

UNIT AGREEMENT
SMITH RANCH UNIT AREA
LEA COUNTY, NEW MEXICO

BEFORE EXAMINER STAMETS
OIL CONSERVATION DIVISION

EXHIBIT NO. 1

CASE NO. 6613

Submitted by Grace Petroleum Corp.

Hearing Date 8-8-79

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

5 NOW, THEREFORE, in consideration of the premises and the promises herein
6 contained, the parties hereto commit to this agreement their respective
7 interests in the below-defined unit area, and agree severally among them-
8 selves as follows:

9 1. ENABLING ACT AND REGULATIONS. The Mineral Leasing Act of February
10 25, 1920, as amended, supra, and all valid pertinent regulations, including
11 operating and unit plan regulations, heretofore issued thereunder or valid,
12 pertinent and reasonable regulations hereafter issued thereunder are accepted
13 and made a part of this agreement as to Federal lands, provided such regula-
14 tions are not inconsistent with the terms of this agreement; and as to non-
15 Federal lands, the oil and gas operating regulations in effect as of the
16 effective date hereof governing drilling and producing operations, not in-
17 consistent with the terms hereof or the laws of the State of which the non-
18 Federal land is located, are hereby accepted and made a part of this agreement.

19 2. UNIT AREA. The area specified on the map attached hereto marked
20 Exhibit "A" is hereby designated and recognized as constituting the unit area,
21 containing 1,599.96 acres, more or less.

22 Exhibit "A" shows, in addition to the boundary of the unit area, the
23 boundaries and identity of tracts and leases in said area to the extent known
24 to the Unit Operator. Exhibit "B" attached hereto is a schedule showing to
25 the extent known to the Unit Operator the acreage, percentage, and kind of
26 ownership of oil and gas interests in all land in the unit area. However,
27 nothing herein or in said schedule or map shall be construed as a representa-
28 tion by any party hereto as to the ownership of any interest other than such
29 interest or interests as are shown in said map or schedule as owned by such
30 party. Exhibits "A" and "B" shall be revised by the Unit Operator whenever
31 changes in the unit area render such revision necessary, or when requested by
32 the Oil and Gas Supervisor, hereinafter referred to as "Supervisor", or
33 when requested by the Commissioner of Public Lands of the State of New Mexico,
34 hereinafter referred to as "Commissioner", and not less than five copies of the

1 revised exhibits shall be filed with the Supervisor, and two copies thereof
2 shall be filed with the Commissioner, and one copy with the Oil Conservation
3 Division of the Energy and Minerals Department of the State of New Mexico,
4 hereinafter referred to as "Division".

5 The above-described unit area shall when practicable be expanded to
6 include therein any additional lands or shall be contracted to exclude lands
7 whenever such expansion or contraction is deemed to be necessary or advis-
8 able to conform with the purposes of this agreement. Such expansion or
9 contraction shall be effected in the following manner:

10 a) Unit Operator, on its own motion or on demand of the Director
11 of the Geological Survey, hereinafter referred to as "Director", or on de-
12 mand of the Commissioner, after preliminary concurrence by the Director
13 and the Commissioner, shall prepare a notice of proposed expansion or con-
14 traction describing the contemplated changes in the boundaries of the unit
15 area, the reasons therefor, and the proposed effective date thereof, pre-
16 ferably the first day of a month subsequent to the date of notice.

17 b) Said notice shall be delivered to the Supervisor, the Commissioner
18 and the Division and copies thereof mailed to the last known address of
19 each working interest owner, lessee, and lessor whose interests are affected,
20 advising that 30 days will be allowed for submission to the Unit Operator of
21 any objections.

22 c) Upon expiration of the 30-day period provided in the preceding
23 item (b) hereof, Unit Operator shall file with the Supervisor, the Commis-
24 sioner and the Division evidence of mailing of the notice of expansion
25 or contraction and a copy of any objections thereto which have been filed
26 with the Unit Operator, together with an application in sufficient number,
27 for approval of such expansion or contraction and with appropriate joinders.

28 d) After due consideration of all pertinent information, the expansion
29 or contraction shall, upon approval by the Supervisor, the Commissioner and
30 the Division, become effective as of the date prescribed in the notice
31 thereof.

32 e) All legal subdivisions of lands (i.e., 40 acres by Government
33 survey or its nearest lot or tract equivalent; in instances of irregular

1 surveys unusually large lots or tracts shall be considered in multiples
2 of 40 acres or the nearest aliquot equivalent thereof), no parts of which
3 are entitled to be in a participating area on or before the fifth anniver-
4 sary of the effective date of the first initial participating area estab-
5 lished under this unit agreement, shall be eliminated automatically from
6 this agreement, effective as of said fifth anniversary, and such lands shall
7 no longer be a part of the unit area and shall no longer be subject to this
8 agreement, unless diligent drilling operations are in progress on unitized
9 lands not entitled to participation on said fifth anniversary, in which event
10 all such lands shall remain subject hereto so long as such drilling opera-
11 tions are continued diligently with not more than 90 days' time elapsing
12 between the completion of one well and the commencement of the next well.
13 All legal subdivisions of lands not entitled to be in a participating area
14 within 10 years after the effective date of the first initial participating
15 area approved under this agreement shall be automatically eliminated from
16 this agreement as of said tenth anniversary. All lands proved productive
17 by diligent drilling operations after the aforesaid 5-year period shall
18 become participating in the same manner as during said 5-year period. How-
19 ever, when such diligent drilling operations cease, all nonparticipating
20 lands shall be automatically eliminated effective as of the 91st day there-
21 after. The Unit Operator shall, within 90 days after the effective date of
22 any elimination hereunder, describe the area so eliminated to the satisfac-
23 tion of the Supervisor and the Commissioner, and promptly notify all parties
24 in interest.

25 If conditions warrant extension of the 10-year period specified in
26 this subsection 2(e), a single extension of not to exceed 2 years may be
27 accomplished by consent of the owners of 90% of the working interests in the
28 current nonparticipating unitized lands and the owners of 60% of the basic
29 royalty interests (exclusive of the basic royalty interests of the United
30 States) in nonparticipating unitized lands with approval of the Director and
31 Commissioner, provided such extension application is submitted to the Director
32 and Commissioner not later than 60 days prior to the expiration of said ten-year
period.

1 Any expansion of the unit area pursuant to this section which embraces
2 lands theretofore eliminated pursuant to this subsection 2(e) shall not be
3 considered automatic commitment or recommitment of such lands.

4 3. UNITIZED LAND AND UNITIZED SUBSTANCES. All land committed to this
5 agreement shall constitute land referred to herein as "unitized land" or
6 "land subject to this agreement". All oil and gas in any and all formations
7 of the unitized land are unitized under the terms of this agreement and herein
8 are called "unitized substances".

9 4. UNIT OPERATOR. GRACE PETROLEUM CORPORATION is hereby designated as Unit
10 Operator and by signature hereto as Unit Operator agrees and consents to
11 accept the duties and obligations of Unit Operator for the discovery,
12 development and production of unitized substances as herein provided. When-
13 ever reference is made herein to the Unit Operator, such reference means
14 the Unit Operator acting in that capacity and not as an owner of interest
15 in unitized substances, and the term "working interest owner" when used
16 herein shall include or refer to Unit Operator as the owner of a working
17 interest when such an interest is owned by it.

18 5. RESIGNATION OR REMOVAL OF UNIT OPERATOR. Unit Operator shall
19 have the right to resign at any time prior to the establishment of a
20 participating area or areas hereunder, but such resignation shall not
21 become effective so as to release Unit Operator from the duties and obliga-
22 tions of Unit Operator and terminate Unit Operator's rights as such for a
23 period of 6 months after notice of intention to resign has been served by
24 Unit Operator on all working interest owners and the Supervisor, the
25 Commissioner and the Division, and until all wells then drilled here-
26 under are placed in a satisfactory condition for suspension or abandonment
27 whichever is required by the Supervisor as to Federal lands and by the Com-
28 missioner as to State lands, unless a new Unit Operator shall have been
29 selected and approved and shall have taken over and assumed the duties and
30 obligations of Unit Operator prior to the expiration of said period.

31 Unit Operator shall have the right to resign in like manner and subject
32 to like limitations as above provided at any time a participating area

1 established hereunder is in existence, but, in all instances of resignation
2 or removal, until a successor Unit Operator is selected and approved as
3 hereinafter provided, the working interest owners shall be jointly responsi-
4 ble for performance of the duties of Unit Operator, and shall, not later
5 than 30 days before such resignation or removal becomes effective, appoint
6 a common agent to represent them in any action to be taken hereunder.

7 The resignation of Unit Operator shall not release Unit Operator from
8 any liability for any default by it hereunder occurring prior to the effec-
9 tive date of its resignation.

10 The Unit Operator may, upon default or failure in the performance of
11 its duties or obligations hereunder, be subject to removal by the same
12 percentage vote of the owners of working interests as herein provided for
13 the selection of a new Unit Operator. Such removal shall be effective
14 upon notice thereof to the Supervisor and the Commissioner.

15 The resignation or removal of Unit Operator under this agreement shall
16 not terminate its right, title or interest as the owner of a working inter-
17 est or other interest in unitized substances, but upon the resignation or
18 removal of Unit Operator becoming effective, such Unit Operator shall
19 deliver possession of all wells, equipment, materials and appurtenances used
20 in conducting the unit operations to the new duly qualified successor Unit
21 Operator or to the common agent, if no such new Unit Operator is elected,
22 to be used for the purpose of conducting unit operations hereunder. Nothing
23 herein shall be construed as authorizing removal of any material, equipment
24 and appurtenances needed for the preservation of any wells.

25 6. SUCCESSOR UNIT OPERATOR. Whenever the Unit Operator shall tender
26 his or its resignation as Unit Operator or shall be removed as hereinabove
27 provided, or a change of Unit Operator is negotiated by working interest
28 owners, the owners of the working interests in the participating area or
29 areas according to their respective acreage interests in such participating
30 area or areas, or, until a participating area shall have been established,
31 the owners of the working interests according to their respective acreage
32 interests in all unitized land, shall by majority vote select a successor
33 Unit Operator: Provided, That, if a majority but less than 75 per cent of

1 the working interests qualified to vote are owned by one party to this
2 agreement, a concurring vote of one or more additional working interest
3 owners shall be required to select a new operator. Such selection shall
4 not become effective until

5 a) a Unit Operator so selected shall accept in writing the duties
6 and responsibilities of Unit Operator, and

7 b) the selection shall have been approved by the Supervisor and
8 the Commissioner.

9 If no successor Unit Operator is selected and qualified as herein
10 provided, the Director and Commissioner at their election may declare
11 this unit agreement terminated.

12 7. ACCOUNTING PROVISIONS AND UNIT OPERATING AGREEMENT. If the
13 Unit Operator is not the sole owner of working interest, costs and expenses
14 incurred by Unit Operator in conducting unit operations hereunder shall be
15 paid and apportioned among and borne by the owners of working interests,
16 all in accordance with the agreement or agreements entered into by and
17 between the Unit Operator and the owners of working interests, whether one
18 or more, separately or collectively. Any agreement or agreements entered
19 into between the working interest owners and the Unit Operator as provided
20 in this section, whether one or more, are herein referred to as the "unit
21 operating agreement". Such unit operating agreement shall also provide
22 the manner in which the working interest owners shall be entitled to receive
23 their respective proportionate and allocated share of the benefits accruing
24 hereto in conformity with their underlying operating agreements, leases or
25 other independent contracts, and such other rights and obligations as be-
26 tween Unit Operator and the working interest owners as may be agreed upon
27 by Unit Operator and the working interest owners; however, no such unit
28 operating agreement shall be deemed either to modify any of the terms and
29 conditions of this unit agreement or to relieve the Unit Operator of any
30 right or obligation established under this unit agreement, and in case of any
31 inconsistency or conflict between this unit agreement and the unit operating
32 agreement, this unit agreement shall govern. Three true copies of any unit
33 operating agreement executed pursuant to this section should be filed with

1 the Supervisor and two true copies with the Commissioner and one true copy
2 with the Division, prior to approval of this unit agreement.

3 8. RIGHTS AND OBLIGATIONS OF UNIT OPERATOR. Except as otherwise
4 specifically provided herein, the exclusive right, privilege, and duty of
5 exercising any and all rights of the parties hereto which are necessary
6 or convenient for prospecting for, producing, storing, allocating, and
7 distributing the unitized substances are hereby delegated to and shall be
8 exercised by the Unit Operator as herein provided. Acceptable evidence of
9 title to said rights shall be deposited with said Unit Operator and, together
10 with this agreement, shall constitute and define the rights, privileges, and
11 obligations of Unit Operator. Nothing herein, however, shall be construed
12 to transfer title to any land or to any lease or operating agreement, it
13 being understood that under this agreement the Unit Operator, in its capacity
14 as Unit Operator, shall exercise the rights of possession and use vested in
15 the parties hereto only for the purposes herein specified.

16 9. DRILLING TO DISCOVERY. Within 6 months after the effective date
17 hereof, the Unit Operator shall begin to drill an adequate test well at a
18 location approved by the Supervisor, if on Federal land, or by the Commissioner
19 if on State land, unless on such effective date a well is being drilled
20 conformably with the terms hereof, and thereafter continue such drilling
21 diligently until the Morrow Sand formation has been tested or until at a
22 lesser depth unitized substances shall be discovered which can be produced
23 in paying quantities (to-wit: quantities sufficient to repay the costs of
24 drilling, completing, and producing operations, with a reasonable profit) or the
25 Unit Operator shall at any time establish to the satisfaction of the Supervisor
26 if located on Federal lands, or the Commissioner if located on State lands,
27 that further drilling of said well would be unwarranted or impracticable,
28 provided, however, that unit Operator shall not in any event be required to
29 drill said well to a depth in excess of 13,550 feet. Until the discovery of
30 a deposit of unitized substances capable of being produced in paying quantities,
31 the Unit Operator shall continue drilling one well at a time, allowing not more
32 than 6 months between the completion of one well and the beginning of the next

1 well, until a well capable of producing unitized substances in paying
2 quantities is completed to the satisfaction of said Supervisor if on Federal
3 land, or the Commissioner if on State land, or until it is reasonable
4 proved that the unitized land is incapable of producing unitized substances
5 in paying quantities in the formations drilled hereunder. Nothing in this
6 section shall be deemed to limit the right of the Unit Operator to resign as
7 provided in Section 5 hereof, or as requiring Unit Operator to commence or
8 continue any drilling during the period pending such resignation becoming
9 effective in order to comply with the requirements of this section. The
10 Supervisor and Commissioner may modify the drilling requirements of this
11 section by granting reasonable extensions of time when, in their opinion,
12 such action is warranted. Upon failure to commence any well provided for
13 in this section within the time allowed, including any extension of time
14 granted by the Supervisor and the Commissioner, this agreement will
15 automatically terminate; upon failure to continue drilling diligently any
16 well commenced hereunder, the Supervisor and Commissioner may, after 15 days
17 notice to the Unit Operator, declare this unit agreement terminated.

18 10. PLAN OF FURTHER DEVELOPMENT AND OPERATION. Within 6 months
19 after completion of a well capable of producing unitized substances in
20 paying quantities, the Unit Operator shall submit for the approval of the
21 Supervisor and the Commissioner an acceptable plan of development and operation
22 for the unitized land which, when approved by the Supervisor and the Commissioner,
23 shall constitute the further drilling and operating obligations of the Unit
24 Operator under this agreement for the period specified therein. Thereafter,
25 from time to time before the expiration of any existing plan, the Unit Operator
26 shall submit for the approval of the Supervisor and the Commissioner a plan
27 for an additional specified period for the development and operation of the
28 unitized land.

29 Any plan submitted pursuant to this section shall provide for the
30 exploration of the Unitized area and for the diligent drilling necessary
31 for determination of the area or areas thereof capable of producing unitized
32 substances in paying quantities in each and every productive formation and

1 shall be as complete and adequate as the Supervisor, the Commissioner
2 and Division may determine to be necessary for timely development and
3 proper conservation of the oil and gas resources of the unitized area
4 and shall:

- 5 a) specify the number and locations of any wells to be drilled and
6 the proposed order and time for such drilling; and
- 7 b) to the extent practicable, specify the operating practices regarded
8 as necessary and advisable for proper conservation of natural
9 resources.

10 Separate plans may be submitted for separate productive zones, subject to
11 the approval of the Supervisor, the Commissioner and the Division.

12 Plans shall be modified or supplemented when necessary to meet changed
13 conditions or to protect the interests of all parties to this agreement.
14 Reasonable diligence shall be exercised in complying with the obligations
15 of the approved plan of development. The Supervisor and Commissioner are
16 authorized to grant a reasonable extension of the 6-month period herein
17 prescribed for submission of an initial plan of development where such
18 action is justified because of unusual conditions or circumstances. After
19 completion hereunder of a well capable of producing any unitized substances
20 in paying quantities, no further wells, except such as may be necessary to
21 afford protection against operations not under this agreement and such as may
22 be specifically approved by the Supervisor and the Commissioner, shall be
23 drilled except in accordance with a plan of development approved as herein
24 provided.

25 11. PARTICIPATION AFTER DISCOVERY. Upon completion of a well capable
26 of producing unitized substances in paying quantities or as soon thereafter
27 as required by the Supervisor and Commissioner, the Unit Operator shall sub-
28 mit for approval by the Supervisor and Commissioner a schedule, based on
29 subdivisions of the public land survey or aliquot parts thereof, of all land
30 then regarded as reasonably proved to be productive in paying quantities;
31 all lands in said schedule on approval of the Supervisor and Commissioner to
32 constitute a participating area, effective as of the date of completion of
33 such well or the effective date of this unit agreement, whichever is later.

1 The acreages of both Federal and non-Federal lands shall be based upon
2 appropriate computations from the courses and distances shown on the
3 last approved public land survey as of the effective date of each initial
4 participating area. Said schedule shall also set forth the percentage of
5 unitized substances to be allocated as herein provided to each tract in
6 the participating area so established, and shall govern the allocation
7 of production commencing with the effective date of the participating area.
8 A separate participating area shall be established for each separate pool
9 or deposit of unitized substances or for any group thereof which is pro-
10 duced as a single pool or zone, and any two or more participating areas
11 so established may be combined into one, on approval of the Supervisor
12 and Commissioner. When production from two or more participating areas,
13 so established, is subsequently found to be from a common pool or deposit
14 said participating areas shall be combined into one effective as of such
15 appropriate date as may be approved or prescribed by the Supervisor and
16 Commissioner. The participating area or areas so established shall be revised
17 from time to time, subject to like approval, to include additional land then
18 regarded as reasonably proved to be productive in paying quantities or neces-
19 sary for unit operations, or to exclude land then regarded as reasonably
20 proved not to be productive in paying quantities and the schedule of allo-
21 cation percentages shall be revised accordingly. The effective date of any
22 revision shall be the first day of the month in which is obtained the know-
23 ledge or information on which such revision is predicated, provided, however,
24 that a more appropriate effective date may be used if justified by the Unit
25 Operator and approved by the Supervisor and Commissioner. No land shall be
26 excluded from a participating area on account of depletion of the unitized
27 substances, except that any participating area established under the provisions
28 of this unit agreement shall terminate automatically whenever all completions
29 in the formation on which the participating area is based are abandoned.

30 It is the intent of this section that a participating area shall repre-
31 sent the area known or reasonably estimated to be productive in paying quanti-
32 ties, but, regardless of any revision of the participating area, nothing herein
33 contained shall be construed as requiring any retroactive adjustment for

1 production obtained prior to the effective date of the revision of the
2 participating area.

3 In the absence of agreement at any time between the Unit Operator
4 and the Supervisor and Commissioner as to the proper definition or rede-
5 finition of a participating area, or until a participating area has, or
6 areas have, been established as provided herein, the portion of all pay-
7 ments affected thereby shall be impounded in a manner mutually acceptable
8 to the owners of working interests and the Supervisor and Commissioner.
9 Royalties due the United States and the State of New Mexico, which shall
10 be determined by the Supervisor for Federal land and the Commissioner for
11 State land and the amount thereof shall be deposited, as directed by the
12 Supervisor and Commissioner respectively, to be held as unearned money
13 until a participating area is finally approved and then applied as earned
14 or returned in accordance with a determination of the sum due as Federal
15 and State royalty on the basis of such approved participating area.

16 Whenever, it is determined, subject to the approval of the Supervisor
17 as to wells drilled on Federal land and of the Commissioner as to wells
18 drilled on State land, that a well drilled under this agreement is not
19 capable of production in paying quantities and inclusion of the land on
20 which it is situated in a participating area is unwarranted, production
21 from such well shall, for the purposes of settlement among all parties
22 other than working interest owners, be allocated to the land on which the
23 well is located unless such land is already within the participating area
24 established for the pool or deposit from which such production is obtained.
25 Settlement for working interest benefits from such a well shall be made as
26 provided in the unit operating agreement.

27 12. ALLOCATION OF PRODUCTION. All unitized substances produced from
28 each participating area established under this agreement, except any part
29 thereof used in conformity with good operating practices within the unitized
30 area for drilling, operating, camp and other production or development pur-
31 poses, for repressuring or recycling in accordance with a plan of development
32 approved by the Supervisor and Commissioner, or unavoidably lost, shall be
33 deemed to be produced equally on an acreage basis from the several tracts

1 of unitized land of the participating area established for such production
2 and, for the purpose of determining any benefits accruing under this agree-
3 ment, each such tract of unitized land shall have allocated to it such per-
4 centage of said production as the number of acres of such tract included
5 in said participating area bears to the total acres of unitized land in
6 said participating area, except that allocation of production hereunder for
7 purposes other than for settlement of the royalty, overriding royalty, or
8 payment out of production obligations of the respective working interest
9 owners, shall be on the basis prescribed in the unit operating agreement
10 whether in conformity with the basis of allocation herein set forth or other-
11 wise. It is hereby agreed that production of unitized substances from a
12 participating area shall be allocated as provided herein regardless of
13 whether any wells are drilled on any particular part or tract of said part-
14 icipating area. If any gas produced from one participating area is used for
15 repressuring or recycling purposes in another participating area, the first
16 gas withdrawn from such last mentioned participating area for sale during
17 the life of this agreement shall be considered to be the gas so transferred
18 until an amount equal to that transferred shall be so produced for sale and
19 such gas shall be allocated to the participating area from which initially
20 produced as such area was last defined at the time of such final production.

21 13. DEVELOPMENT OR OPERATION OF NON-PARTICIPATING LAND OR FORMATION.

22 Any party hereto owning or controlling the working interest in any unitized
23 land having thereon a regular well location may with the approval of the
24 Supervisor as to Federal land or the Commissioner as to State land, at such
25 party's sole risk, cost and expense, drill a well to test any formation for
26 which a participating area has not been established or to test any formation for
27 which a participating area has been established if such location is not within
28 said participating area, unless within 90 days of receipt of notice from said
29 party of his intention to drill the well the Unit Operator elects and commences
30 to drill such a well in like manner as other wells are drilled by the Unit
31 Operator under this agreement.

32 If any well drilled as aforesaid by a working interest owner results

1 in production such that the land upon which it is situated may properly be
2 included in a participating area, such participating area shall be established
3 or enlarged as provided in this agreement and the well shall thereafter be
4 operated by the Unit Operator in accordance with the terms of this agreement
5 and the unit operating agreement.

6 If any well drilled as aforesaid by a working interest owner obtains
7 production in quantities insufficient to justify the inclusion of the land
8 upon which such well is situated in a participating area, such well may be
9 operated and produced by the party drilling the same subject to the conserva-
10 tion requirements of this agreement. The royalties in amount or value of
11 production from any such well shall be paid as specified in the underlying
12 lease and agreements affected.

13 14. ROYALTY SETTLEMENT. The United States and any State and any
14 royalty owner who is entitled to take in kind a share of the substances
15 now unitized hereunder shall hereafter be entitled to the right to take in
16 kind its share of the unitized substances, and the Unit Operator, or the
17 working interest owner in case of the operation of a well by a working inter-
18 est owner as herein provided for in special cases, shall make deliveries of
19 such royalty share taken in kind in conformity with the applicable contracts,
20 laws and regulations. Settlement for royalty interest not taken in kind shall
21 be made by working interest owners responsible therefor under existing con-
22 tracts, laws and regulations, or by the Unit Operator, on or before the last
23 day of each month for unitized substances produced during the preceding cal-
24 endar month; provided, however, that nothing herein contained shall operate
25 to relieve the lessees of any land from their respective lease obligations
26 for the payment of any royalties due under their leases.

27 If gas obtained from lands not subject to this agreement is introduced
28 into any participating area hereunder, for use in repressuring, stimulation
29 of production, or increasing ultimate recovery, in conformity with a plan of
30 operations approved by the Supervisor, the Commissioner, and Division, a
31 like amount of gas, after settlement as herein provided for any gas transferred
32 from any other participating area and with appropriate deduction for loss from
33 any cause, may be withdrawn from the formation in which the gas is introduced,

1 royalty free as to dry gas, but not as to any products which may be extracted
2 therefrom; provided that such withdrawal shall be at such time as may be
3 provided in the approved plan of operations or as may otherwise be consented
4 to by the Supervisor, the Commissioner and Division as conforming to good
5 petroleum engineering practice; and provided further, that such right of
6 withdrawal shall terminate on the termination of this unit agreement.

7 Royalty due the United States shall be computed as provided in the
8 operating regulations and paid in value or delivered in kind as to all unitized
9 substances on the basis of the amounts thereof allocated to unitized Federal
10 land as provided herein at the rate specified in the respective Federal leases,
11 or at such lower rate or rates as may be authorized by law or regulation;
12 provided, that for leases on which the royalty rate depends on the daily
13 average production per well, said average production shall be determined in
14 accordance with the operating regulations as though each participating area
15 were a single consolidated lease.

16 Royalty due on account of State lands shall be computed and paid on the
17 basis of all unitized substances allocated to such lands.

18 15. RENTAL SETTLEMENT. Rental or minimum royalties due on leases com-
19 mitted hereto shall be paid by working interest owners responsible therefor
20 under existing contracts, laws and regulations, provided that nothing herein
21 contained shall operate to relieve the lessees of any land from their respec-
22 tive lease obligations for the payment of any rental or minimum royalty due
23 under their leases. Rental or minimum royalty for lands of the United States
24 subject to this agreement shall be paid at the rate specified in the respective
25 leases from the United States unless such rental or minimum royalty is waived,
26 suspended or reduced by law or by approval of the Secretary or his duly
27 authorized representative.

28 Rentals on State of New Mexico lands subject to this agreement shall be
29 paid at the rates specified in the respective leases.

30 With respect to any lease on non-Federal land containing provisions which
31 would terminate such lease unless drilling operations are commenced upon the
32 land covered thereby within the time therein specified or rentals are paid for
33 the privilege of deferring such drilling operations, the rentals required

1 thereby shall, notwithstanding any other provisions of this agreement, be
2 deemed to accrue and become payable during the term thereof as extended by
3 this agreement and until the required drilling operations are commenced
4 upon the land covered thereby or until some portion of such land is included
5 within a participating area.

6 16. CONSERVATION. Operations hereunder and production of unitized
7 substances shall be conducted to provide for the most economical and effi-
8 cient recovery of said substances without waste, as defined by or pursuant
9 to State or Federal laws or regulations.

10 17. DRAINAGE. The Unit Operator shall take such measures as the
11 Supervisor and Commissioner deem appropriate and adequate to prevent drain-
12 age of unitized substances from unitized land by wells on land not subject
13 to this agreement.

14 18. LEASES AND CONTRACTS CONFORMED AND EXTENDED. The terms, conditions
15 and provisions of all leases, subleases and other contracts relating to ex-
16 ploration, drilling, development or operations for oil or gas on lands com-
17 mitted to this agreement are hereby expressly modified and amended to the
18 extent necessary to make the same conform to the provisions hereof, but
19 otherwise to remain in full force and effect; and the parties hereto hereby
20 consent that the Secretary as to Federal leases and the Commissioner as to
21 State leases shall and each by his approval hereof, or by the approval hereof
22 by their duly authorized representatives, do hereby establish, alter, change
23 or revoke the drilling, producing, rental, minimum royalty and royalty
24 requirements of Federal and State leases committed hereto and the regulations
25 in respect thereto to conform said requirements to the provisions of this
26 agreement, and, without limiting the generality of the foregoing, all leases,
27 subleases, and contracts are particularly modified in accordance with the
28 following:

- 29 a) The development and operation of lands subject to this agreement
30 under the terms hereof shall be deemed full performance of all obligations
31 for development and operation with respect to each and every separately
32 owned tract subject to this agreement, regardless of whether there is
33 any development of any particular tract of the unit area.

1 (b) Drilling and producing operations performed hereunder upon any
2 tract of unitized land will be accepted and deemed to be performed
3 upon and for the benefit of each and every tract of unitized land, and
4 no lease shall be deemed to expire by reason of failure to drill or
5 produce wells situated on the land therein embraced.

6 (c) Suspension of drilling or producing operations on all unitized
7 lands pursuant to direction or consent of the Secretary and Commissioner
8 or their duly authorized representatives shall be deemed to constitute
9 such suspension pursuant to such direction or consent as to each and every
10 tract of unitized land. A suspension of drilling or producing operations
11 limited to specified lands shall be applicable only to such lands.

12 (d) Each lease, sublease or contract relating to the exploration, drilling,
13 development or operation for oil or gas of lands other than those of the
14 United States or State of New Mexico committed to this agreement, which,
15 by its terms might expire prior to the termination of this agreement, is
16 hereby extended beyond any such term so provided therein so that it shall be
17 continued in full force and effect for and during the term of this agreement.

18 (e) Any Federal lease for a fixed term of twenty (20) years or any renewal
19 thereof or any part of such lease which is made subject to this agreement
20 shall continue in force beyond the term provided therein until the termination
21 hereof. Any other Federal lease committed hereto shall continue in force
22 beyond the term so provided therein or by law as to the land committed so
23 long as such lease remains subject hereto, provided that production is had
24 in paying quantities under this unit agreement prior to the expiration date
25 of the term of such lease, or in the event actual drilling operations are
26 commenced on unitized lands, in accordance with the provisions of this
27 agreement, prior to the end of the primary term of such lease and are being
28 diligently prosecuted at that time, such lease shall be extended for two years
29 and so long thereafter as oil or gas is produced in paying quantities in
30 accordance with the provisions of the Mineral Leasing Act Revision of 1960.

31 (f) Each sublease or contract relating to the operation and development
32 of unitized substances from lands of the United States committed to this
33 agreement, which by its terms would expire prior to the time at which the

1 underlying lease, as extended by the immediately preceding paragraph, will
2 expire, is hereby extended beyond any such term so provided therein so that
3 it shall be continued in full force and effect for and during the term of
4 the underlying lease as such term is herein extended.

5 (g) Any lease embracing lands of the State of New Mexico which is made
6 subject to this agreement, shall continue in force beyond the term provided
7 therein as to the lands committed hereto until the termination hereof,
8 subject to the provisions of subsection (e) of Section 2 and subsection (i)
9 of this Section 18.

10 (h) The segregation of any Federal lease committed to this agreement is
11 governed by the following provisions in the fourth paragraph of Sec. 17(j)
12 of the Mineral Leasing Act, as amended by the Act of September 2, 1960 (74
13 Stat. 781-784): "Any (Federal) lease heretofore or hereafter committed to
14 any such (unit) plan embracing lands that are in part within and in part
15 outside of the area covered by any such plan shall be segregated into separate
16 leases as to the lands committed and the lands not committed as of the effective
17 date of unitization: Provided, however, That any such lease as to the
18 nonunitized portion shall continue in force and effect for the term thereof
19 but for not less than two years from the date of such segregation and so long
20 thereafter as oil or gas is produced in paying quantities."

21 (i) Any lease embracing lands of the State of New Mexico having only a
22 portion of its lands committed hereto, shall be segregated as to the portion
23 committed and the portion not committed, and the provisions of such lease
24 shall apply separately to such segregated portions commencing as of the
25 effective date hereof; provided, however, notwithstanding any of the pro-
26 visions of this agreement to the contrary any lease embracing lands of the
27 State of New Mexico having only a portion of its lands committed hereto shall
28 continue in full force and effect beyond the term provided therein as to all
29 lands embraced in such lease, if oil or gas is discovered and is capable of
30 being produced in paying quantities from some part of the lands embraced in
31 such lease at the expiration of the secondary term of such lease; or if, at the
32 expiration of the secondary term, the lessee or Unit Operator is then engaged in

1 bona fide drilling or reworking operations on some part of the lands
2 embraced in such lease, the same, as to all lands embraced therein,
3 shall remain in full force and effect so long as such operations
4 are being diligently prosecuted, and if they result in the production of
5 oil or gas, said lease shall continue in full force and effect as to
6 all of the lands embraced therein, so long thereafter as oil or gas
7 in paying quantities is being produced from any portion of said lands.

8 (j) Any lease, other than a Federal lease, having only a portion of
9 its lands committed hereto shall be segregated as to the portion com-
10 mitted and the portion not committed, and the provisions of such lease
11 shall apply separately to such segregated portions commencing as of
12 the effective date hereof. In the event any such lease provides for
13 a lump sum rental payment, such payment shall be prorated between the
14 portions so segregated in proportion to the acreage of the respective
15 tracts.

16 19. COVENANTS RUN WITH LAND. The covenants herein shall be construed
17 to be covenants running with the land with respect to the interest of the
18 parties hereto and their successors in interest until this agreement terminates,
19 and any grant, transfer, or conveyance of interest in land or leases subject
20 hereto shall be and hereby is conditioned upon the assumption of all privileges
21 and obligations hereunder by the grantee, transferee or other successor in
22 interest. No assignment or transfer of any working interest, royalty, or
23 other interest subject hereto shall be binding upon Unit Operator until the
24 first day of the calendar month after Unit Operator is furnished with the
25 original, photostatic, or certified copy of the instrument of transfer.

26 20. EFFECTIVE DATE AND TERM. This agreement shall become effective
27 upon approval by the Secretary and Commissioner, or their duly authorized
28 representatives and shall terminate five (5) years from said effective date
29 unless:

- 30 (a) such date of expiration is extended by the Director and Commissioner,
31 or
32 (b) it is reasonably determined prior to the expiration of the fixed

1 term or any extension thereof that the unitized land is incapable of
2 production of unitized substances in paying quantities in the formations
3 tested hereunder and after notice of intention to terminate the agreement
4 on such ground is given by the Unit Operator to all parties in interest
5 at their last known addresses, the agreement is terminated with the ap-
6 proval of the Supervisor and the Commissioner, or

7 (c) a valuable discovery of unitized substances has been made or
8 accepted on unitized land during said initial term or any extension
9 thereof, in which event the agreement shall remain in effect for such
10 term and so long as unitized substances can be produced in quantities
11 sufficient to pay for the cost of producing same from wells on unitized
12 land within any participating area established hereunder and, should
13 production cease, so long thereafter as diligent operations are in pro-
14 gress for the restoration of production or discovery of new production
15 and so long thereafter as unitized substances so discovered can be
16 produced as aforesaid, or

17 (d) it is terminated as heretofore provided in this agreement. This
18 agreement may be terminated at any time by not less than 75 per centum,
19 on an acreage basis, of the working interest owners signatory hereto,
20 with the approval of the Supervisor and Commissioner; notice of any such
21 approval to be given by the Unit Operator to all parties hereto.

22 21. RATE OF PROSPECTING, DEVELOPMENT AND PRODUCTION. The Director is
23 hereby vested with authority to alter or modify from time to time in his dis-
24 cretion the quantity and rate of production under this agreement when such
25 quantity and rate is not fixed pursuant to Federal or State law or does not
26 conform to any statewide voluntary conservation or allocation program, which
27 is established, recognized and generally adhered to by the majority of oper-
28 ators in such State, such authority being hereby limited to alteration or mod-
29 ification in the public interest, the purpose thereof and the public interest
30 to be served thereby to be stated in the order of alteration or modification.
31 Without regard to the foregoing, the Director is also hereby vested with
32 authority to alter or modify from time to time in his descretion the rate of

1 prospecting and development and the quantity and rate of production under
2 this agreement when such alteration or modification is in the interest of
3 attaining the conservation objectives stated in this agreement and is not
4 in violation of any applicable Federal or State law; provided, further, that
5 no such alteration or modification shall be effective as to any land of the
6 State of New Mexico, as to the rate of prospecting and developing in the
7 absence of the specific written approval thereof by the Commissioner and
8 as to any lands of the State of New Mexico subject to this agreement as to
9 the quantity and rate of production in the absence of specific written
10 approval thereof by the Commission.

11 Powers in this section vested in the Director shall only be exercised
12 after notice to Unit Operator and opportunity for hearing to be held not
13 less than 15 days from notice.

14 22. CONFLICT OF SUPERVISION. Neither the Unit Operator nor the work-
15 ing interest owners nor any of them shall be subject to any forfeiture, termin-
16 ation or expiration of any rights hereunder or under any leases or contracts
17 subject hereto, or to any penalty or liability on account of delay or failure
18 in whole or in part to comply with any applicable provision thereof to the
19 extent that the Unit Operator, working interest owners or any of them are
20 hindered, delayed or prevented from complying therewith by reason of failure
21 of the Unit Operator to obtain in the exercise of due diligence, the concur-
22 rence of proper representatives of the United States and proper representatives
23 of the State of New Mexico in and about any matters or things concerning which
24 it is required herein that such concurrence be obtained. The parties hereto,
25 including the Commission, agree that all powers and authority vested in the
26 Commission in and by any provisions of this agreement are vested in the Com-
27 mission and shall be exercised by it pursuant to the provisions of the laws
28 of the State of New Mexico and subject in any case to appeal or judicial re-
29 view as may now or hereafter be provided by the laws of the State of New Mexico.

30 23. APPEARANCES. Unit Operator shall, after notice to other parties
31 affected, have the right to appear for and on behalf of any and all interests
32 affected hereby before the Department of the Interior, the Commissioner of
33 Public Lands of the State of New Mexico and the Oil Conservation Division of the

1 Energy and Minerals Department of the State of New Mexico and to appeal from
2 orders issued under the regulations of said Department, the Division or
3 Commissioner or to apply for relief from any of said regulations or in any pro-
4 ceedings relative to operations before the Department of the Interior, the
5 Commissioner, or Division, or any other legally constituted authority; provided,
6 however, that any other interested party shall also have the right at his own
7 expense to be heard in any such proceeding.

8 24. NOTICES. All notices, demands or statements required hereunder
9 to be given or rendered to the parties hereto shall be deemed fully given if
10 given in writing and personally delivered to the party or sent by postpaid
11 registered or certified mail, addressed to such party or parties at their
12 respective addresses set forth in connection with the signatures hereto or
13 to the ratification or consent hereof or to such other address as any such
14 party may have furnished in writing to party sending the notice, demand or
15 statement.

16 25. NO WAIVER OF CERTAIN RIGHTS. Nothing in this agreement contained
17 shall be construed as a waiver by any party hereto of the right to assert
18 any legal or constitutional right or defense as to the validity or invalidity
19 of any law of the State wherein said unitized lands are located, or of the
20 United States, or regulations issued thereunder in any way affecting such
21 party, or as a waiver by any such party of any right beyond his or its
22 authority to waive.

23 26. UNAVOIDABLE DELAY. All obligations under this agreement requiring
24 the Unit Operator to commence or continue drilling or to operate on or pro-
25 duce unitized substances from any of the lands covered by this agreement shall
26 be suspended while the Unit Operator, despite the exercise of due care and
27 diligence, is prevented from complying with such obligations, in whole or in
28 part, by strikes, acts of God, Federal, State or municipal law or agencies,
29 unavoidable accidents, uncontrollable delays in transportation, inability
30 to obtain necessary materials in open market, or other matters beyond the
31 reasonable control of the Unit Operator whether similar to matters herein
32 enumerated or not. No unit obligation which is suspended under this section
33 shall become due less than thirty (30) days after it has been determined that

1 the suspension is no longer applicable. Determination of creditable
2 "Unavoidable Delay" time shall be made by the Unit Operator subject to
3 approval of the Supervisor and Commissioner.

4 27. NONDISCRIMINATION. In connection with the performance of work
5 under this agreement, the operator agrees to comply with all of the pro-
6 visions of section 202 (1) to (7) inclusive of Executive Order 11246 (30 F. R.
7 12319), as amended, which are hereby incorporated by reference in this agreement.

8 28. LOSS OF TITLE. In the event title to any tract of unitized land
9 shall fail and the true owner cannot be induced to join in this agree-
10 ment, such tract shall be automatically regarded as not committed hereto
11 and there shall be such readjustment of future costs and benefits as may be
12 required on account of the loss of such title. In the event of a dispute
13 as to title to any royalty, working interest or other interests subject
14 thereto, payment or delivery on account thereof may be withheld without
15 liability for interest until the dispute is finally settled; provided, that,
16 as to Federal and State land or leases, no payments of funds due the United
17 States or State of New Mexico should be withheld, but such funds of the
18 United States shall be deposited as directed by the Supervisor and such
19 funds of the State of New Mexico shall be deposited as directed by the
20 Commissioner to be held as unearned money pending final settlement of the
21 title dispute, and then applied as earned or returned in accordance with
22 such final settlement.

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

25 29. NON-JOINDER AND SUBSEQUENT JOINDER. If the owner of any sub-
26 stantial interest in a tract within the unit area fails or refuses to sub-
27 scribe or consent to this agreement, the owner of the working interest in
28 that tract may withdraw said tract from this agreement by written notice
29 delivered to the Supervisor and the Commissioner and the Unit Operator
30 prior to the approval of this agreement by the Supervisor and Commissioner.
31 Any oil or gas interests in lands within the unit area not committed hereto
32 prior to submission of this agreement for final approval may thereafter be
33 committed hereto by the owner or owners thereof subscribing or consenting

1 to this agreement, and, if the interest is a working interest, by the owner
2 of such interest also subscribing to the unit operating agreement. After
3 operations are commenced hereunder, the right of subsequent joinder, as
4 provided in this section, by a working interest owner is subject to such
5 requirements or approvals, if any, pertaining to such joinder, as may be
6 provided for in the unit operating agreement. After final approval hereof,
7 joinder by a non-working interest owner must be consented to in writing by
8 the working interest owner committed hereto and responsible for the payment
9 of any benefits that may accrue hereunder in behalf of such non-working
10 interest. A non-working interest may not be committed to this unit agree-
11 ment unless the corresponding working interest is committed hereto. Joinder
12 to the unit agreement by a working interest owner, at any time, must be
13 accompanied by appropriate joinder to the unit operating agreement, if more
14 than one committed working interest owner is involved, in order for the
15 interest to be regarded as committed to this unit agreement. Except as
16 may otherwise herein be provided, subsequent joinders to this agreement shall
17 be effective as of the first day of the month following the filing with the
18 Supervisor and the Commissioner of duly executed counterparts of all or any
19 papers necessary to establish effective commitment of any tract to this
20 agreement unless objection to such joinder is duly made within 60 days by
21 the Supervisor, provided, however, that as to State lands all subsequent
22 joinders must be approved by the Commissioner.

23 30. COUNTERPARTS. This agreement may be executed in any number of
24 counterparts no one of which needs to be executed by all parties or may
25 be ratified or consented to by separate instrument in writing specifically
26 referring hereto and shall be binding upon all those parties who have exe-
27 cuted such a counterpart, ratification, or consent hereto with the same
28 force and effect as if all such parties had signed the same document and
29 regardless of whether or not it is executed by all other parties owning
30 or claiming an interest in the lands within the above described unit area.

1 31. NO PARTNERSHIP. It is expressly agreed that the relation of
2 the parties hereto is that of independent contractors and nothing in this
3 agreement contained, expressed or implied, nor any operations conducted
4 hereunder, shall create or be deemed to have created a partnership or
5 association between the parties hereto or any of them.

6 32. PROTECTION OF POTASH DEPOSITS. No wells will be drilled for
7 oil or gas at a location on Federal lands which in the opinion of the
8 Supervisor or at a location on State lands which in the opinion of the Com-
9 missioner would result in undue waste of potash deposits or constitute a
10 hazard to or unduly interfere with mining operations being conducted for the
11 extraction of potash deposits.

12 The drilling or abandonment of any well on unitized land shall be
13 done in accordance with applicable oil and gas operating regulations, including
14 such requirements as to Federal lands as may be prescribed by the Supervisor
15 and as to State lands by the Commissioner, as necessary to prevent the infil-
16 tration of oil, gas or water into formations containing potash deposits or
17 into mines or workings being utilized in the extraction of such deposits.

18 Well records and survey plats that an oil and gas lessee of Federal
19 lands must file pursuant to applicable operating regulations (30 CFR Part 221)
20 shall be available for inspection at the Office of the Supervisor to any
21 party holding a potash permit or lease on the Federal land on which the well
22 is situated insofar as such records are pertinent to the mining and protection
23 of potash deposits.

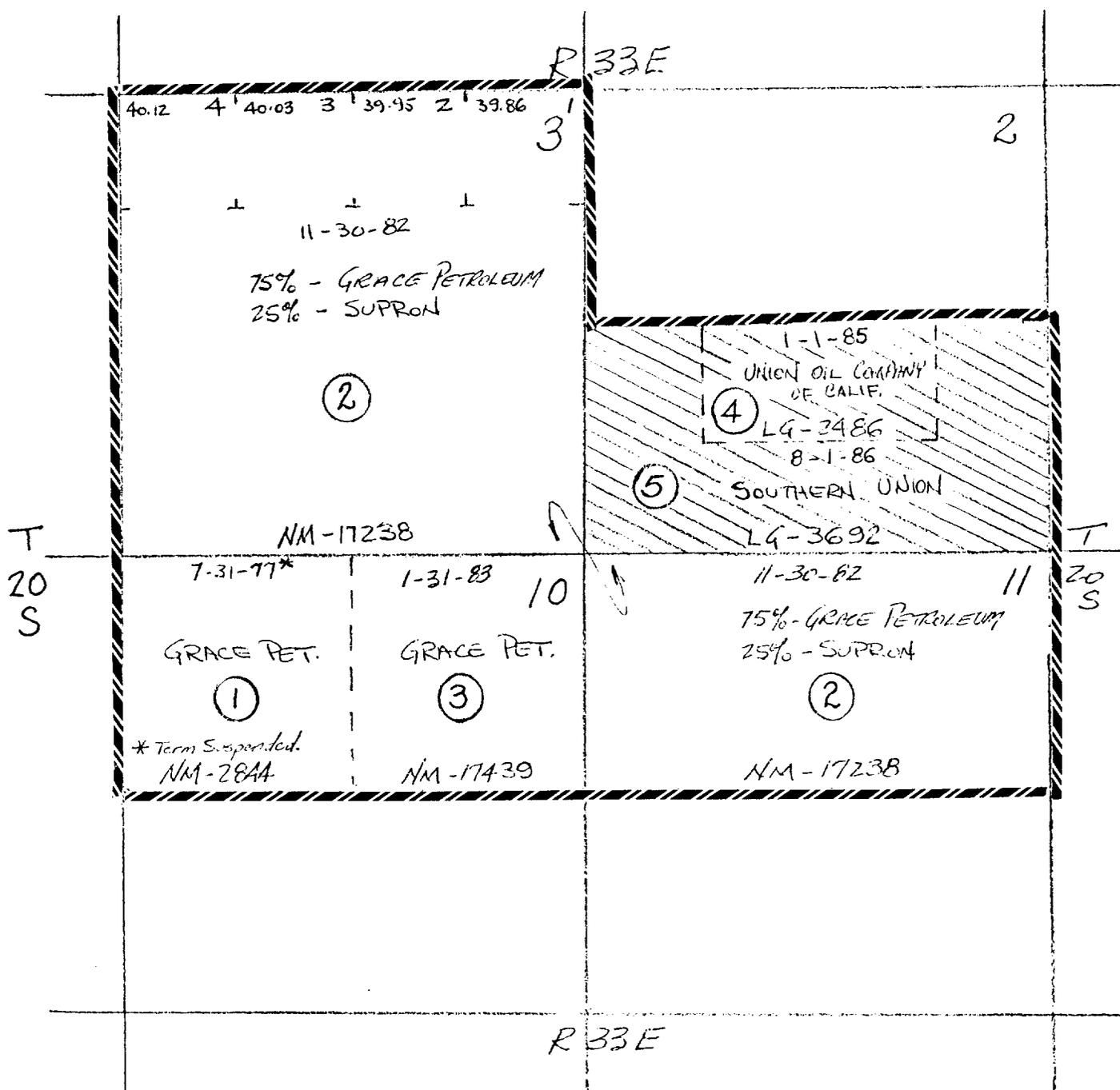
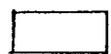
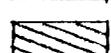


EXHIBIT "A"
 SMITH RANCH UNIT
 LEA COUNTY, NEW MEXICO
 1,599.96 ACRES

-  UNIT OUTLINE
-  FEDERAL ACREAGE
-  STATE ACREAGE
-  TRACT NUMBER

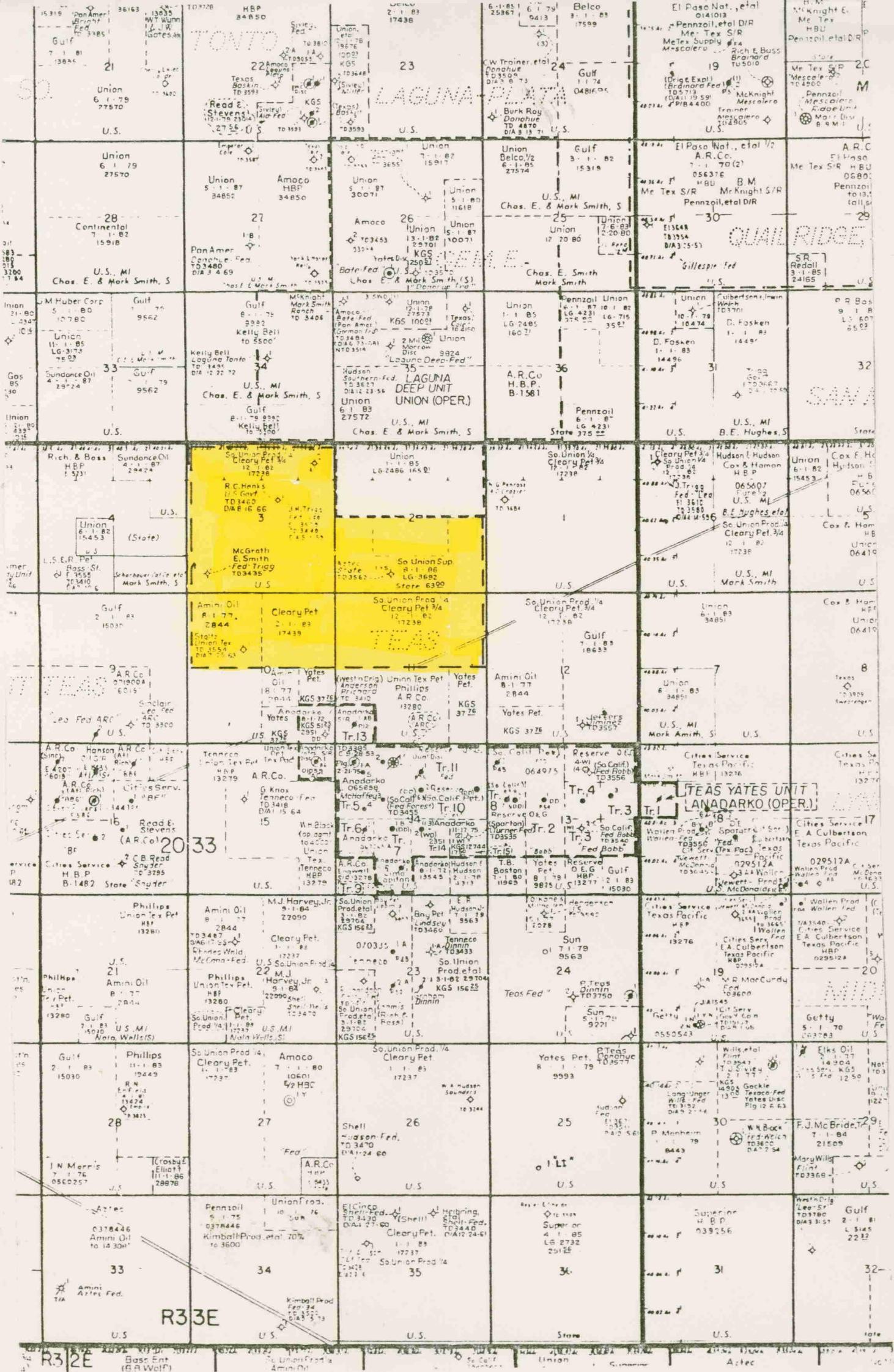
TRACT No.	SERIAL No.	ACRES
1	NM-2844	160.00
2	NM-17238	959.96
3	NM-17439	160.00
	SUB-TOTAL	1279.96 (79.999%)
4	LG-2486	80.00
5	LG-3692	240.00
	SUB-TOTAL	320.00 (20.001%)
	TOTAL	1599.96

EXHIBIT "B"

SMITH RANCH UNIT AREA

T-20-S, R-33-E, N.M.P.M.
LEA COUNTY, NEW MEXICO

TRACT NO.	DESCRIPTION OF LAND	NUMBER OF ACRES	SERIAL NO. & EXP. DATE OF LEASES (New Mexico Serials)	BASIC ROYALTY OWNERSHIP PERCENTAGE		LESSEE OF RECORD	OVERRIDING ROYALTY OWNERSHIP AND PERCENTAGE		WORKING INTEREST AND PERCENTAGE
				USA	12.5		Grace Petroleum Corporation	N.W.Glade : 3.00 Bullion Monarch Company : 2.00	
1	Sec.10: NW/4	160.00	NM-2844 7-31-77 (Term Suspended)	USA	12.5	Grace Petroleum Corporation	N.W.Glade : 3.00 Bullion Monarch Company : 2.00	Grace: All	
2	Sec.3: Lots 1,2,3, 4, S/2 N/2, S/2(All) Sec.11: N/2	959.96	NM-17238 11-30-82	USA	12.5	Grace Petroleum Corporation & Supron Energy Corporation	Eva G. Manning : 2.50 C.F.Strange: 2.50	Grace: 75% Supron: 25%	
3	Sec.10: NE/4	160.00	NM-17439 1-31-83	USA	12.5	Grace Petroleum Corporation	Jack C. Fraser : 5.00	Grace: All	
3 Federal Tracts - 1,279.96 acres, being 79.999% of Unit Area									
4	Sec.2: NE/4 SW/4, NW/4 SE/4	80.00	LG-2486 1-1-85	State	12.5	Union Oil Company of California	None	Union: All	
5	Sec.2: NW/4 SW/4, S/2 S/2, NE/4 SE/4	240.00	LG-3692 8-1-86	State	12.5	Southern Union Supply Company	None	Southern Union: All	
2 State Tracts - 320.00 acres, being 20.001% of Unit Area									
TOTAL: 5 Tracts - 1,599.96 acres in entire Unit Area									



BEFORE EXAMINER STAMETS
OIL CONSERVATION DIVISION

LEASE STATUS MAP

EXHIBIT NO. 2

CASE NO. 6613

SMITH RANCH UNIT PROSPECT

Submitted by GRACE

Lea County, New Mexico

Hearing Date