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

3. Special Inventories

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

(4) Wells permanently shut down but on which plugging operations are deferred shall be dropped from the overhead schedule at the time the shutdown is effected. When such wells are plugged, overhead shall be charged at the producing well rate during the time required for the plugging operation.

(5) Wells being plugged back, drilled deeper, or converted to a source or input well shall be included in the overhead schedule the same as drilling wells.

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

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

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

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

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

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

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

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

None except as included in District expense

14. Other Expenditures

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

III. BASIS OF CHARGES TO JOINT ACCOUNT

1. Purchases

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

2. Material Furnished by Operator

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

A. New Material (Condition "A")

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

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

(3) Cash discount shall not be allowed.

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

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

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

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

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

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

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

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

3. Premium Prices

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

4. Warranty of Material Furnished by Operator

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

5. Operator's Exclusively Owned Facilities

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

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