

EXHIBIT 2

Case #10971
NMOCD Examiner Hearing
May 12, 1994
Merrion Oil & Gas

MERRION OIL & GAS CORPORATION

SECONDARY UNIT AGREEMENT

**FOR HORIZONTAL DRILLING AND THE INJECTION OF WATER AND/OR
GAS
IN THE EAGLE MESA ENTRADA FIELD
SANDOVAL COUNTY, NEW MEXICO
July 12, 1991**

SECONDARY UNIT AGREEMENT

FOR HORIZONTAL DRILLING AND THE INJECTION OF WATER AND/OR GAS IN THE EAGLE MESA ENTRADA FIELD SANDOVAL COUNTY, NEW MEXICO

TABLE OF CONTENTS

<u>SECTION</u>		<u>PAGE</u>
	Preliminary Recitals.....	1
1	Enabling Act and Regulations.....	1
2	Secondary Unit Area.....	2
3	Expansion of Secondary Unit Area.....	2
4	Secondary Unit Area and Secondary Unit Substances....	2
5	Tracts Qualified for Participation.....	3
6	Secondary Unit Operator.....	3
7	Resignation or Removal of Secondary Unit Operator.....	3.4
8	Successor Secondary Unit Operator.....	4
9	Accounting Provisions and Secondary Unit Operating Agr..	4
10	Rights and Obligations of Secondary Unit Operator.....	4.5
11	Plan of Operation.....	5
12	Participation and Allocation of Production.....	5.6
13	Royalty Settlement.....	6,7
14	Rental Settlement.....	7
15	Conservation.....	8
16	Drainage.....	8
17	Gauge of Merchantable Oil.....	8
18	Leases and Contracts Conformed and Extended.....	8.9
19	Covenants Run with Land.....	9
20	Effective Date.....	10
21	Term.....	10
22	Termination by Working Interest Owners.....	10
23	Rate of Prospecting, Development and Production.....	10
24	Appearances.....	10.11
25	Notices.....	11
26	No Waiver of Certain Rights.....	11
27	Force Majeure.....	11
28	Nondiscrimination.....	11
29	Loss of Title.....	11.12
30	Subsequent Joinder.....	12
31	Counterparts.....	12
32	Taxes.....	12
33	No Partnership.....	12

Exhibit A: Map of Secondary Unit Area and Net Play

Exhibit B: Description of Secondary Unit Area & Tract
Participation

Exhibit C: Yearly Plan of Development

**SECONDARY UNIT AGREEMENT
FOR HORIZONTAL DRILLING AND THE INJECTION OF WATER AND/OR
GAS
IN THE EAGLE MESA ENTRADA FIELD
SANDOVAL COUNTY, NEW MEXICO**

THIS SECONDARY UNIT AGREEMENT, entered into as of the 12th day of July, 1991, by and between the parties subscribing, ratifying or consenting hereto and herein after referred to as the "parties".

WITNESSETH:

WHEREAS, the parties hereto are the owners of working, or other oil and gas interests in the Secondary Unit Area subject to this Secondary Unit Agreement; and

WHEREAS, the term "Working Interest" as used herein shall mean the interest held in Secondary Unit Substances or in lands containing Secondary Unit Substances by virtue of a lease, operating agreement, fee title, or otherwise, which is chargeable with and obligated to pay or bear all or a portion of the costs of drilling, developing, producing, and operating the land under the Secondary Unit Agreement; and

WHEREAS, the Act of March 3, 1909, as amended and the Mineral Leasing Act of February 25, 1920, 41 Stat. 437, as amended, 30 U.S.C. Sec. 181 et Seq., authorizes Federal and Indian lessees and their representatives to unite or cooperate with each other, or jointly or separately with others, in collectively adopting and operating a Secondary Unit plan of development or operation of any oil or gas pool, field, or like area, or any part thereof for the purposes of more properly conserving the natural resources thereof whenever determined and certified by the Secretary of the Interior, or his representative, to be necessary or advisable in the public interest; and

WHEREAS, it is the purpose of the parties hereto to conserve natural resources, prevent waste, to obtain additional hydrocarbon production which would not be available by normal lease development, and secure other benefits obtainable through development and operation of the Area subject to this Secondary Unit Agreement under the terms, conditions, and limitations herein set forth.

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

1. ENABLING ACT AND REGULATIONS. The Act of March 3, 1909, as amended, and the Mineral Leasing Act of February 25, 1920, supra, and all valid, pertinent regulations, including operating and Secondary Unit plan regulations, heretofore issued thereunder or valid, pertinent and reasonable regulations hereafter issued thereunder, are accepted and made a part of this Secondary Unit Agreement as to Federal and Indian lands, provided such regulations are not inconsistent with the terms of this Agreement.

2. **SECONDARY UNIT AREA.** The area specified on the plat attached hereto marked **Exhibit "A"** is hereby designated and recognized as constituting the Secondary Unit Area containing **280** acres, more or less.

Exhibit "A" is a map that shows the boundary of the Secondary Unit Area and the boundaries and identity of tracts and leases in this Secondary Unit. The term "tract" as used herein shall mean the parcel of land described as such and given a tract number in Exhibit "B" attached hereto. Exhibits "A" and "B" shall be revised by the Secondary Unit Operator whenever changes in the Secondary Unit Area render such revision necessary, or when requested by the Authorized Officer, which shall include the Bureau of Indian Affairs Area Director or his authorized representative hereinafter referred to as "AO". Also, Exhibit "B", attached hereto, is a schedule showing to the extent known to the Secondary Unit Operator the acreage, percentage, and kind of ownership of oil and gas interests in all lands in the Secondary Unit Area (Tract participation). Exhibit "C" attached hereto sets out the basic plan of development which will be updated each year on or before January 15th, and will be supplemented with sundry notices.

3. **EXPANSION OF SECONDARY UNIT AREA.** The Secondary Unit Area may, with the approval of the AO, be expanded to include therein any additional lands whenever such expansion is necessary or advisable to conform with the purpose of this Agreement and, with prior consent of the AO, Secondary Unit Operator, acting on behalf of the Working Interest Owners collectively, after being duly authorized by them as provided for in the Secondary Unit Operating Agreement, has negotiated an Agreement or Agreements with the owners of such lands fixing the tract participation of each Tract and providing for the commitment of the interest of such owners to this Agreement and to the Secondary Unit Operating Agreement. Whenever the Secondary Unit Agreement is enlarged so as to admit additional land, Exhibit "A" shall be revised as set forth in Section 12. Participation and Allocation of Production.

After due consideration of all pertinent information, the expansion shall, upon approval by the AO, become effective as of the date prescribed in the notice thereof.

4. **SECONDARY UNIT AREA AND SECONDARY UNIT SUBSTANCES.** All land committed to this Agreement as provided in Section 5. Tracts Qualified for Participation, as to the Secondary Unit Formation defined immediately below, shall constitute land referred to herein as "Secondary Unit Area" or "land subject to this Agreement". All oil and gas in and produced from the Secondary Unit Formation under the terms of this Agreement is called "Secondary Unit Substances".

The Secondary Unit Formation shall mean the Entrada Formation as identified by the resistivity log run in the Navajo 14C-1 well, located in Section 14, Township 19 North, Range 4 West, Sandoval County, New Mexico, with the top of the Secondary Unit Formation being found at a depth of 5450 feet below the surface and the base of the Secondary Unit Formation being found at a depth of 5635' below the surface.

5. **TRACTS QUALIFIED FOR PARTICIPATION.** Inasmuch as the objective of the ~~Secondary Unit Agreement~~ is to have lands in the Secondary Unit Area operated and ~~entitled to participation~~ under the terms hereof, no joinder shall be considered a commitment to the Secondary Unit Agreement unless the Tract involved is qualified under this Section. On or after the effective date hereof, the Tracts within the Secondary Unit Area, which shall be entitled to participation in the production of Secondary Unit Substances therefrom, shall be those Tracts within the Secondary Unit Area more particularly described in Exhibit "B" that are qualified as follows:

Each Tract in which Working Interest Owners owning one hundred percent (100%) of the Working Interests have signed or ratified this Agreement and the Secondary Unit Operating Agreement, and in which: (1) all Working Interest Owners in such Tract join in a request for inclusion of such Tract in Secondary Unit Participation upon the basis of such commitment status, and further as to which (2) seventy-five percent (75%) or more of the combined voting interests of Working Interest Owners in all Tracts vote in favor of the acceptance of such Tract as qualified. The voting interest of each Working Interest Owner shall be equal to the ratio (expressed in percentage) which the total of such Working Interest Owner's percentage participation in all Tracts which qualify, bears to the total percentage participation of all Working Interest Owners in all Tracts which qualify, as such percentages are shown on Exhibit "B".

6. **SECONDARY UNIT OPERATOR.** Merrion Oil and Gas Corporation is hereby designated as Secondary Unit Operator, and by signature hereto as Secondary Unit Operator agrees and consents to accept the duties and obligations of Secondary Unit Operator for the development and production of Secondary Unit Substances as herein provided.

7. **RESIGNATION OR REMOVAL OF SECONDARY UNIT OPERATOR.** Secondary Unit Operator shall have the right to resign at any time, but such resignation shall not become effective, so as to release Secondary Unit Operator from the duties and obligations of Secondary Unit Operator and terminate that Operator's rights as such, for a period of six (6) months after notice of intention to resign has been served by Secondary Unit Operator on all Working Interest Owners and the AO, and until all wells are placed in a satisfactory condition for suspension or abandonment, whichever is required by the AO, unless a new Secondary Unit Operator shall have been selected and accepted and shall have taken over and assumed the duties and obligation of Secondary Unit Operator prior to the expiration of said period.

The resignation of Secondary Unit Operator shall not release the Secondary Unit Operator from any liability for default by it hereunder occurring prior to the effective date of its resignation.

The resignation or removal of Secondary Unit Operator under this Agreement shall not terminate its right, title, or interest as the owner of a working interest or other interest in Secondary Unit Substances, but upon the resignation or removal of Secondary Unit Operator becoming effective, such Secondary Unit Operator shall deliver possession of all wells, equipment, materials, and appurtenances used in conducting the Secondary Unit operations

and owned by the Working Interest Owners to the new duly qualified successor Secondary Unit Operator; or to the owners thereof if no such new Secondary Unit Operator is elected; to be used for the purpose of conducting Secondary Unit operations hereunder. Nothing herein shall be construed as authorizing removal of any material, equipment, and appurtenances needed for the preservation of any wells.

8. SUCCESSOR SECONDARY UNIT OPERATOR. Whenever the Secondary Unit Operator shall tender his or its resignation as Secondary Unit Operator, or a change of Secondary Unit Operator is negotiated by Working Interest Owners, a successor Secondary Unit Operator shall be selected by Working Interest Owners voting according to their respective Tract participation in all Secondary Unit Area by a majority vote. Such selection shall not become effective until:

- (a) A Secondary Unit Operator so selected shall accept in writing the duties and responsibilities of Secondary Unit Operator; and
- (b) The selection shall have been approved by the AO.

If no successor Secondary Unit Operator is selected and qualified as herein provided, the AO, at his election, may declare this Secondary Unit Agreement terminated.

9. ACCOUNTING PROVISIONS AND SECONDARY UNIT OPERATING AGREEMENT. If the Secondary Unit Operator is not the sole owner of Working Interests, then said costs and expenses incurred by Secondary Unit Operator in conducting Secondary Unit Operations hereunder shall be paid and apportioned among and borne by the owners of Working Interests, in accordance with the Agreement or Agreements, whether one or more, entered into between the Working Interest Owners and the Secondary Unit Operator as provided in this section are herein referred to as the "Secondary Unit Operating Agreement".

Such Secondary Unit Operating Agreement shall also set forth such other rights and obligations as between Secondary Unit Operator and the Working Interest Owners as may be agreed upon by Secondary Unit Operator and the Working Interest Owners, however, no such Secondary Unit Operating Agreement shall be deemed either to modify any of the terms and conditions of this Secondary Unit Agreement or to relieve the Secondary Unit Operator of any right or obligation established under this Secondary Unit Agreement, and in case of any inconsistency or conflict between the Secondary Unit Agreement and the Secondary Unit Operating Agreement, this Secondary Unit Agreement shall prevail. Operator shall provide the BLM and BIA with three (3) original copies each of this Agreement.

10. RIGHTS AND OBLIGATIONS OF SECONDARY UNIT OPERATOR. Except as otherwise specifically provided herein, the exclusive right, privilege, and duty of exercising any and all rights of the parties hereto, including surface rights, which are necessary or convenient for prospecting for, producing, storing, allocating, and distributing the Secondary Unit Substances are hereby delegated to and shall be exercised by the Secondary Unit Operator as herein provided. Nothing herein, however, shall be construed to transfer title to any land or to any

~~lease or operating agreement~~; it being understood that under this Agreement the **Secondary Unit Operator**, in its capacity as **Secondary Unit Operator**, shall exercise the ~~rights of possession~~ and use vested in the parties hereto for the purposes herein specified.

11. **PLAN OF OPERATION.** It is recognized and agreed by the parties hereto that the **Secondary Unit Area** is developed and productive, and only such drilling as is incidental to horizontally drilled well(s) or, injection of any substance into the **Secondary Unit Formation** or, a pressure maintenance program, is contemplated hereby which will result in the maximized production of secondary reserves.

Inasmuch as the primary purpose of this **Secondary Unit Agreement** is to permit the institution and consummation of the drilling of a horizontal well(s), a gas or water injection program for the maximum economic production of **Secondary Unit Substances** consistent with good engineering and conservation practices, **Secondary Unit Operator**, concurrently with the filing of this **Secondary Unit Agreement** for final approval by the AO, shall submit to the AO for approval, a **Plan of Operation** for the **Secondary Unit Area**, and upon approval thereof by the AO, such plan shall constitute the future operating obligations of the **Secondary Unit Operator** under this **Secondary Unit Agreement**. Thereafter, said plan may be modified or supplemented when necessary to meet changed conditions or to protect the interest of all parties to the **Secondary Unit Agreement**. Reasonable diligence shall be exercised in complying with the obligations of any approved **Plan of Operation**.

Secondary Unit Operator shall have the following rights, including but not limited to (1) drill a horizontal well or wells and/or, (2) inject into the **Secondary Unit formation** any substances, but specifically natural gas, water, or carbon dioxide for secondary recovery or pressure maintenance purposes, (3) drill for, produce or use fresh water, (4) build pipelines and roads and construct surface facilities in accordance with a **Plan of Operation** approved by the AO, including the right to drill and maintain injection wells on the **Secondary Unit Area** and completed in the **Secondary Unit Formation** for said purpose, and the parties hereto, to the extent of their rights and interests, hereby grant to the **Secondary Unit Operator** the right to use as much of the surface of the land within the **Secondary Unit Area** as may be reasonably necessary for the operation and the development of the **Secondary Unit Area** hereunder.

12. **PARTICIPATION AND ALLOCATION OF PRODUCTION.** Beginning at 7:00 a.m. on the day of approval of this Agreement by the Secretary of the Interior, or his duly authorized representative and either, injection of any substance into the **Secondary Unit Formation** as set out herein, or the first day of production of a horizontal well drilled in the **Secondary Unit Area**, the Tract Participation of each Tract shall be based upon the following formula:

$$\text{Tract Participation} = \frac{\text{Number of Acres under each Tract}}{\text{(divided by) Total Number of Acres in the Secondary Unit Area}}$$

ILLEGIBLE

The boundaries of the Secondary Unit Area as used in this Agreement, is defined as total net oil thickness as mapped in Exhibit "A". Lands with less than 10 feet of net oil thickness are considered unproductive, and thus, are not contained within the Secondary Unit Area.

The figure set forth opposite each Tract in Exhibit "B" represent the Tract Participation to which such Tract is entitled if all Tracts are committed hereto and qualified as of the effective date of this Agreement.

Promptly after approval of the Secondary Unit Agreement, if all Tracts are not qualified hereto, Secondary Unit Operator shall revise Exhibits "A" & "B" to show the Tracts qualified to this Agreement by setting forth opposite each Tract a revised tract participation therefore, which shall be calculated by using the same Tract factors and formula which were used to arrive at the Tract Participation of each tract as set out in the original Exhibits "A" & "B", but applying the same only to those Tracts which are qualified effective as of the effective date of this Secondary Unit Agreement.

If, after the effective date of this Agreement, any Tract or Tracts are subsequently committed hereto and qualified because of expansion of the Area under Section 3, Expansion of Secondary Unit Area, or any Tract or Tracts are subsequently qualified under the provision of Section 5, Tracts Qualified for Participation, and Section 30, Subsequent Joinder, or if any Tract is eliminated from the Secondary Unit Agreement as provided in Section 29, Loss of Title, the schedule of participation as shown in Exhibit "A" shall be revised by the Secondary Unit Operator to show the new Tract Participation of all the then qualified Tracts; and the revised Exhibit "B", upon approval by the AO, shall govern the allocation of production for the effective date thereof until a new schedule is so approved.

On the effective date, and thereafter, all Secondary Unit Substances produced hereunder (except any part thereof used in conformity with good operating practices for drilling, operating, camp, and other production or development purposes, for pressure maintenance or secondary recovery operations in accordance with a plan of operation approved by the AO, or unavoidably lost), shall be deemed to be produced from the several Tracts of Secondary Unit Area, and for the purpose of determining any benefits accruing under this Agreement, each such Tract shall have allocated to it that percentage of said production equal to its Tract Participation effective hereunder during the respective period such Secondary Unit substances were produced, as set out in Exhibit "B".

The amount of Secondary Unit Substances allocated to each Tract shall be deemed to be produced from such Tract irrespective of the location of the wells from which the same is produced and regardless of depletion of wells or Tracts.

13. ROYALTY SETTLEMENT. The United States, under existing contract, is entitled to take in kind a share of the substance now produced cooperatively from any tract, shall hereafter be entitled to the right to take in kind their share of the Secondary Unit Substances allocated to such tract or tracts and Secondary Unit

ILLEGIBLE

Operator shall ~~make deliveries of~~ such royalty share taken in kind in conformity with the applicable ~~contracts,~~ laws and regulations. Settlement for Royalty Interest not taken in kind shall be made by Working Interest Owners responsible therefore under existing contracts, laws and regulations on or before the last day of each month for Secondary Unit Substances produced during the preceding calendar month; provided, however, that nothing herein contained shall operate to relieve the lessees of any land from their respective lease obligations for the payment of any royalties due under their leases.

If gas obtained from lands or formations not subject to this Agreement are introduced into the Secondary Unit Formation hereunder, for use in repressuring, stimulation of production, or increasing ultimate recovery, which shall be in conformity with a plan first approved by the AO, a like amount of gas less appropriate deduction for loss or depletion from any cause, may be withdrawn from the Secondary Unit Formation, royalty free as to dry gas, but not as to the products extracted therefrom; provided that such withdrawal shall be at such time and may be provided in the approved plan of operation or as may otherwise be consented to by the AO as conformity to good petroleum engineering practice; and provided further, that such right of withdrawal shall terminate on the termination of this Secondary Unit Agreement.

If natural gasoline, liquid petroleum gas fractions or other liquid hydrocarbon substances (herein, collectively call "LPGS") which were not extracted from gas produced from the Secondary Unit Formation are injected into the Secondary Unit Formation, which shall be in conformity with a Plan of Operation first approved by the AO, Working Interest Owners shall be entitled to recover, royalty free, part of all such LPGS pursuant to such conditions and formulas as may be prescribed or approved by the AO.

Royalty due the United States shall be computed as provided in the operating regulations and paid in value or delivered in kind as to all Secondary Unit Substances on the basis of the amounts thereof allocated to Secondary Unit Federal land as provided herein at the rates specified in the respective Federal leases, or at such lower rates as may be authorized by law or regulation; provided that for leases on which the royalty rate depends on the daily average production per well, said average production shall be determined in accordance with the operating regulations as though the Secondary Unit lands were a single consolidated lease.

14. RENTAL SETTLEMENT. Rental or minimum royalties due on leases committed hereto shall be paid by Working Interest Owners responsible therefore under existing contracts, laws and regulations, provided that nothing herein contained shall operate to relieve the lessees of any land from their respective lease obligations for the payment of any rental or minimum royalty in lieu thereof due under their leases.

Rental and minimum royalty for lands of the United States subject to this Agreement shall be paid at the rate specified in the respective leases from the United States unless such rental or minimum royalty is waived, suspended or reduced by law or by approval of the Secretary or his duly authorized representative.

15. **CONSERVATION.** Operations hereunder and production of Secondary Unit Substances shall be conducted to provide for the most economical and efficient recovery of said substances without waste, as defined by or pursuant to State or Federal law or regulation.

16. **DRAINAGE.** The Secondary Unit Operator shall take appropriate and adequate measures to prevent drainage of Secondary Unit Substances from the Secondary Unit Area by wells on land not subject to this Agreement, or with prior consent of the AO, pursuant to applicable regulations pay a fair and reasonable compensatory royalty as determined by the AO. In the event compensatory royalty is so paid, it shall be treated in the same manner as Secondary Unit Substances.

Further, in order to compensate the United States for drainage from any unleased Federal lands sharing a common pool, or deposit, with land in the participating area, one-eighth of the production that would be attributable to such Federal lands under Section 12 of this agreement, if they were leased, committed and within the participating area, shall be payable as compensatory royalties to the Federal Government monthly on the last day of the calendar month next following the calendar month of production under the Bureau of Land Management's case recordation number for the participating area. Payment shall accrue from the date of first production of unitized substances from the participating area (or participating area expansion) sharing a common pool or deposit with the unleased Federal lands. If leased Federal lands that share in actual production allocation from the participating area become unleased, the payment shall accrue from the date the Federal lands become unleased. Payment due under this provision shall end when the unleased Federal tract is leased or when production of unitized substances ceases within the participating area sharing a common pool with the unleased Federal tract, whichever occurs first.

17. **GAUGE OF MERCHANTABLE OIL.** Secondary Unit Operator shall make a proper and timely gauge of all lease and other tanks within the Secondary Unit Area and associated with the operation of the Secondary Unit Area in order to ascertain the amount of merchantable oil above the pipeline connections in such tanks at 7:00 a.m. on the effective date injection operations are commenced or, the first day of production of a horizontal well drilled on the Secondary Unit Area. All such oil shall be and remain the property of the parties entitled thereto the same as if the Secondary Unit Agreement had not been formed; and such parties shall promptly remove said oil from said tanks. Any such oil not so removed shall be sold by Secondary Unit Operator for the account of parties entitled thereto, subject to the payment of all royalties, overriding royalties, production payment, and all other payments under the terms and provisions of the applicable lease leases or other contracts.

18. **LEASES AND CONTRACTS CONFORMED AND EXTENDED.** The terms, conditions, and provisions of all leases, subleases, and other contracts relating to exploration, drilling, development, or operation for oil or gas of lands committed to this Agreement are hereby expressly modified and amended to the extent necessary to make the same conform to the provisions hereof, but otherwise to remain in full force and effect; and the parties hereto hereby consent that the

~~Secretary shall and by his approval hereof, or by the approval hereof by his duly authorized representative, does hereby establish, alter, change, or revoke the drilling, producing, rental, minimum royalty, and royalty requirement of federal leases committed hereto and the regulations in respect thereto to conform said requirements to the provisions of this Agreement. and, without limiting the generality of the foregoing, all leases, subleases, and contracts are particularly modified in accordance with the following:~~

(a) The development and operations of lands subject to this Agreement under the terms hereof shall be deemed to be in full performance of all obligations for development and operation with respect to each and every part of separately owned Tracts subject to this Agreement, regardless of whether there is any development of any particular part of a Tract on the Secondary Unit Area, notwithstanding anything to the contrary in any lease, operating agreement, or other contract by and between the parties hereto, or their respective predecessors in interest, or any of them.

(b) Drilling and production operations performed hereunder upon any Tract of the Secondary Unit Area will be accepted and deemed to be performed upon and for the benefit of each and every Tract of Secondary Unit Area, and no lease shall be deemed to expire by reason of failure to drill or produce wells situated on the land therein embraced.

(c) Suspension of drilling or producing operations on all Secondary Unit Area pursuant to direction or consent of the Secretary or his duly authorized representative shall be deemed to constitute such suspension pursuant to such direction or consent as to each and every Tract of Secondary Unit Area.

(d) Each lease, sublease, or contract relating to the exploration, drilling, development, or operation for oil or gas of lands committed to this Agreement, which, by its terms might expire prior to the termination of the Agreement, is hereby extended beyond any such term so provided therein so that it shall be continued in full force and effect for and during the term of this Agreement.

19. COVENANTS RUN WITH LAND. The covenants herein shall be construed to be covenants running with the land with respect to the interest of the parties hereto and their successors in interest until this Agreement terminates, and any grant, transfer, or conveyance of interest in land or leases subject hereto shall be and hereby is conditioned upon the assumption of all privileges and obligations hereunder by the grantee, transferee or other successor interest. No assignment or transfer of any working interest shall be binding upon Secondary Unit Operator nor shall any transfer of any Royalty Interest or other interest be binding on the Working Interest Owner responsible for payment or settlement thereof, until the first day of the calendar month after Secondary Unit Operator or the responsible Working Interest Owner, as the case may be, is furnished with the original, photostat, or certified copy of the instrument of transfer.

20. EFFECTIVE DATE. This Agreement shall become binding upon each party who executes or ratifies it as of the effective date of execution or ratification by such party and shall become effective as of 7:00 a.m. on the day of approval of this Agreement by the Secretary of the Interior, or his duly authorized representatives.

21. TERM. The term of this Agreement shall be for and during the time that Secondary Unit Substances are capable of being produced in quantities sufficient to pay for the cost of producing same from wells on Secondary Unit Area unless sooner terminated by the AO as provided in Section 8, Successor Secondary Unit Operator, or by the Working Interest Owners as provided in Section 22. Termination by Working Interest Owners.

22. TERMINATION BY WORKING INTEREST OWNERS. This Agreement may be terminated at any time by Working Interest Owners owning ninety percent (90%) or more of the participation percentage in the Secondary Unit Area with the approval of the AO. Notice of any such termination shall be given by the Secondary Unit Operator to all parties hereto.

Upon termination of this Agreement, the parties hereto shall be governed by the terms and provisions of the leases and contract affecting the separate Tracts.

If not specified otherwise by the leases cooperating under this Agreement, basic Royalty Owners hereby grant Working Interest Owners a period of six (6) months after termination of this Agreement in which to salvage, sell, distribute, or otherwise dispose of the personal property and facilities used in connection with Secondary Unit operations.

23. RATE OF PROSPECTING, DEVELOPMENT AND PRODUCTION. The AO in the BLM's office is hereby vested with authority to alter or modify from time to time in his discretion the quantity and rate of production under this Agreement when such quantity and rate is not fixed pursuant to Federal or State law or does not conform to any statewide voluntary conservation or allocation program, which is established, recognized and generally adhered to by the majority of operators in such state, such authority being hereby limited to alteration or modification in the public interest, the purpose thereof and the public interest to be served thereby to be stated in the order of alteration or modification is in the interest of attaining the conservation objectives stated in this Agreement and is not in violation of any applicable Federal or State law.

Powers in this section vested in the AO shall only be exercised after notice to Secondary Unit Operator and opportunity for hearing to be held not less than fifteen (15) days from notice.

24. APPEARANCES. Secondary Unit Operator shall, after notice to other parties affected, have the right to appear for and on behalf of any and all interests affected hereby before the Department of the Interior and to appeal from orders issued under the regulations of said Department or to apply for relief from any of

~~said regulations or in any proceedings relative to operations before the Department of the Interior or any other legally constituted authority; provided, however, that any other interested party shall also have the right at his own expense to be heard in any such proceeding.~~

25. NOTICES. All notices, demands, or statements required hereunder to be given or rendered to the parties hereto shall be deemed fully given, if given in writing, or personally delivered to the party or sent by postpaid registered or certified mail, addressed to such party at the address such party has furnished to the party sending the notice, demand or statement.

26. NO WAIVER OF CERTAIN RIGHTS. Nothing in this Agreement shall be construed as a waiver by any party hereto of the right to assert any legal or constitutional right or defense as to the validity or invalidity of any law of the State of New Mexico, or of the United States, or regulations issued thereunder in any way affecting such party, or as a waiver by any such party of any right beyond his or its authority to waive provided however, each party hereto except the United States covenants that during the existence of this Agreement, such party shall not resort to any action at law or in equity to partition the Secondary Unit Area or the facilities used in the development or operation thereof and to that extent waives the benefits all laws authorizing such partition.

27. FORCE MAJEURE. All obligations under this Agreement except the payment of money, shall be suspended while, but only so long as, the Secondary Unit Operator, despite the exercise of due care and diligence, is prevented from complying with such obligations, in whole or in part, by strikes, acts of God, Federal, State or municipal law or agencies, unavoidable accidents, uncontrollable delays in transportation, inability to obtain necessary materials in open market or other matters beyond the reasonable control of the Secondary Unit Operator, whether similar to matters herein enumerated or not.

28. NON-DISCRIMINATION. In connection with the performance of work under this Agreement, the Secondary Unit Operator agrees to comply with all the provisions of Section 202 (1) to (7) inclusive of Executive Order 11246, 30 F.R. 12319, which are hereby incorporated by reference in this Agreement.

29. LOSS OF TITLE. In the event title to any Tract in Secondary Unit Area shall fail and the true owner cannot be induced to join in this Secondary Unit Agreement, such Tract shall be automatically regarded as not committed hereto and there shall be such readjustment of future costs and benefits as may be required on account of the loss of such title. In the event of a dispute as to title or as to any Royalty, Working Interest or other interest subject hereto, payment or delivery on account thereof may be withheld without liability for interest until the dispute is finally settled; provided that as to Federal land or leases, no payments for funds due the United States should be withheld, but such funds shall be deposited as directed by the AO to be held as unearned money pending final settlement of the title dispute, and then applied as earned or returned in accordance with such final settlement. Secondary Unit Operator as such is relieved from any responsibility for any defect or failure of any title hereunder.

~~Operator shall be obligated to hire Tribal members for those tasks involving Secondary Unit lands for which they are qualified to perform.~~

30. **SUBSEQUENT JOINDER.** After the effective date of this Agreement, the commitment of any interest in any Tract within the Secondary Unit Area shall be upon such equitable terms as may be negotiated by Working Interest Owners and the owner of such interest. After the effective date hereof, joinder by a Royalty Owner must be consented to in writing by the Working Interest Owner committed hereto and responsible for the payment of any benefits that may accrue hereunder in behalf of such Royalty Interest. Joinder by any Royalty Owner at any time must be accompanied or preceded by appropriate joinder by the Owner of the corresponding Working Interest in order for the interest to be regarded as effectively committed. Joinder to the Secondary Unit Agreement by a Working Interest Owner at any time must be accompanied by appropriate joinder to the Secondary Unit Operating Agreement in order for the interest to be regarded as committed to this Secondary Unit Agreement. Except as may otherwise herein be provided, subsequent joinders to this Agreement shall be effective as of the first day of the month following the filing with the AO of duly executed counterparts of all or any papers necessary to establish commitment of any Tract to this Agreement unless objection to such joinder is made within sixty (60) days by the AO.

31. **COUNTERPARTS.** This Agreement may be executed in any number of counterparts, no one of which needs to be executed by all parties, or may be ratified or consented to by separate instrument in writing specifically referring hereto and shall be binding upon all those parties who have executed such a counterpart, ratification, or consent hereto with the same force and effect as if all such parties had signed the same document and regardless of whether or not it is executed by all other parties owning or claiming an interest in the lands within the above-described Secondary Unit Area. Execution hereof by any party in one capacity shall also constitute execution in any other capacity.

32. **TAXES.** The Working Interest Owners shall render and pay for their account and the account of the Royalty Owners all valid taxes on or measured by the Secondary Unit Substances in and under or that may be produced, gathered and sold from the land covered by this Agreement after its effective date, or upon the proceeds derived therefrom. The Working Interest Owners on each tract shall and may charge the proper proportion of said taxes to Royalty Owners having interest in said Tract, and may currently retain and deduct a sufficient amount of the Secondary Unit Substances or derivative products, or net proceeds thereof, from the allocated share of each Royalty Owner to secure reimbursement for the taxes so paid. No such taxes shall be charged to the United States or the State of New Mexico or to any lessor who has a contract with his lessee which requires the lessee to pay such taxes. This paragraph is not applicable to Indian allotted lands.

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

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed and have set opposite their respective names the effective date of execution.

MERRION OIL & GAS CORPORATION

[Handwritten Signature]

Secondary Unit Operator
J. Gregory Merrion, President

Bureau of Land Management
(Stamp of Approval)

Department of the Interior
Bureau of Indian Affairs

APPROVED:

Pursuant to Secretarial Redlegation
Order 209 IM 8 and 230 IM 3.

For [Handwritten Signature]
Walt Mills, Area Director
Navajo Area Office

Date: 8/29/91

STATE OF Arizona)
COUNTY OF Cochise) ss

Before me, a notary public, on this 19th day of August, 1991, personally appeared Thomas K. Swales, Navajo Area Director, to me known to be the identical person who executed the within and foregoing Communitization Agreement, and acknowledged to me that he executed the same as his free and voluntary act and deed for the uses and purposes set forth.

My Commission Expires: 10-2-92

[Handwritten Signature]
(Notary Public)

ACKNOWLEDGEMENT

STATE OF NEW MEXICO)
)§
COUNTY OF SAN JUAN)

BEFORE ME, the undersigned authority, a Notary Public in and for said county and State, on this day personally appeared J. Gregory Merrion, known to me to be the person and officer whose name is subscribed to the foregoing instrument and acknowledged to me that the same was the act of MERRION OIL & GAS CORPORATION, a corporation, and that he executed the same as the act of such corporation for the purposes and consideration therein expressed and in the capacity therein stated.

GIVEN UNDER BY HAND AND SEAL OF OFFICE, this the 21 day of July, 1991.

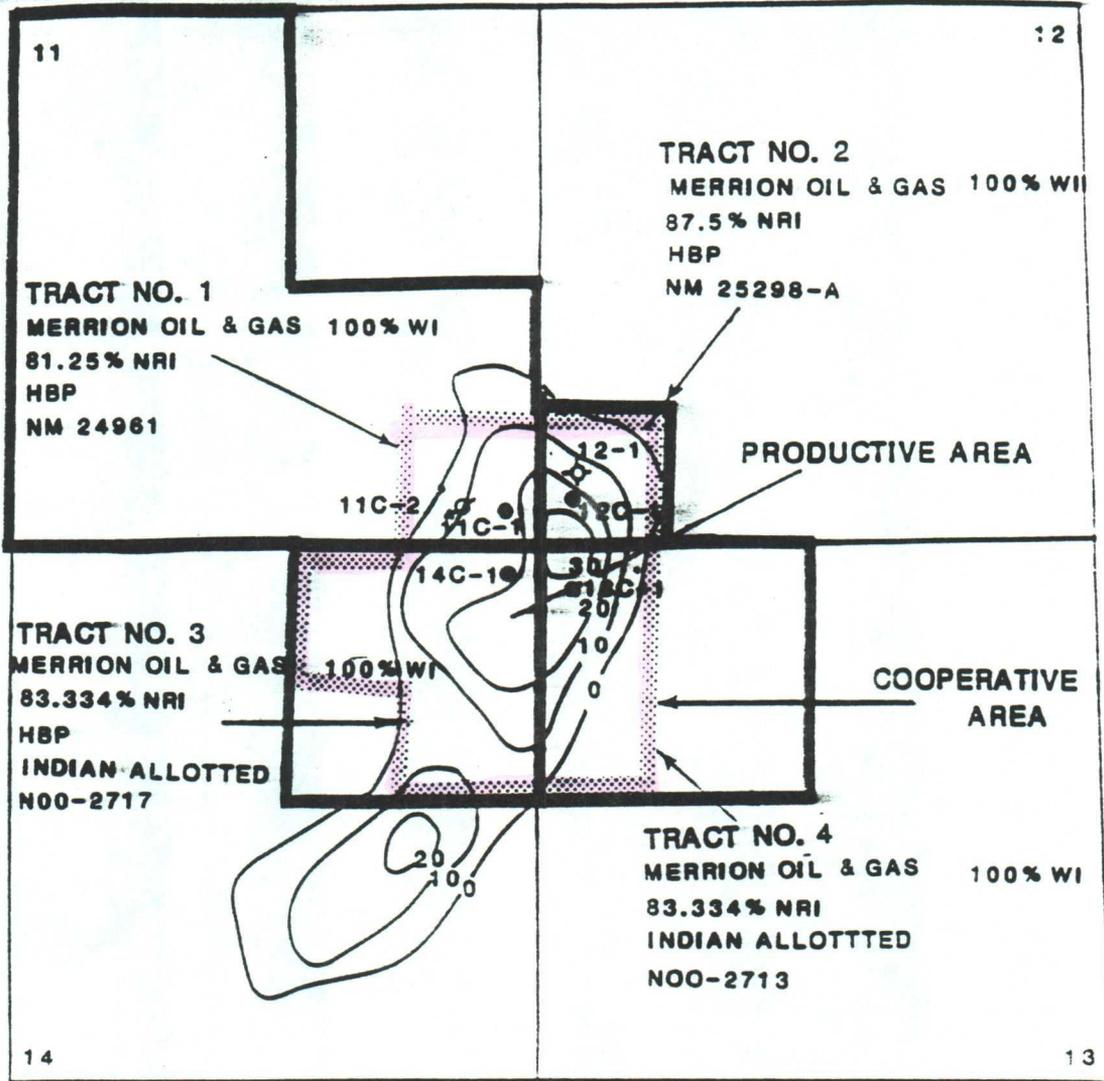
My Commission Expires:

July 22 1995

Shirley A. Merrion
Notary Public

END OF ACKNOWLEDGEMENT

EXHIBIT A



SCALE : 1" = 2000'
 C.I. = 10'

R 4 W

MERRION	
OIL & GAS CORP.	
(505)327-9801	510 Reilly Avenue Farmington, New Mexico 87401
EAGLE MESA ENTRADA FIELD	
SANDOVAL CO., NEW MEXICO	
NET PAY-LEASE MAP	
GEOLOGY	CONTOUR INTERVAL
DRAFTING	SCALE
DATE	REVISED
	FILE NO.
	MAP NO.

The final step is then to overlay the oil equipotential map over the structure contour map. The points of equal value are contoured to define the 0' net pay outline. Each subsequent net pay contour is then constructed from the intersection of oil equipotential lines and the sum of the structure contour and the contour interval.

Once the contour map is constructed the reservoir can be planimetered to volumetrically calculate oil in place. Since anything below 10' of net pay is considered non-recoverable, only that portion of the reservoir above 10' of pay was planimetered. The tract by tract break down of acre feet of pay in the cooperative area is as follows:

Tract 1 : 374.50 acre/ft

Tract 2 : 300.40 acre/ft

Tract 3 : 815.40 acre/ft

Tract 4 : 511.45 acre/ft

V. SUMMARY

The combination of well control, seismic have produced the most accurate maps that can be generated given the data available.

The existence in all Entrada oil accumulations of a 10' immovable oil zone and the fact that water coning is virtually instantaneous upon production would strongly suggest that long range lateral movement of oil in the reservoir is not likely.

Two separate and distinct net pay lobes can be mapped using the described techniques at Eagle Mesa. It is felt that the thin zone of net pay, less than 10', separating these lobes is a natural barrier to drainage. Hence, any production from the northern lobe should not effect the southern lobe and the converse would also be true.

Therefore, there are natural and logical boundaries established to justify two separate participating areas within the Secondary Unit Agreement outline.

ILLEGIBLE



United States Department of the Interior

BUREAU OF LAND MANAGEMENT
Farmington Resource Area
1235 Laplata Highway
Farmington, New Mexico 87401

IN REPLY REFER TO:
Eagle Mesa Secondary Unit
3180 (019)

MAY 29 1992

Ms. Crystal Williams
Merrion Oil & Gas Corporation
P.O. Box 840
Farmington, NM 87499

Dear Ms. Williams:

On April 3, 1992 our office approved a revised Exhibit "B" for the Eagle Mesa Secondary Unit. This Exhibit "B" had incorrect data in the No. of Acres column.

The corrected Exhibit "B" has been received and is accepted for record. Copies of the document are being distributed to the appropriate Government offices and one copy is returned herewith.

If you have any questions please contact Janice Easley at (505) 327-5344 or 599-8963.

Sincerely,

for John L. Keller
Chief, Branch of Mineral Resources

1 Enclosure
1 - Exhibit B