

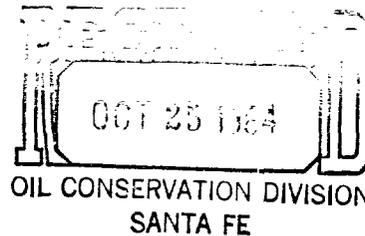


Donald W. Johnson
Division Manager
Production Department
Hobbs Division
North American Production

Conoco Inc.
P.O. Box 460
726 East Michigan
Hobbs, NM 88240
(505) 393-4141

October 17, 1984

New Mexico Oil Conservation Division
Department of Energy and Minerals
P.O. Box 2088
Santa Fe, New Mexico 87501



Case 8415

Attention Mr. Michael E. Stogner

Gentlemen:

Application for Examiner Hearing, Skaggs "B" Well No. 7, Lea County,
New Mexico - Conoco Inc.

Attached are three (3) copies of the subject Application. Please schedule this for Examiner Hearing on the first available docket.

Yours very truly,

D. W. Johnson
Division Manager

HAI:mjs

Attachments

cc: Tom Kellahin - Santa Fe
V. T. Lyon - Houston

Jason Kellahin
W. Thomas Kellahin
Karen Aubrey

KELLAHIN and KELLAHIN
Attorneys at Law
El Patio - 117 North Guadalupe
Post Office Box 2265
Santa Fe, New Mexico 87504-2265

Telephone 982-4285
Area Code 505

December 10, 1984

RECEIVED

DEC 10 1984

Mr. Michael E. Stogner
Oil Conservation Division
P. O. Box 2088
Santa Fe, New Mexico 87501

OIL CONSERVATION DIVISION

"Hand Delivered"

Re: Conoco Inc
NMOCD Case 8415

Dear Mr. Stogner:

In accordance with your request at the hearing of the above referenced compulsory pooling case held on November 28, 1984, please find enclosed a proposed order.

I wish to take this opportunity to explain to you the overhead rates requested and hopefully satisfy the concerns you expressed at the hearing.

While the overhead rates vary between operators, you will generally see that the overhead rates charged by independent operators will be lower than those charged by the major companies. That does not mean that the major companies have larger overheads and therefore drill wells that cost more dollars. It is simply a reflection of the fact that the independent operators charge certain expenses directly to the well while the major operators will charge those same expenses into the overhead rates.

For example: many independent's hire consultants, engineers, and geologists to work on an individual well. All those expenses are direct costs to the well and are not included in their overhead rates. The independent can then charge a smaller amount for the overhead because these expenses are already charged to the well. The major will not have as great, if any, outside consultant expenses. The costs of geologists and engineers to supervise the major's well, is part of their normal staff expenses. Accordingly, these costs are not direct costs to the well, but are prorated among all of their wells and recovered in the overhead charges.

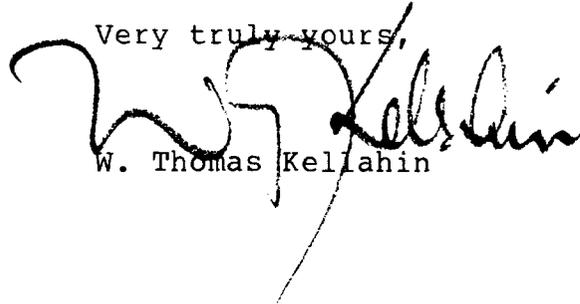
KELLAHIN AND KELLAHIN

Mr. Michael E. Stogner
December 10, 1984
Page 2

I have enclosed a copy of the COPAS accounting procedures for your information. I hope that this will help clarify that the total well costs are about the same, but that the method by which those costs are recovered will vary between the major operator and the independent operator.

Please call me if you have any questions.

Very truly yours,

A handwritten signature in black ink, appearing to read 'W. Thomas Kellahin', is written over the typed name. The signature is fluid and cursive, with a large initial 'W' and a long, sweeping tail.

W. Thomas Kellahin

WTK:ca
Enc.

cc: Hugh Ingram
Conoco Inc.
P. O. Box 460
Hobbs, New Mexico 88240

Vic Lych
Conoco Inc.
P. O. Box 2197
Houston, Texas 77252

ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING
CALLED BY THE OIL CONSERVATION
DIVISION FOR THE PURPOSE OF
CONSIDERING:

CASE NO. 8415
Order No. R-

APPLICATION OF CONOCO INC.
FOR COMPULSORY POOLING,
UNORTHODOX LOCATION, AND
NON-STANDARD PRORATION UNIT,
LEA COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 9 a.m. on November 28, 1984, at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this ____ day of December, 1984, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

FINDS:

(1) That due public notice having been given as required by law, the Division has jurisdiction of this cause and the subject matter thereof.

(2) That the applicant, Conoco Inc. seeks an order pooling all mineral interests in the Skaggs Abo Gas Pool Formation underlying the N/2N/2 of Section 12, Township 20 South, Range 37 East, NMPM, Lea County, New Mexico.

(3) That the N/2N/2 of Section 12 is a non-standard spacing and proration unit for the Skaggs Abo Gas Pool.

Case No. 8415
Order No. R--

(4) That applicant further seeks approval of the non-standard gas proration unit and the unorthodox gas well location 990 feet FNL and 1980 feet FEL of said Section 12.

(5) That the applicant has the right to drill and has drilled its Skaggs "B" well No. 7 completed in the Skaggs Abo Gas Pool and dually completed in the Skaggs Drinkard Oil Pool.

(6) That there are interest owners in the proposed gas proration and spacing unit who have not agreed to pool their interests.

(7) That to avoid the drilling of unnecessary wells, to prevent waste, to protect correlative rights, and to afford to the owner of each interest in said unit the opportunity to recover or receive without unnecessary expense his just and fair share of the gas in any pool thereunder, the subject application should be approved by pooling all mineral interests, whatever they may be, within said unit.

(8) That the applicant, Conoco Inc., should be designated the operator of the subject well and unit.

(9) That any non-consenting working interest owner should be afforded the opportunity to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production.

(10) That any non-consenting working interest owner who does not pay his share of estimated well costs should have withheld from production his share of the reasonable well costs plus an additional 200 percent thereof as a reasonable charge for the risk involved in the well.

(11) The substantial evidence supports a 200% risk factor, including but not limited to, the fact that Abo wells in the immediate area are uneconomic.

(12) That any non-consenting interest owner should be afforded the opportunity to object to the actual well costs but that actual well costs should be adopted as the reasonable well costs in the absence of such objection.

(13) That following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs should pay to the

Case No. 8415
Order No. R-

operator any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(14) That \$5700.00 per month should be fixed as a reasonable charge for supervision (combined fixed rates) while drilling and that \$500.00 per month should be fixed as a reasonable charge for supervision while producing; that this charge should be adjusted annually based upon the percentage increase or decrease in the average weekly earnings of crude petroleum and gas production workers; that the operator should be authorized to withhold from production the proportionate share of such supervision charge attributable to each non-consenting working interest, and in addition thereto, the operator should be authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(15) That all proceeds from production from the subject well which are not disbursed for any reason should be placed in escrow to be paid to the true owner thereof upon demand and proof of ownership.

(16) That upon the failure of the operator of said pooled unit to commence drilling of the well to which said unit is dedicated on or before the expiration of 120 days from the effective date of this order, the order pooling said unit should become null and void and of no effect whatsoever.

IT IS THEREFORE ORDERED:

(1) That all mineral interests, whatever they may be, in the Skaggs Abo Gas Pool underlying the N/2N/2 of Section 12, Township 20 South, Range 37 East, NMPM, Lea County, New Mexico, are hereby pooled to form a non-standard 160-acre spacing and proration unit dedicated to the Skaggs "B" Well No. 7.

(2) That Conoco Inc. is hereby designated the operator of the subject well and unit.

(3) That Applicant and Alan J. Antweil have made a good faith and diligent effort to locate Millie B. Jones who owns 1/320 unleased mineral interest in the Abo gas production from the subject well.

Case No. 84-5
Order No. R-

(4) That Applicant shall be entitled to recover from Millie B. Jones' share of the gas production from the subject well, her share of the costs of the well plus an additional 200% as a risk factor.

(5) That after recovering the costs and penalty amounts from Millie B. Jones' share of the proceeds from the well, Applicant shall deposit into an interest bearing account in Lea County, New Mexico, all other proceeds to which Millie B. Jones may be entitled, less her proportionate share of the overhead charges as approved by this order.

(6) That within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs in advance as provided above shall pay to the operator his pro rate share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator his pro rate share of the amount that estimated well costs exceed reasonable well costs.

(7) That the operator is hereby authorized to withhold the following costs and charges from production.

(a) The pro rate share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

(b) As a charge for the risk involved in the drilling of the well, 200 percent of the pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

(8) That the operator shall distribute said costs and charges withheld from production to the parties who advanced the well costs.

Case No. 8415
Order No. R-

(9) That \$5700.00 per month is hereby fixed as a reasonable charge for supervision (combined fixed rates) while drilling, and that \$500.00 per month is hereby fixed as a reasonable charge for supervision while producing, provided that this rate shall be adjusted on the first day of April of each year following the effective date of this order; that the adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings Crude Petroleum and Gas Production Workers for the last calendar year compared to the preceeding calendar year as shown by "The Index of Average Weekly Earnings of Crude Petroleum and Gas Production Workers" as published by the United States Department of Labor, Bureau of Labor Statistics, and the adjusted rate shall be the rates currently in use, plus or minus the computed adjustment; that the operator is hereby authorized to withhold from production the proportionate share of such supervision charge attributable to each non-consenting working interest, and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating such well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(10) That any unsevered mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under the terms of this order.

(11) That the unorthodox Skaggs Abo Gas well location, 990 Feet FNL and 1980 feet FEL of said Section 12, and the non-standard gas proration and spacing unit consisting of the N/2N/2 of said Section 12 are hereby approved.

(12) That any well costs or charges which are to be paid out of production shall be withheld only from the working interest's share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(13) That all proceeds from production from the subject well which are not disbursed for any reason shall immediately be placed in escrow in Lea County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership; that the operator shall notify the division of the name and addresses of said escrow agent within 30 days from the date of first deposit with said escrow agent.

Case NO. 8415
Order No. R-

(13) That jurisdiction of this cause is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

KELLAHIN and KELLAHIN
Attorneys at Law
El Patio - 117 North Guadalupe
Post Office Box 2265
Santa Fe, New Mexico 87504-2265

Telephone 982-4285
Area Code 505

Jason Kellahin
W. Thomas Kellahin
Karen Aubrey
James B. Grant

December 12, 1984

Mr. Michael E. Stogner
Oil Conservation Division
P. O. Box 2088
Santa Fe, New Mexico 87501

"Hand Delivered"

Re: Conoco Inc.
OCD Case 8415 *M.S.*

Dear Mike:

On December 10, 1984, I wrote you concerning the referenced case and forgot to enclose the COPAS accounting procedures for your information. Please find those documents enclosed.

Very truly yours,

WTK
W. Thomas Kellahin

WTK:ca
Enc.



Production Department
Hobbs Division
North American Production

Conoco Inc.
P.O. Box 460
726 East Michigan
Hobbs, NM 88240
(505) 393-4141

January 14, 1985

New Mexico Oil Conservation Division
P.O. Box 2088
Santa Fe, New Mexico 87501

M.S.

Attention Mr. Mike Stogner

Gentlemen:

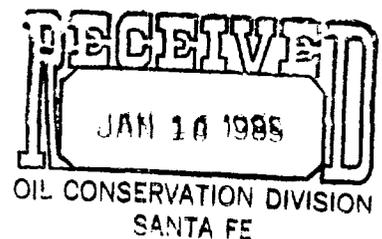
Skaggs "B" Well No. 7 - Case No. 8415, Order No. R-7755

In accordance with the subject Order, attached is Conoco's estimate of the cost for drilling and completing the Skaggs "B" Well No. 7.

Yours very truly,


H. A. Ingram
Conservation Coordinator

:mjs
Attachment
cc: Tom Kellahin





Donald W. Johnson
 Division Manager
 Production Department
 Hobbs Division
 North American Production

Conoco Inc.
 P.O. Box 460
 726 East Michigan
 Hobbs, NM 88240
 (505) 393-4141

January 8, 1985

Working Interest Owners
 Skaggs "B" No.7
 (Mailing List Attached)

Gentlemen:

Skaggs "B" No. 7, 990' FNL and 1980' FEL Section 12, T-20S, R-37E, Lea County, New Mexico

Conoco drilled the subject well as a dual Tubb/Drinkard oil well and the costs were paid equally by Conoco, Amoco, Arco, and Chevron. However the well was completed as a dual Drinkard/Abo well and the costs are to be borne by the Drinkard-Shallow Owners and the Abo-Deep Owners as per the Cost Allocation Procedures - Article XV - Operating Agreement dated April 1, 1984.

The estimated costs are as follows:

Description	Shallow Owners	Deep Owners	Shared Equally	Total Estimated Cost
D & E Depreciable Investment	\$ 23,800	\$31,600	\$159,400	\$214,800
D & E Intangible Investment	105,000	70,300	240,200	415,500
Prod. Fac. Depreciable Invst.	45,700	37,100	---	82,800
Prod. Fac. Intangible Invst.	1,800	1,000	---	2,800
Total	\$176,300	\$140,000	\$399,600	\$715,900

Please indicate your approval to pay the costs, based on your working interest and the Cost Allocation Procedures, by executing in the space provided below and returning a copy to the above address.

If you have any questions, please contact Don Bingham at the above telephone number, extension 106.

Yours very truly,

Donald W. Johnson
 Division Manager

DEB:tr

AGREED TO AND ACCEPTED _____ DAY OF _____ 1985.

BY: _____

Skaggs "B" No.7
Working Interest Owners

Amoco Production Company
P.O. Box 3092
Houston, TX 77001

Smith Collins
P.O. Box 2449
Hobbs, NM 88240

Chevron USA, Inc.
P.O. Box 1660
Midland, TX 79701

Marion Z. Given
P.O. Box 20602
El Paso, TX 79998

ARCO Oil and Gas Company
P.O. Box 1710
Hobbs, NM 88240

Francis Z. Litt
P.O. Box 20602
El Paso, TX 79998

Alan J. Antwell
P.O. Box 2010
Hobbs, NM 88240

Ninette Altus
3932 Las Vegas
El Paso, TX 79902

Bravo Energy, Inc.
P.O. Box 758
Hobbs, NM 88240

Richard Breton
9728 Darway
El Paso, TX 79925

Opal Barton
P.O. Box 978
Hobbs, NM 88240

Myer Erlich
3906 Flamingo
El Paso, TX 79902

S. D. Steed
P.O. Box 6254
Fort Worth, TX 76115

Barry Antweil
P. O. Box 2010
Hobbs, NM 88240

KMC No. 1, a Partnership
Attn: Allen Eubanks, Partner
Alpha Tower
5757 Alpha Road
Suite 201
Dallas, TX 75240

Mark Antweil
P. O. Box 2010
Hobbs, NM 88240

Lyle Walker
C/O K-Bob's Inc.
300 Capital Bank Bldg.
5307 E. Mockingbird Lane
Dallas, TX 75206

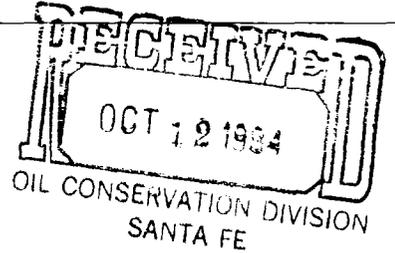
Paul L. Silverman
P. O. Box 1604
Hobbs, NM 88240

T. G. McCormick
625 Abo
Hobbs, NM 88240



Donald W. Johnson
Division Manager
Production Department
Hobbs Division
North American Production

Conoco Inc.
P.O. Box 460
726 East Michigan
Hobbs, NM 88240
(505) 393-4141



October 2, 1984

State of New Mexico
Energy and Minerals Department
Oil Conservation Division
P. O. Box 2088
Santa Fe, NM 87501

Attention: Mr. Joe D. Ramey, Director

Gentlemen:

Request for Non-Standard Proration Unit - Skaggs B No. 7, 990' FNL and 1980' FEL of Section 12, T20S, R37E, Lea County, NM. Skaggs Abo Gas Pool.

Conoco Inc. respectfully requests administrative approval of a 160-acre non-standard proration unit for its Skaggs B No. 7 well in the Skaggs Abo Gas Pool. The proposed unit will consist of the N/2 N/2 of Section 12 as shown on the attached acreage plat.

The proposed unit will conform to regulatory requirements in the following ways:

- 1) Said unit consists of contiguous quarter-quarter sections (and/or lots).
- 2) Said unit lies wholly within a single governmental section.
- 3) The entire proposed unit may be reasonably presumed to be productive of gas.
- 4) Copies of this application have been furnished by certified mail to all offset operators and all operators within said section.

The attached plats show the proposed unit, the location of Well No. 7 and the offset ownership.

Very truly yours,

MAB:jr

NEW MEXICO OIL CONSERVATION COMMISSION
WELL LOCATION AND ACREAGE DEDICATION PLAT

Form C-102
Supersedes C-128
Effective 1-1-65

All distances must be from the outer boundaries of the Section.

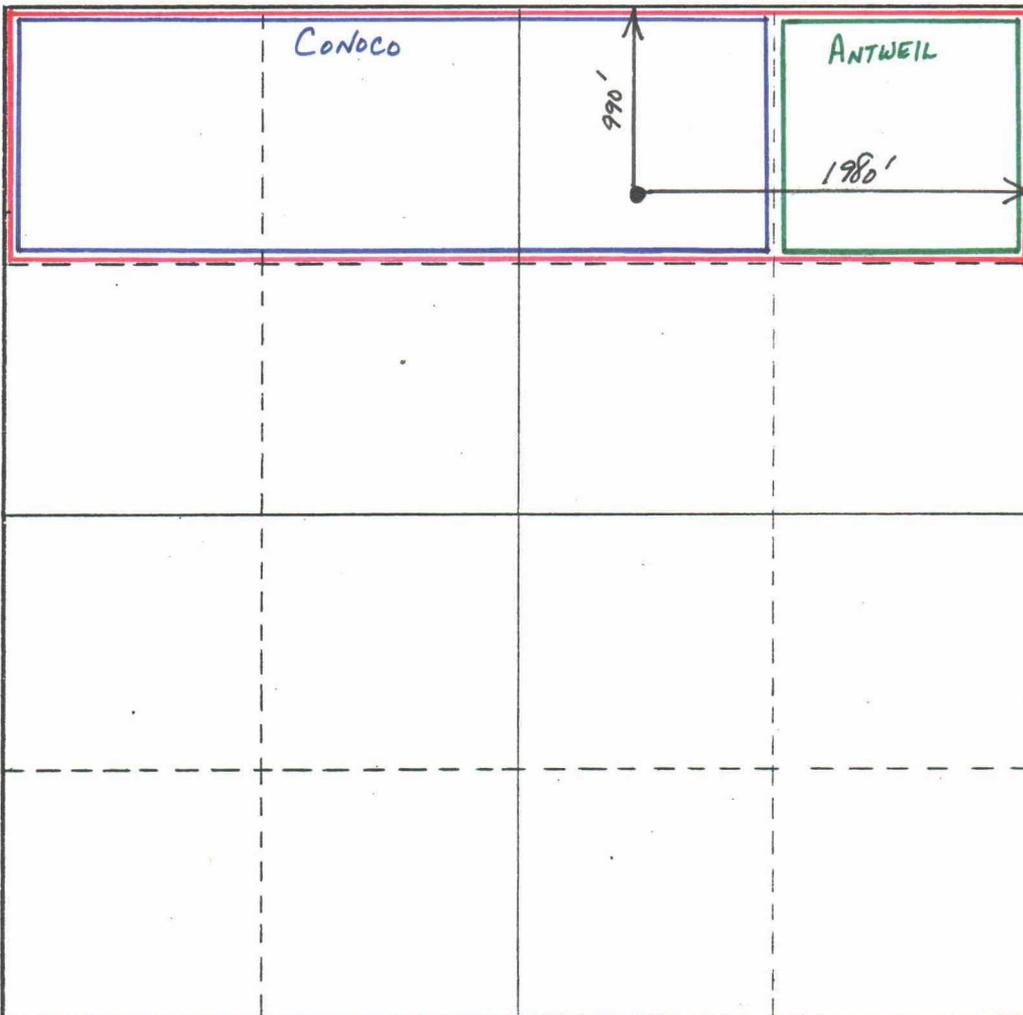
Operator Conoco Inc.		Lease Skaggs B		Well No. 7
Unit Letter B	Section 12	Township 20S	Range 37E	County Lea
Actual Footage Location of Well: 990 feet from the North line and 1980 feet from the East line				
Ground Level Elev.	Producing Formation Abo Gas	Pool Skaggs Abo	Dedicated Acreage: 160 Acres	

- ★ 1. Outline the acreage dedicated to the subject well by colored pencil or hachure marks on the plat below.
2. If more than one lease is dedicated to the well, outline each and identify the ownership thereof (both as to working interest and royalty).
3. If more than one lease of different ownership is dedicated to the well, have the interests of all owners been consolidated by communitization, unitization, force-pooling, etc?

Yes No If answer is "yes," type of consolidation communitization

If answer is "no," list the owners and tract descriptions which have actually been consolidated. (Use reverse side of this form if necessary.) _____

No allowable will be assigned to the well until all interests have been consolidated (by communitization, unitization, forced-pooling, or otherwise) or until a non-standard unit, eliminating such interests, has been approved by the Commission.



CERTIFICATION

I hereby certify that the information contained herein is true and complete to the best of my knowledge and belief.

Name David L. Smylie
Position Administrative Supervisor
Company Conoco Inc.

Date October 2, 1984

I hereby certify that the well location shown on this plat was plotted from field notes of actual surveys made by me or under my supervision, and that the same is true and correct to the best of my knowledge and belief.

Date Surveyed _____

Registered Professional Engineer and/or Land Surveyor _____

Certificate No. _____



Mailing List

Offset Operators and Operators Within The Section

Antweil Oil Company
Box 2010
Hobbs, NM 88240

Texaco Inc.
Box 3109
Midland, TX 79701

Exxon Company, U.S.A.
Box 2180
Houston, TX 77001

I & W Inc.
P. O. Box 176
Artesia, NM 88210

Smith, Salsich & McGrath
411 N. Lorraine
Midland, TX 79704

Skaggs B No. 7 Working Interest Owners

Amoco Production Company (25% W.I.)
P. O. Box 3092
Houston, TX 77001

Amoco Production Company
P. O. Box 68
Hobbs, NM 88240

ARCO Oil and Gas Company (25% W.I.)
P. O. Box 1710
Hobbs, NM 88240

Chevron USA, Inc. (25% W.I.)
P. O. Box 1660
Midland, TX 79701

Mailing List

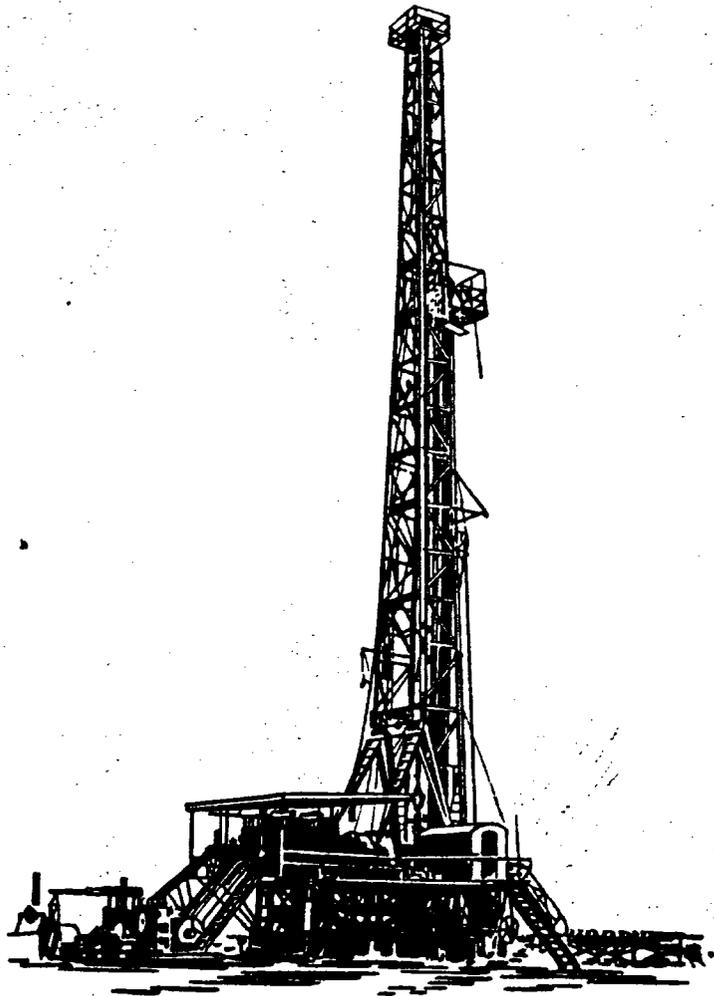
Antweil-Working Interest Owners

Ninette Altus 3932 Las Vegas El Paso, TX 79902	(2.00% W.I.)	Smith Collins P. O. Box 2449 Hobbs, NM 88240	(6.25% W.I.)
Alan J. Antweil, <u>et al</u> P. O. Box 2010 Hobbs, NM 88240	(53.68750% W.I.)	Myer Erlich 3906 Flamingo El Paso, TX 79902	(2.00% W.I.)
Opal Barton P. O. Box 978 Hobbs, NM 88240	(5.9375% W.I.)	Marion Z. Given P. O. Box 20602 El Paso, Texas 79998	(6.25% W.I.)
Bravo Energy, Inc. P. O. Box 758 Hobbs, NM 88240	(12.5% W.I.)	Francis Z. Litt P. O. Box 20602 El Paso, Texas 79998	(3.125% W.I.)
Richard Breton 9728 Darway El Paso, TX 79925	(2.00% W.I.)	S. D. Steed P. O. Box 6254 Fort Worth, TX 76115	(6.25% W.I.)

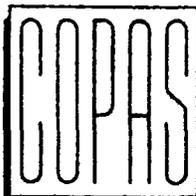
BULLETIN NO.

8

ACCOUNTING PROCEDURE
JOINT OPERATIONS
1969



RECOMMENDED BY



COUNCIL OF PETROLEUM ACCOUNTANTS SOCIETIES OF NORTH AMERICA

May be purchased direct from the publisher
Kraftbilt Products, P. O. Box 800, Tulsa, Okla. 74101

October, 1969

CONTENTS

SPECIMEN, FORM 601 COPAS-1968	3
I. GENERAL PROVISIONS	15
Definitions	
Statements and Billings	
Advances and Payments by Non-Operators	
Adjustments	
Audits	
Approval by Non-Operators	
II. DIRECT CHARGES	17
Lease Rentals and Royalties	
Labor	
Employee Benefits	
Material	
Transportation	
Services	
Damages and Losses to Joint Property	
Legal Expense	
Taxes	
Insurance	
Other Expenditures	
III. INDIRECT CHARGES	23
District Expense, Administrative Overhead and Warehousing	
Combined Rates – Well Basis	
Combined Rates – Percentage Basis	
Application of Administrative Overhead or Combined Rates – Well Basis	
Application of Administrative Overhead or Combined Rates – Percentage Basis	
Major Construction Overhead	
Amendment of Rates	
IV. BASIS OF CHARGES TO JOINT ACCOUNT	36
Purchases	
Material Furnished from Operator's Warehouse or Other Properties	
Premium Prices	
Warranty of Material Furnished by Operator	
Equipment and Facilities Furnished by Operator	
V. DISPOSAL OF MATERIAL	41
Material Purchased by Operator or Non-Operators	
Division in Kind	
Sales to Outsiders	
VI. BASIS OF PRICING MATERIAL TRANSFERRED FROM JOINT PROPERTY	43
VII. INVENTORIES	43

FOREWORD

The oil and gas industry has undergone considerable change during the past several years, as have most other industries of our time. As the industry changes, so have the methods of accounting for the activities of the industry. The Petroleum Accountants Societies, through representation on the Council of Petroleum Accountants Societies of North America, have recognized these changes as they pertain to joint interest accounting and have modernized and updated the accounting procedure related to joint operating agreements by recommending the COPAS-1968 Accounting Procedure.

The COPAS-1968 Accounting Procedure includes both fixed and percentage rate provisions for overhead recovery and recognizes industry trends in the areas of accounting for controllable material, labor, employee benefits, transportation, insurance, indirect charges, pricing, etc. As a result of changes made in these areas, COPAS-1968 is an accounting procedure which can be used throughout the country and will assist in standardizing and simplifying joint interest accounting practices and procedures. To accomplish this, it was necessary to incorporate options in the procedure which did not appear in previous accounting procedures.

This bulletin does not replace COPAS Bulletin No. 5 which pertains to the COPAS-1962 Accounting Procedure, but is to explain, interpret and elaborate on the provisions of the COPAS-1968 Accounting Procedure to acquaint the user with its various options and alternates as well as the intent which the COPAS-1968 writers attempted to set forth.

This bulletin has been reviewed by the Petroleum Accountants Societies through representation on the Council of Petroleum Accountants Societies of North America and it is recommended that the contents of this bulletin be used as a guide to joint interest operations accounting.

It is not intended or recommended that the provisions of the COPAS-1968 Accounting Procedure replace the provisions of the COPAS-1962 Accounting Procedure or any other accounting procedures which are presently a part of any existing agreement except by agreement of the Parties to such agreements.

The Council is grateful to and appreciative of all the Petroleum Accountants Societies for the work contributed to the finalization of this bulletin. Special consideration is due the Petroleum Accountants Society of Houston for their work in preparing the initial draft of the bulletin.

EXHIBIT " "

Attached to and made a part of
.....
.....
.....

**ACCOUNTING PROCEDURE
JOINT OPERATIONS**

I. GENERAL PROVISIONS

1. Definitions

"Joint Account" shall mean the account showing the charges and credits accruing because of the Joint Operations and which are to be shared by the Parties.

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

"Controllable Material" shall be defined as set forth under the subparagraph selected below:

- A. Material which at the time is so classified in the Material Classification Manual as most recently recommended by the Council of Petroleum Accountants Societies of North America.
- B. Material which is ordinarily so classified and controlled by Operator in the conduct of its operations. List shall be furnished Non-Operators upon request.

2. Statements and Billings

Operator shall bill Non-Operators on or before the last day of each month for their proportionate share of costs and expenses for the preceding month. Such bills will be accompanied by statements reflecting the total charges and credits as set forth under the subparagraph selected below:

- A. Statement in detail of all charges and credits to the Joint Account.
- B. Statement of all charges and credits to the Joint Account, summarized by appropriate classifications indicative of the nature thereof.
- C. Statement of all charges and credits to the Joint Account, summarized by appropriate classification indicative of the nature thereof, except that items of Controllable Material and unusual charges and credits shall be detailed.

3. Advances and Payments by Non-Operators

Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the rate of ten per cent (10%) per annum or the maximum contract rate permitted by the applicable usuary laws in the state in which the Joint Property is located, whichever is the lesser.

4. Adjustments

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

5. Audits

A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the accounting hereunder for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct joint or simultaneous audits in a manner which will result in a minimum of inconvenience to the operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator.

6. Approval by Non-Operators

Where an approval or other agreement of Non-Operators is expressly required under Paragraphs 5A, 5B, 6A and 8 of Section II, Section III, Section V, Section VI, and Paragraph 4 of Section VII, of this Accounting Procedure and if the agreement to which this Accounting Procedure is attached contains no contrary provisions in regard thereto, the Operator shall notify all Non-Operators and the agreement or approval of a majority in interest of the Non-Operators shall be controlling on all Non-Operators.

II. DIRECT CHARGES

Operator shall charge the Joint account with the following items:

1. Rentals and Royalties

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

2. Labor

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

- (2) Salaries of first-level supervisors in the field if such charges are excluded from overhead rates in Option A of Section III.
 - (3) Salaries and wages of technical employees temporarily assigned to and directly employed on the Joint Property if such charges are excluded from overhead rates in Option B of Section III.
 - (4) Salaries and wages of technical employees either temporarily or permanently assigned to and directly employed in the operation of the Joint Property if such charges are excluded from overhead rates in Option C of Section III.
- B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to the employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II and Paragraph 1A of Section III; except that in the case of those employees only a pro rata portion of whose salaries and wages are chargeable to the Joint Account under Paragraph 1A of Section III, not more than the same pro rata portion of the benefits and allowances herein provided for shall be charged to the Joint Account. Cost under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 2A of this Section II and Paragraph 1A of Section III. If percentage assessment is used, the rate shall be based on the Operator's cost experience.
- C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's labor cost of salaries and wages chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II and Paragraph 1A of Section III.
- D. Reasonable personal expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II and for which expenses the employees are reimbursed under Operator's usual practice.

3. Employee Benefits

Operator's current cost of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II and Paragraph 1A of Section III shall be chargeable as indicated in the subparagraph selected below:

- A. Operator's actual cost.
- B. Operator's actual cost not to exceed fifteen per cent (15%).

4. Material

Material purchased or furnished by Operator for use on the Joint Property as provided under Section IV. So far as it is reasonably practical and consistent with efficient and economical operation, only such Material shall be purchased for or transferred to the Joint Property as may be required for immediate use; and the accumulation of surplus stocks shall be avoided.

5. Transportation

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

- A. If Material is moved to the Joint Property from the Operator's warehouse or other

properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by Operator and Non-Operators.

- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by Operators and Non-Operators. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by Operator and Non-Operators.
- C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking costs of \$100 or less.

6. Services

- A. The cost of contract services and utilities procured from outside sources other than services covered by Paragraph 8 of this Section II and Paragraph 1B of Section III. The cost of professional consultant services shall not be charged to the Joint Account unless agreed to by Operator and Non-Operators.
- B. Use and service of equipment and facilities furnished by Operator as provided in Paragraph 5 of Section IV.

7. Damages and Losses to Joint Property

All costs or expenses necessary for the repair or replacement of Joint Property made necessary because of damages or losses incurred by fire, flood, storm, theft, accident, or other cause, except to the extent that the damage or loss could have been avoided through the exercise of reasonable diligence on the part of Operator. Operator shall furnish Non-Operators written notice of damages or losses incurred as soon as practicable after a report thereof has been received by Operator.

8. Legal Expense

All costs and expenses of handling, investigating, and settling litigation or claims arising by reason of the Joint Operations or necessary to protect or recover the Joint Property, including, but not limited to, attorney's fees, court costs, cost of investigation or procuring evidence and amounts paid in settlement or satisfaction of any such litigation or claims; provided, (a) no charge shall be made for the services of Operator's legal staff or other regularly employed personnel (such services being considered to be Administrative Overhead under Section III), unless agreed to by Operator and Non-Operators, and (b) no charge shall be made for the fees and expenses of outside attorneys unless the employment of such attorneys is agreed to by Operator and Non-Operators.

9. Taxes

All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof, or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties.

10. Insurance

Net premiums paid for insurance required to be carried on the Joint Property for the protection of the Parties.

In the event Joint Operations are conducted in a state in which Operator may act as self-insurer for Workmen's Compensation and/or Employers Liability under the

respective state's laws, Operator may, at its election, include the risk under its self-insurance program and in that event, Operator shall include a charge therefor on the following basis:

.....
.....
.....

11. Other Expenditures

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

III. INDIRECT CHARGES

Operator may charge the Joint Account for indirect costs either by use of an allocation of district expense items plus the rate for administrative overhead, and plus the warehousing charges, all as provided for in Paragraph 1 of this Section III or by combining all three of said items under the rates provided for in Paragraph 2 or 3 of this Section III, as indicated next below:

OPERATOR SHALL CHARGE INDIRECT COSTS TO THE JOINT ACCOUNT UNDER THE TERMS OF:

- Paragraph 1. (District Expense, Administrative Overhead and Warehousing)
- Paragraph 2. (Combined Rates - Well Basis)
- Paragraph 3. (Combined Rates - Percentage Basis)

The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by Operator and Non-Operators as a direct charge to the Joint Account.

THE OVERHEAD RATES PROVIDED FOR IN ANY OF THE PARAGRAPHS SELECTED ABOVE

- A. shall shall not include salaries and personal expenses of first-level supervisors in the field.
- B. shall shall not include salaries, wages and personal expenses of technical employees temporarily assigned to and directly employed on the Joint Property.
- C. shall shall not include salaries, wages and personal expenses of technical employees either temporarily or permanently assigned to and directly employed in the operation of the Joint Property.

1. District Expense, Administrative Overhead and Warehousing

A. District Expense

Operator shall charge the Joint Account with a pro rata portion of the salaries, wages and expenses of Operator's production superintendent and other employees serving the Joint Property and other properties of the Operator in the same operating area, whose time is not allocated directly to the properties, and a pro rata portion

of the cost of maintaining and operating a production office known as Operators'office located at or near (or a comparable office if location changed); and necessary sub-offices (if any), maintained for the convenience of the above-described office, and all necessary camps, including housing facilities for employees if required, used in connection with the operations of the Joint Property and other properties in the same operating area. The expense of, less any revenue from, such facilities may, at the option of Operator, include depreciation of investment or a fair monthly rental in lieu of depreciation. Such charges shall be apportioned to all properties served on some equitable basis consistent with Operator's accounting practice.

B. Administrative Overhead

Operator shall charge administrative overhead to the Joint Account at the following rates, which charge shall be in lieu of the cost and expense of all offices of the Operator not covered by Paragraph 1A of this Section III, including salaries, wages and expenses of personnel assigned to such offices. Such charge shall be in addition to the salaries, wages and expenses of employees of Operator authorized to be charged direct as provided in Paragraphs 2 and 8 of Section II. Such charge shall be made on the basis indicated below, either (1) well basis or (2) percentage basis, at the rates shown thereunder.

(1) Well Basis

RATE PER WELL PER MONTH

<u>Well Depth</u>	<u>DRILLING WELL RATE</u> (Use Total Depth)		<u>PRODUCING WELL RATE</u> (Use Current Producing Depth)		
	<u>Each Well</u>	<u>First Five</u>	<u>Next Five</u>	<u>All Wells Over Ten</u>	
.....	
.....	
.....	
.....	

(2) Percentage Basis

PERCENTAGE BASIS

Development:

..... Percent (%) of the cost of development of the Joint Property exclusive of costs provided under Paragraph 8 of Section II and all salvage credits.

Operating:

..... Percent (%) of the cost of operating the Joint Property exclusive of costs provided under Paragraphs 1 and 8 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.

C. Operator's Warehouse Operating and Maintenance Expense

- Included in district expense
- No charge either direct or indirect
- Percentage basis (describe fully)
-
-

2. Combined Rates - Well Basis

Operator shall charge the Joint Account for the services covered by Paragraph 1 of this Section III on the basis indicated below:

Well Depth	DRILLING WELL RATE (Use Total Depth)		PRODUCING WELL RATE (Use Current Producing Depth)		
	Each Well	First Five	Next Five	All Wells Over Ten	
.....	
.....	
.....	
.....	

3. Combined Rates - Percentage Basis

Operator shall charge the Joint Account for the services covered by Paragraph 1 of this Section III on the basis indicated below:

PERCENTAGE BASIS

A. Development:

..... Percent (%) of the cost of development of the Joint Property exclusive of costs provided under Paragraph 8 of Section II and all salvage credits.

B. Operating:

..... Percent (%) of the cost of operating the Joint Property exclusive of costs provided under Paragraphs 1 and 7 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.

4. Application of Administrative Overhead or Combined Rates - Well Basis

The following limitations, instructions and charges shall apply in the application of the rates as provided under either Paragraph 1B (1) or Paragraph 2 of this Section III.

A. Charges for drilling wells shall begin on the date each well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during the suspension of drilling operations for fifteen (15) or more consecutive days.

B. The status of wells shall be as follows:

(1) Producing gas wells, injection wells for recovery operations, water supply wells utilized for waterflooding operations and salt water disposal wells shall be considered the same as producing oil wells.

(2) Wells permanently shut down but on which plugging operations are deferred shall be dropped from the well schedule at the time the shutdown is affected. Any well being plugged or produced during any portion of the month shall be considered as a producing well for the entire month.

(3) Wells being plugged back, drilled deeper, converted to a source or input well, or which are undergoing any type of workover that requires the use of a drilling rig or workover rig capable of drilling shall be considered the same as drilling wells.

(4) Temporarily shut-down wells, which are not produced or worked upon for a

period of a full calendar month, shall not be included in the well schedule, provided however, wells shut in by governmental regulatory body shall be included in the well schedule only in the event the allowable production is transferred to some other well or wells on the Joint Property. In the even of a unit allowable, shut-in wells shall be counted in determining the charge hereunder for such month if said wells contribute allowable production that is actually produced during such month from one or more unit wells as a result of allowable transfer, inclusion in the unit allowable or other circumstances, but the total shut-in well count shall be limited to the minimum number of shut-in wells necessary to provide the contributed allowable actually produced during the month.

(5) Gas wells shall be included in the well schedule if directly connected to a permanent sales outlet even though temporarily shut in due to overproduction or failure of purchaser to take the allowed production.

(6) Wells completed in multiple horizons, shall be considered as a producing well for each separately producing horizon, providing each completion is considered a separate well by governmental or other statewide regulatory authority.

C. The well rates for producing wells shall be applied to the individual leases; provided that, whenever leases covered by this agreement are operated as a unitized project, the well rates shall be applied to the total number of producing wells, irrespective of individual leases.

D. The well rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the preceding calendar year as shown by "The Index of Average Weewly Earnings of Crude Petroleum and Gas Production Workers" as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian Index as published by the Dominion Bureau of Statistics, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

5. Application of Administrative Overhead or Combined Rates - Percentage Basis

For the purpose of determining charges on a Percentage Basis under Paragraph 1B (2) or Paragraph 3 of this Section III, Development shall include all costs in connection with drilling, redrilling, deepening or any remedial operations on any or all wells involving the use of drilling crew and equipment; also, preliminary expenditures necessary in preparation for drilling and expenditures incurred in abandoning when wel is not completed as a producer; and original cost of construction or installation of fixed assets, the expansion of fixed assets and any other project clearly discernible as a fixed asset, except Major Construction as defined in Paragraph 6 of this Section III. All other costs shall be considered as Operating.

6. Major Construction Overhead

For the construction of compressor plants, water stations, secondary recovery systems, drilling and production platforms, salt water disposal facilities, and other such projects, as distinguished from the more usual drilling and producing operations, Operator in addition to the Administrative Overhead or Combined Rates provided for in Paragraph 1, 2 or 3 of this Section III shall either negotiate a rate prior to beginning of

construction or shall charge the Joint Account with an additional overhead charge as follows:

- A. Total cost less than \$25,000, no charge.
- B. Total cost more than \$25,000, but less than \$100,000,% of total cost.
- C. Total cost of \$100,000 or more,% of the first \$100,000 plus% of all over \$100,000 of total cost.

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

7. Amendment of Rates

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

IV. BASIS OF CHARGES TO JOINT ACCOUNT

Subject to the further provisions of this Section IV, Operator will procure all Material and services for the Joint Property. At the Operator's option, Non-Operators may supply Material or services for the Joint Property.

1. Purchases

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

2. Material furnished from Operator's Warehouse or Other Properties

A. New Material (Condition "A")

- (1) Tubular goods, except line pipe, shall be priced on a maximum carload and/or barge load weight basis regardless of quantity transferred and equalized to the lowest prevailing price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available effective at date of transfer.
- (2) Line pipe shall be priced at the current replacement cost effective at date of transfer from a reliable supply store nearest the Joint Property where such Material is normally available if the movement is less than 30,000 pounds. If the movement is 30,000 pounds or more, it shall be priced on the same basis as casing and tubing under Subparagraph (1) of this paragraph.
- (3) When the Operator has equalized actual hauling costs as provided for in Paragraph 5 of Section II, Operator is permitted to include ten cents (10c) per hundred-weight on all tubular goods furnished from his stocks in lieu of loading and unloading costs sustained.
- (4) Other Material shall be priced at the current replacement cost of the same kind of Material, effective at date of movement and f.o.b. the supply store or railway point nearest the Joint Property where Material of the same kind is normally available.
- (5) The Joint Account shall not be credited with cash discounts applicable to prices provided for in this Paragraph 2 of Section IV.

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

- (1) Material in sound and serviceable condition and suitable for reuse without reconditioning, shall be classified as Condition "B" and priced at seventy-five per cent (75%) of the current price of new Material.
- (2) Material which is not suitable for its original function until after reconditioning shall be furnished to the Joint Account under one of the two methods defined below:
 - (a) Classified as Condition "B" and priced at seventy-five per cent (75%) of the current price of new Material. The cost of reconditioning shall be absorbed by the Operator of the transferring property.
 - (b) Classified as Condition "C" and priced at fifty per cent (50%) of current price of new Material. The cost of reconditioning also shall be charged to the receiving property, provided Condition "C" value, plus cost of reconditioning, does not exceed Condition "B" value.
- (3) Obsolete Material or Material which cannot be classified as Condition "B" or Condition "C" shall be priced at a value commensurate with its use. Material no longer suitable for its original purpose but usable for some other purpose, shall be priced on a basis comparable with that of items normally used for such other purpose.
- (4) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

3. Premium Prices

Whenever Material is not readily obtainable at prices specified in Paragraphs 1 and 2 of this Section IV because of national emergencies, strikes or other unusual causes over which the Operator has no control, the Operator may charge the Joint Account for the required Material at the Operator's actual cost incurred in procuring such Material, in making it suitable for use, and in moving it to the Joint Property, provided, that notice in writing is furnished to Non-Operators of the proposed charge prior to billing Non-Operators for such Material. Each Non-Operator shall have the right, by so electing and notifying Operator within 10 days after receiving notice from Operator, to furnish in kind all or part of his share of such Material suitable for use and acceptable to Operator.

4. Warranty of Material Furnished by Operator

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

5. Equipment and Facilities Furnished by Operator

- A. Operator shall charge the Joint Account for use of equipment and facilities at rates commensurate with cost of ownership and operation. Such rates shall include cost of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on investment not to exceed six per cent (6%) per annum, provided such rates shall not exceed those currently prevailing in the immediate area within which the Joint Property is located. In lieu of rates based on costs of ownership and operation of equipment, other than automotive, Operator may elect to use commercial rates prevailing in the area of the Joint Property less 20%; for automotive

equipment, rates as published by the Petroleum Motor Transport Association may be used. Rates for laboratory services shall not exceed those currently prevailing if performed by outside service laboratories. Rates for trucks, tractors and well service units may include wages and expenses of operator.

- B. Whenever requested, Operator shall inform Non-Operators in advance of the rates it proposes to charge.
- C. Rates shall be revised and adjusted from time to time when found to be either excessive or insufficient.

V. DISPOSAL OF MATERIAL

The Operator may purchase, but shall be under no obligation to purchase, interest of Non-Operators in surplus Condition "A" or "B" Material. The disposition of surplus Controllable Material, not purchased by Operator, shall be agreed to by Operator and Non-Operators, provided Operator shall dispose of normal accumulations of junk and scrap Material either by transfer or sale from Joint Property.

1. Material Purchased by the Operator or Non-Operators.

Material purchased by either the Operator or Non-Operators shall be credited by the Operator to the Joint Account for the month in which the Material is removed by the purchaser.

2. Division in Kind

Division of Material in kind, if made between Operator and Non-Operators, shall be in proportion to the respective interests in such Material. The Parties will thereupon be charged individually with the value of the Material received or receivable. Proper credits shall be made by the Operator to the Joint Account.

3. Sales to Outsiders

Sales to outsiders of Material from the Joint Property shall be credited by Operator to the Joint Account at the net amount collected by Operator from vendee. Any claim by vendee related to such sale shall be charged back to the Joint Account if and when paid by Operator.

VI. BASIS OF PRICING MATERIAL TRANSFERRED FROM JOINT ACCOUNT

Material purchased by either Operator or Non-Operators or divided in kind, unless agreed to by Operator and Non-Operators shall be priced on the following basis:

1. New Price Defined

New price as used in this Section VI shall be the price specified for new Material in Section IV.

2. New Material

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

3. Good Used Material

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

- A. At seventy-five per cent (75%) of current new price if Material was charged to Joint Account as new, or
 - B. At sixty-five per cent (65%) of current new price if Material was originally charged to the Joint Account as secondhand at seventy-five per cent (75%) of new price.
4. **Other Used Material**
Used Material (Condition "C"), at fifty per cent (50%) of current new price, being used Material which:
- A. Is not sound and serviceable condition but suitable for reuse after reconditioning, or
 - B. Is serviceable for original function but not suitable for reconditioning.
5. **Bad-Order Material**
Material (Condition "D"), no longer suitable for its original purpose without excessive repair cost but usable for some other purpose at a price comparable with that of items normally used for such other purpose.
6. **Junk Material**
Junk Material (Condition "E"), being obsolete and scrap Material, at prevailing prices.
7. **Temporarily Used Material**
When the use of Material is temporary and its service to the Joint Property does not justify the reduction in price as provided for in Paragraph 3B of this Section VI, such material shall be priced on a basis that will leave a net charge to the Joint Account consistent with the value of the service rendered.

VII. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

Reconciliation of inventory with the Joint Account shall be made, and a list of overages and shortages shall be furnished to the Non-Operators. Inventory adjustments shall be made by Operator with the Joint Account for overages and shortages, but Operator shall be held accountable to Non-Operators only for shortages due to lack of reasonable diligence.

3. Special Inventories

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

4. Expense of Conducting Periodic Inventories

The expense of conducting periodic inventories shall not be charged to the Joint Account unless agreed to by Operator and Non-Operators.

I. GENERAL PROVISIONS

1. Definitions

Controllable Material

Option "A" defines controllable material as material which at the time is so classified in the Material Classification Manual as most recently recommended by the Council of Petroleum Accountants Societies of North America. As of 1970 the most recently recommended Material Classification Manual is Bulletin No. 6, "Material Classification Manual 1967".

Option "B" defines controllable material as material which is ordinarily so classified and controlled by Operator in the conduct of its operations. A list of such material shall be furnished Non-Operators upon request. Since there is a wide variation in the industry by Operators regarding material ordinarily classified as controllable, it should be pointed out that such a list is subject to change as the Operator's practice changes.

2. Statements and Billings

A. Detailed Billings

"Statement in detail of all charges and credits to the Joint Account."

This type of billing contains a reference (generally known as the voucher reference) to the accounts and/ or to the source information of the Operator of each transaction contained in the billing. Each transaction further reflects the complete description and price of each item or unit charged.

Labor charges should be described in sufficient detail to enable the Non-Operator to apply the correct distribution and accounting. It is not necessary to identify each individual employee by name on the billings.

Material and supplies should be described in such a manner to provide a means of price verification by the Non-Operator. Serial numbers and/or other identifying registration data should be shown.

Prorated charges from Operator's wholly owned clearing accounts, such as district supervision costs, should be billed in such a manner to show the basis of the allocation of the whole to the particular property charged. It is not required that the detailed transactions to the basic account that is cleared be shown on the billing to a property charged for an allocated portion; however, if the basic account is a Joint Property from which clearings are made to other properties, then the billing should reflect the same detail as provided for herein for other Joint Properties. The statement should also include AUTHORITY FOR EXPENDITURE with well number, facility name or other appropriate identification.

B. Summary Billings

"Statement of all charges and credits to the Joint Account summarized by the appropriate classifications indicative of the nature thereof."

Reference is made to the "Classification for Use in Summary Form Billing Producing and Gasoline Plant Operations" Bulletin No. 1 recommended by COPAS.

This type of billing consists of a statement of charges and credits to the Joint Account summarized in such a manner to permit identification of labor, material, transportation, taxes, contract services, district expense, employee benefits, overhead and other such classifications, and in such a manner to identify development, operating and other types of expense.

Capital expenditures should be classified and billed in such a manner that tangibles and intangibles may be segregated. The statement should also include AUTHORITY FOR EXPENDITURE with well number, facility name or other appropriate identification.

C. Semi-Summary Billings

"Statement of all charges and credits to the Joint Account, summarized by appropriate classification indicative of the nature thereof, except that items of Controllable Material and unusual charges and credits shall be detailed."

This type of billing is designed to permit the detailed accounting control of equipment and to summarize, by appropriate classifications, the intangible charges and credits. The billing should reflect a detailed statement of all Controllable Material presented in such a manner as to provide a means of price verification by the Non-Operator which would include unit price, number of units, sales tax, condition and other appropriate information.

Ordinary charges and credits other than Controllable Material should be summarized and classified in such a manner to enable the Non-Operator to make proper distribution between capital expenditures, development and operating expenses, and in such a manner to permit identification of labor, material, transportation, contract services, district expense, employee benefits, overhead and other such classifications.

The billing should reflect a detailed statement of any unusual charges and credits applicable to the Joint Account. Examples of such transactions would be lease bonuses and rentals, ad valorem taxes, legal expense, damages, well contributions, audit adjustments and audit expenses. The statement should also include AUTHORITY FOR EXPENDITURE with well number, facility name or other appropriate identification.

3. Advances and Payments by Non-Operators

Remittances should be made promptly by the Non-Operators in accordance with the terms of the contract. If such remittances are not made timely, interest should accrue monthly on the unpaid balance at the stipulated rate. It is recognized, subject to provisions to the contrary, that the Operator has advanced his money to finance the operations; and, if the remittances by Non-Operator are timely, or if interest payments are made on delinquent accounts, the Non-Operator still enjoys a more favorable financial position. It is, therefore, suggested that interest should be applied universally by Operators when applicable and accepted without reservation or criticism by Non-Operators who for any reason do not remit in accordance with the limitations of the contract. To encourage the enforcement of this provision, any policy by the Operator of placing a notation on his billings to the effect that the interest provision is to be applied is hereby sanctioned. Attention is directed to the maximum contract interest rates permitted by the applicable usury laws.

4. Adjustments

The monthly Joint Account billing should be paid as rendered by the Operator. If any item on the Operator's statement is questionable, the payment for such item should be included by the Non-Operator with the remainder of the billing. A request for an adjustment or explanation should be directed promptly to the Operator. The Operator should answer such request promptly; and if an adjustment is in order, he should issue a credit (or debit) memorandum or advise the Non-Operator of the corrections on the next monthly billing.

When the total monthly billing to a particular Non-Operator's account reflects a credit balance, the Operator should accompany the billing with his check to settle the account, except where inventory and ownership adjustments are involved. In these instances some Operators affect distribution after collection of sufficient funds from the Non-Operators.

5. Audits

Reference is made to the COPAS Bulletin No. 3, "The Initiation of Joint Account Audits, Audit Protocol and Auditing Guides in the Petroleum Industry".

6. Approval by Non-Operators

This provision prohibits a minority in interest of the Non-Operators from vetoing approval by a majority in interest of the Non-Operators.

II. DIRECT CHARGES

1. Lease Rentals and Royalties

No comments necessary.

2. Labor

Operator's labor cost applies to the salaries and wages of personnel on the Operator's payroll whose time is chargeable directly to the Joint Account. This will include personnel who are directly employed on the property in an operating capacity; and may also include first-level supervisors if the contract so provides in Section III, Indirect Charges under Option "A". This may also include technical employees who can be charged if the contract so provides in Section III, Indirect Charges under Options "B" and/or "C". In most instances the original time sheets or some other written documentation should show the time spent on any particular job or Joint Property; and the charge should be based upon such time shown. In some instances, however, certain employees may directly serve a number of properties, each having one or more wells; and it may not be practical and/or equitable to use time as a basis for the charge. This can result from location of employees' headquarters (dog house, etc.), travel time required, common facilities serving properties manned by the employee and other reasons. In such instances, it is sometimes more feasible to allocate the charge to all properties served on a well, or other equitable basis, than on the time spent on the individual properties.

Following is a detailed explanation of direct labor chargeable to the Joint Account:

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

These are defined as employees below first-level supervision directly employed on the Joint Property.

- (2) "Salaries of first-level supervisors in the field if such charges are excluded from overhead rates in Option 'A' of Section III."

These are defined as employees and their assistants below the district expense level who supervise employees and/or contract labor directly engaged in operating and maintaining producing properties and production facilities.

In addition to supervising basic lease and facility operation and maintenance, the first-level supervisor may spend part of his time supervising special construction projects and overseeing drilling and well remedial work.

The first-level supervisor does not have an engineering or administrative staff and relies upon the staff associated with an administrative or functional office above the first-level of supervision for these services.

The salaries and wages incurred necessary to provide first-level supervision may be charged direct or apportioned to all properties served on an equitable basis consistent with the Operator's accounting practices.

- (3) "Salaries and wages of technical employees temporarily assigned to and directly employed on the Joint Property if such charges are excluded from overhead rates in Option 'B' of Section III."

Technical employees are defined as those having special and specific engineering or geological skills whose services are required on the Joint Property in connection with the handling of specific operating conditions and problems.

- (4) "Salaries and wages of technical employees either temporarily or permanently assigned to and directly employed in the operation of the Joint Property if such charges are excluded from overhead rates in Option 'C' of Section III."

This provision recognizes that a technical employee is not required to be physically on the property in order for his time to be a direct charge. Such an employee may be physically at the location where he is regularly assigned, but performing special duties benefiting the Joint Property.

It is not intended that the Joint Account will be charged for the salaries and wages of technical employees after the specific operating condition or problem requiring their services ceases to exist. Technical employees usually have no supervisory authority except that required to resolve the particular problem to which they are assigned.

Time worked under these provisions is generally charged in increments of a full work day. The time worked in increments of less than one full work day cannot be accumulated and would be considered included in the overhead rate.

- B. Operator's cost of holiday, vacation, sickness, disability benefits, jury duty and excused allowances are recognized Joint Account costs, chargeable on a "when and as paid" basis or by "percentage assessment". Unless an employee is regularly assigned to a particular property for the entire year, it is very difficult to make an equitable charge by the "when and as paid" basis. It is generally agreed that the "percentage assessment" provides a more equitable distribution of these costs. It is recommended that the "percentage assessment" be reviewed currently and that proper adjustments be made in the rate to provide, over a period of time, that actual costs are distributed to the properties served. This may require that any balance in the accrual account be used in determining the new adjusted rate.
- C. Costs pursuant to governmental authority are recognized Joint Account costs. Since these costs are limited, being based upon a maximum amount earned by each employee and the maximum earnings may be different for each category of charge, the cost terminates at various times during the year for individual employees. Although it is acceptable to determine the average time for payout of each category and discontinue such charges at the expiration of that period, this usually produces inequities in charges to the individual properties. This is particularly true if a property is discontinued in the early part of the year, or begins operations in the latter part of the year. For this reason, it is recommended that a percentage be determined for twelve months to spread the costs over the entire year.

D. Travel and reimbursable personal expenses of those employees serving the Joint Property should be charged equitably and consistently with wages and salaries as provided under "A" above. Personal expenses may include relocation expenses such as real estate fees, closing costs, compensation for loss on sale of home, carpeting and drapery expenses, etc.

3. Employee Benefits

Employee benefits are generally considered to be a part of the employer's total labor cost. The operating agreement usually provides that the Operator shall charge the Joint Account with the current cost of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus and other benefit plans of a like nature applicable to Operator's labor cost, provided however, the total of such charges shall not exceed the contract limitations. Employee benefits may be generally defined as the types of plans enumerated above and other established plans, such as supplemental or catastrophe medical insurance for employees and dependents, accident and disability insurance and military service benefits which provide for the welfare of the Operator's employees, their families or beneficiaries, and which are made available to all employees of the Operator on an equitable basis. The cost of such plans may be borne entirely by the Operator or jointly by the Operator and the employees. Only the Operator's share of these costs is chargeable to the Joint Account. The following should be excluded:

- A. Operator's cost of holiday, vacation, etc., which is primarily the continuation of salaries and wages during periods of absence by the employee.
- B. Operator's cost pursuant to assessments imposed by governmental authority.
- C. Insurance premiums computed by application of a rate to the amount of payroll.
- D. Costs which are beneficial primarily to the Operator, such as industrial nurse or doctor, safety awards, service awards, employee's credit union, company magazines and periodicals, social functions, dinners and programs for retirements, safety etc., recreational programs and facilities, Christmas bonuses given to selected employees, other special benefits available only to executives, certain employees or groups on a selective basis.

Established plans are those made available to all employees on a regular basis. Such plans may be established in accordance with and subject to collective bargaining agreements.

Charges may be made to the Joint Account for benefit plans expense on a "when and as paid" basis or by "percentage assessment" on the amount of the labor costs. It is generally agreed that the "percentage assessment" provides a more equitable distribution of these costs. If the "percentage assessment" method is used, it should be based on the Operator's actual cost experience, however, the application of a rate determined from the preceding year's experience may be considered as compliance with the "current cost" requirement. Under either method the Operator's cost of administering such plans should be excluded. In determination of actual cost experience, any dividends or refunds received which are applicable to insurance or annuity policies should be used to reduce the cost of such policies.

There is considerable variation in the actual cost of benefits plans in various companies in the industry. Some of the factors causing these variations are number of employees; average age of employees; types of plans established; methods of funding (contributory or non-contributory, trustee or insured) and collective bargaining

agreement requirements. Since these wide variations exist, a percentage limitation may be established. The Operator should determine annually whether his costs equal or exceed the stipulated percent of labor before continuing to make charges at that rate. The "percentage assessment" rate is applicable to the Operator's labor costs under Section II, Paragraphs 2A, and 2B which are chargeable directly to the Joint Account and/or through District Expense but not applicable to Administrative Overhead labor or contract labor.

4. Material

No comments necessary.

5. Transportation

Transportation expense can be defined as the "cost incurred from the point where material and/or personnel is ready for movement until the cargo reaches its destination or delivery point". This activity is largely of a physical or mechanical nature and is readily adaptable to standardization and control.

Transportation shall include all costs incurred in the transportation of employees, equipment, material and supplies necessary for the development, maintenance and operation of the Joint Property.

Employee transportation cost is directly related to the charge for salaries and wages of Operator's employees engaged for the Joint Operation. Transportation cost of employees directly engaged on the Joint Property should be charged as a direct cost. Transportation cost for employees serving all properties in the operating area whose time is chargeable to District Expense should also be charged as District Expense. Transportation costs of transferred employees directly concerned with the operations of the Joint Property, including the cost of moving their household goods and personal effects, shall be a direct charge unless such move is for the primarily benefit of the Operator.

Transportation costs of material necessary for the Joint Operations shall be charged to the Joint Account. In subparagraphs A and B below, the following definitions are applicable:

Reliable Supply Store shall mean a recognized source or common stock point for the particular material involved.

Railway Receiving Point or Recognized Barge Terminal shall mean that location which a vendor would use in determining the sale price to the Operator of new material to be delivered to the Joint Property.

These costs are subject to the following limitations:

- A. If material is moved to the Joint Property from Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest Reliable Supply Store, Recognized Barge Terminal or Railway Receiving Point, where like material is normally available, unless agreed to by Operator and Non-Operators.
- B. If surplus material is moved to the Operator's warehouse or other storage point, transportation cost should be charged not to exceed a charge for a distance greater than the distance to the nearest Reliable Supply Store, Recognized Barge Terminal or Railway Receiving Point, unless agreed to by Operator and Non-Operators. No charge shall be made to the Joint Account for moving material to other properties belonging to Operator, unless agreed to by Operator and Non-Operators.

- C. In the application of the preceding subparagraphs A and B, there shall be no equalization of actual gross trucking costs of \$100 or less, per each movement.
- D. If hauling charges are equalized, Operator may include ten cents (10c) per hundredweight on all tubular goods furnished from his stocks in lieu of one loading at the warehouse or other property and one unloading at the Joint Property. If Operator charges ten cents (10c) per hundredweight, the actual costs of all loading and unloading should be absorbed by the Operator.

6. Services

The contract services and utilities procured from outside sources are chargeable to the Joint Account with the exception of: (1) legal expense as defined in paragraph 8 and (2) cost and expense of services in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies which are covered by the second grammatical paragraph of Section III of the COPAS-1968 Accounting Procedure.

The cost of other professional consultant services shall not be charged to the Joint Account unless agreed to by Operator and Non-Operators.

7. Damages and Losses to Joint Property

The generally accepted operating agreement provides that costs incurred for repairs or replacement of Joint Property because of damage or loss shall be borne by the Joint Account. Damages or losses to the Joint Property because of fire, lightning, windstorm, hurricane, hail, smoke, explosion, flood, theft, accident, vandalism, malicious mischief or any other cause are recognized Joint Account costs except to the extent that the damages or losses could have been prevented through the exercise of reasonable diligence on the part of the Operator.

As soon as practicable the Operator should notify Non-Operators in writing of the damage or loss giving the time, cause, extent and the estimated charge to the Joint Account. The Operator should also give immediate notice to the insurance carrier, if the property is covered by insurance, and protect the property from further damage. If the loss results from theft, vandalism or malicious mischief, the proper law enforcement agency should be notified.

If any equipment is removed from the Joint Property, the Operator should furnish Non-Operators enough information to enable them to make proper entries to their investment records.

Any settlement received from an insurance carrier should be credited to the parties participating in such insurance coverage.

8. Legal Expense

Costs and expenses, other than attorneys' services, incurred in handling, investigating and settling litigation or claims arising by reason of Joint Operations, or necessary to protect or recover the Joint Property, including court costs, costs of investigation or procuring evidence and amounts paid in settlement or satisfaction of any litigation or claim, are recognized as direct Joint Account costs. It should be recognized that these direct costs are subject to the limitation on expenditures provided in the operating agreement. These charges expressly relate only to such costs in connection with litigation and claims.

No charge shall be made for: (1) services of Operator's legal staff or other regularly employed personnel or (2) fees and expenses of outside counsel. By agreement of a

majority in interest of Non-Operators as provided in paragraph No. 6, Section I, Approval by Non-Operators, either of these costs may be charged to the Joint Account. Otherwise, costs of such services whether performed by the legal staff or outside attorneys are considered covered by Administrative Overhead.

There are, however, other legal expenses which arise by reason of the Joint Operations, such as drilling contracts and other contracts of all kinds, title examination and curative activities, gas and oil sales and other disposition, division orders and many other activities relating to the Joint Property. All of these are considered to be covered by Administrative Overhead, whether rendered by staff or outside attorneys, unless agreed to as provided in paragraph No. 6, Section I, Approval by Non-Operators.

If some unusual and special activity occurs, requiring legal services for the benefit of the Parties to the operating agreement, it would be anticipated that the Parties would consent, as necessary, to a direct charge for such services.

Through the use of the procedures outlined in the above paragraphs, an Operator with little or no legal staff and related employees and an Operator who has such a staff but uses outside counsel for all or some of such functions will be treated equally with an Operator who has and uses such a staff.

9. Taxes

No comments necessary.

10. Insurance

The costs of net premiums for insurance required to be carried for the Joint Operations are chargeable to the Joint Account. The types and amounts of insurance are agreed upon by the Parties and are usually included in the operating agreement. Net premiums are those premiums paid by the Operator less any refunds or rebates.

The following are types of insurance commonly required to be carried:

- A. Workmen's Compensation and Employer's Liability Insurance which are designed to cover a company's liability to its employees for on-the-job injuries. This obligation is required to be insured by law in most states; however, some permit self-insurance in which case actual cost should be charged not to exceed state manual rates.
- B. Comprehensive Automobile Liability Insurance which protects the Operators from damages resulting from the use of jointly owned vehicles. In addition to the liability coverage in the policy, there is usually an endorsement adding fire, theft and additional comprehensive coverage which provides protection for physical damage to, or loss of, the vehicles.
- C. Comprehensive General Liability Insurance which provides protection to the Parties from claims by third parties. The primary coverage in this base policy may be supplemented by additions to cover specific risks.

Additional insurance may be required for offshore operations, such as:

- A. Longshoremen and Harbor Workers Compensation Insurance under the United States Longshoremen and Harbor Worker's Compensation Act, Marine and voluntary coverage or similar coverage which may be required for operations outside the continental limits of the United States.
- B. Vessels, Hull and Machinery Insurance to the extent of sound value.

C. Waterborne Cargo Insurance to the extent of sound value.

No charge for insurance premiums on automotive equipment owned exclusively by Operator should be made to the Joint Account except as otherwise provided in the operating agreement.

11. Other Expenditures

No comments necessary.

III. INDIRECT CHARGES

Indirect charges are those costs incurred above the lease operating level which generally are included in District Expense, Warehouse Expense and Administrative Overhead as defined below. Indirect charges are all costs other than those specifically deemed to be direct charges under Section II of COPAS-1968 Accounting Procedure or by special agreement.

Operator may charge the Joint Account for indirect costs in the manner indicated by one of the three options allowed in this Section III. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies are considered included in the overhead under the option selected unless such cost and expense are agreed to be a direct charge by the Operator and Non-Operators.

The COPAS-1968 Accounting Procedure provides options which, dependent on those selected, determine the manner in which the Operator is allowed to recover the salaries and personal expenses of first-level supervisors and technical employees. It is emphasized that a selection must be made in each of the three options, "A", "B", and "C", in order to specifically provide for the proper charging of these costs to the Joint Account.

The terms "first-level supervisor", "technical employees", and "in the operation of" have previously been defined in paragraph No. 2, Section II, of this bulletin. These definitions are to be consistently applied wherever such terms are used in the Indirect Charges Section of COPAS-1968 Accounting Procedure. The term "personal expenses" applicable to first-level supervisors and technical employees refers to travel and reasonable reimbursable expenses. Travel and reimbursable expenses usually include motel, meal, transportation, and any other reasonable costs reimbursed directly to the employee and also may include relocation expenses such as real estate fees, closing costs, compensation for loss on sale of home, carpeting and drapery expense, etc. Not included are other costs related to the employee's function, even though necessary for proper performance of his function, such as office rent, supplies, utilities and maintenance, office staff, office depreciation, etc. Costs of this nature are not considered personal expense but are includable in District Expense and/or Overhead.

I. District Expense, Administrative Overhead and Warehousing

A. District Expense

District Expense Defined

To distinguish between items covered by Administrative Overhead and those items properly includable in District Expense, it is necessary that District Expense be defined.

District Expense is an accumulation of drilling and producing costs of such general nature that all wells, leases and facilities in the district area benefit from

these costs proportionately. District Expense consists of the salaries and expenses of the Operator's employees located in the district serving the Joint Property and other properties of the Operator in the same operating area, whose time is not charged directly to the properties, and the cost of maintaining and operating the field production office and necessary sub-offices, and all necessary camps including housing facilities for employees if required, used in the conduct of the operations of properties in the same operating area. The expense of housing and other facilities, less any revenue therefrom, may include depreciation or a fair monthly rental in lieu of depreciation on the investment.

The Operator's district office is a field production office and sub-offices whose function is to supervise the drilling and producing operations in the specified district. Such office may be called an area office or have some other designation, however, as long as it conforms to the specifications indicated above it is to be recognized as a district office.

Items Generally Included in District Expense

Items included in the categories set out below are chargeable to District Expense. Any items not included in these categories should be considered as covered by Administrative Overhead rates or as direct charges to the Joint Property.

It is noted that salaries and personal expenses of first-level supervisors and technical employees may be included in District Expense or charged directly to the property, depending upon the procedure as selected in Options "A", "B", and "C" of this Section III.

1. Company Labor

Salaries of district superintendent, assistant district superintendent, first-level supervisors, district production engineers, office staff and other employees located in the district and performing district functions.

Employee benefits and Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to the employees whose salaries and wages are chargeable to District Expense are also chargeable as District Expense.

2. Contract Labor

All contract labor incurred directly in the operation or maintenance of district offices or camps.

3. Transportation

Items of trucking, freight and express costs when such items are incurred directly in the operation or maintenance of district offices or camps.

Cost of automobile, boat, helicopter or airplane operations when used by employees whose salaries are chargeable to District Expense. Rates charged for operator owned equipment shall be in accordance with paragraph No. 5, Section IV of the COPAS-1968 Accounting Procedure.

4. Small Tools and Supplies

Cost of supplies and cost of repairs and replacement to district tools when such items are for general use and cannot be allocated to any lease or facility. Such supplies may include wiping rags, gloves, safety supplies, etc.

5. Office Supplies

Cost of stationery and office supplies, cleaning and repairing of office equipment and rentals paid for use of typewriters or other district office equipment. This includes janitor supplies used in the district office.

6. Communications Expense

Telephone, telegraph and teletype service rendered to the district; also operating expenses of radio communication systems which serve the district.

7. Traveling Expense

Items of traveling expense of district employees when such expense is for the sole benefit of the district. Excluded are personal and travel expense of district personnel attending oil shows, API meetings, etc. Costs in connection with company training schools which are for the primary benefit of the Operator are also excluded.

8. Moving Expense

Costs of moving and transfer of district employees including relocation expenses such as real estate fees, closing costs, compensation for loss on sale of home, carpeting and drapery expense, etc., when transferred within or into the district. These costs shall be excluded when they are of primary benefit for the Operator, such as transfer of trainees.

9. Dues and Memberships

Dues and membership in technical organizations with which district personnel should be affiliated. Memberships, contributions or donations paid to a civic organization shall be excluded.

10. Subscriptions

Subscriptions to periodicals, magazines, trade journals and newspapers.

11. Maps, Photostats and Blueprints

Expenses incurred for drafting, mapping, photostat and blue printing work, when such service is of a general district nature.

12. Repairs and Maintenance to District office and camp buildings.

Costs of painting and repairing district office and camp buildings. Also includes costs of repairing and maintaining district and camp roads, walks, fences, and water, electric and gas lines and other facilities serving the district office or camp.

13. Physical and Medical Examinations

Costs of pre-employment and medical examinations of personnel to be employed in the district. Costs of annual or periodic examinations and immunizations shall be included.

14. Ad Valorem Taxes

Ad valorem taxes paid on buildings and equipment when the investment for such buildings and equipment is charged to the district. In those instances where Operator assesses a monthly rental charge for buildings and equipment owned 100 percent by the Operator, the ad valorem taxes shall be included in the rental charge.

15. Insurance

Net costs of all types of insurance, including workmen's compensation and public liability insurance, when such insurance is applicable to the district.

16. Depreciation on District Investment

Depreciation may be charged on Operator's wholly owned district tools and equipment, district camps, district office equipment, etc., only if same is not recoverable through other means such as direct charges, rentals, etc.

17. Rentals

Surface rentals paid in connection with sites for district production offices, camps or other facilities used specifically for district purposes. Also included is rent paid for buildings, office and storage space used by district employees; rentals paid in connection with rights-of-way for district purposes.

18. Utilities

All utilities when they are purchased for consumption by district facilities.

19. Safety

Costs of safety meetings, safety award dinners and first aid training schools.

Methods of Allocating District Expense

District Expense should be apportioned to all properties served on some equitable basis consistent with Operator's accounting practice. Some acceptable methods of allocation are (1) well basis, (2) payroll labor basis, (3) contract labor basis, and (4) percentage basis of certain Development and Operating costs.

B. Administrative Overhead

Administrative Overhead Defined

Administrative Overhead for Joint Account purposes is defined as those general costs attendant to executive and administrative functions incurred by the Operator at the home, division, area, regional, or similar administrative office serving, indirectly, the development and producing operations. In the case of the large companies, the administrative function can be located in more than one office, while in the case of the smaller companies the function is usually located at the home office. Administrative Overhead applicable to the development and production operations includes the overhead of the related facility operations, such as gas systems and plants, salt water disposal systems, additional recovery systems, etc., if such other facility operations are administered by a common staff with the development and producing operations. Administrative Overhead costs of such functional operations as refinery, sales, oil and gas transportation, oil purchases and sales, manufacturing and other operations not directly associated with producing operations should not be included in Administrative Overhead for our purpose. In determining the apportionment of administrative cost of any particular account, equitable weight should be given to all functions served.

It is common practice in the industry to negotiate an agreed rate to reimburse the Operator for overhead costs applicable to the Joint Operation. This rate may be applied on a well basis or as a percent of the cost of Development of the Joint Property and as a percent of the cost of Operating the Joint Property as further defined and explained under the Combined Rates provisions. Such provisions should be reviewed periodically to determine that the rate is equitable and commensurate with Operator's costs, considering changes in the services furnished, the fluctuations of wages and other cost changes from the date of the agreement.

Functions Generally Included in
Administrative Overhead

Listed below are representative functions, the cost of which should be included in the Administrative Overhead rate. It is not intended that this listing include all items applicable to every Operator but it is to serve as a guide for similar functions. The Joint Account should not receive a direct charge for these services even though some of the functions are contract services performed by third parties unless the accounting procedure so indicates under Options "B" or "C" of Section III or by special agreement. It is recognized that the Operator of Joint Properties, in most instances, does not recover his actual cost. The purpose of this section is to provide a basis for a mutual understanding between the Operator and Non-Operators of the functions intended to be included in the overhead rate.

1. General Management
2. General Operating Administration
 - Drilling Superintendent and Office Staff
 - Production Superintendent and Office Staff
 - Civil Engineering
 - Reservoir Analysis and Engineering
 - Petroleum Engineering
 - Negotiation of Production and Residue Gas Sales
 - Negotiation of Major Gas Sales
 - Preparation and Negotiation of Joint Operating Contracts
 - Preparation of General Production Records
 - Traveling and Transportation Expense of Home Office Employees
3. General Accounting and Services
 - Checking of Invoices
 - Preparation of Paychecks
 - Responsibility of Account Distribution or Coding
 - Payment of Vendor's Invoices
 - Maintain Property Investment Records
 - Maintain Joint Interest Cost Records
 - Preparation of Joint Interest Billing
 - Preparation of Royalty Checks
 - Machine Accounting Section
 - Photostat and Other Reproduction Service
 - Ad Valorem Tax Service or Counsel
 - Systems and Procedures
 - Internal Auditing
4. Title Record and Division Order Administration
 - Landmen and Titlemen
 - Maintenance of Division of Interest Records
 - Obtaining Royalty Signatures
5. Exploration Administration
 - Geologists
 - General Research
 - Geophysicists
6. General Purchasing Administration

7. Industrial Relation and Public Relation Administration
Employee Relation Counselor
Safety Engineer
Industrial Nurse or Doctor
Dinners, Parties, etc.
Safety Awards
Incentive Awards
Thanksgiving Turkeys or Christmas Baskets
Contributions to Charity or Civic Organizations
Special Investigators
Administration of Benefit Plans
8. General Oil & Gas Well Proration & Pricing Administration
Preparation of Reports to and representation before governmental agencies
9. General Legal Counsel
Preparation of Contracts
Claims and Litigation
Title and Other Opinions
10. Transportation and Traffic Administration
11. Insurance Administration
- C. Operator's Warehouse Operating and Maintenance Expense

Warehouse handling charges to the Joint Account are intended to provide the Operator a return of the costs of sharing and handling that material on which it is not practical nor feasible to purchase directly from outside sources at the required time of need. Material purchased for use on the Joint Property should be charged directly thereto, thus avoiding warehouse handling charges. No handling charges should be made merely for accounting control purposes when material is moved through the Operator's warehouse.

It is the practice of some Operators to include warehouse expense in the District Expense account which is allocated to all properties served, while it is the practice of other Operators to account for warehouse expense separately in an account not allocable to Joint Accounts. The Operator should recover warehouse costs applicable to the Joint Property either through allocation of District Expense or by an agreed percentage assessment, but he should not duplicate this cost by charging both applications to the Joint Account.

In those instances when the contract provides for a percentage assessment of the value of material furnished from the Operator's warehouse, warehousing costs should not be passed on to the Joint Account in any other manner. The assessment is in lieu of such costs as salaries of warehousemen or clerks receiving and disbursing stock items, depreciation on material storage facilities, loading, unloading and transportation into stocking point, maintenance and care of stocks and storage facilities and any other costs incurred directly for the purpose of warehousing material. If a portion of any District Expense item serves the warehouse operation, then such portion should be included in Operator's warehouse expense rather than District Expense.

Combined Rates

The Combined Rate is a provision whereby all charges considered includable in District Expense, Administrative Overhead and Operator's Warehouse Operating

and Maintenance Expense, as defined in preceding sections of this bulletin, are combined into one rate.

The Combined Rate is initially established during the negotiation of the Joint Operating Agreement. The rate should be commensurate with the Operator's cost of providing the three component services which form the basis of the rate. This rate may be applied on a well basis or as a percent of the cost of Development of the Joint Property and as a percent of the cost of Operating the Joint Property as further defined and explained below. In negotiating this rate, the Non-Operators should be apprised of the Operator's accounting practices regarding certain expenditures before the operating agreement is approved. Such information is essential for proper evaluation of proposed rates and will preclude possible misunderstanding among the parties with regard to direct and indirect charges. For example, an Operator may be requested to specify what technical employees, if any, or what type of miscellaneous field operating supplies, if any, are to be considered a direct charge. It is emphasized that a Joint Account should not receive a direct charge for any materials or services which are includable in the three component services unless by special agreement.

The Combined Rate may either include or exclude the salaries, wages, and personal expenses of first-level supervisors in the field and technical employees temporarily assigned to and employed on the Joint Property and/or in the operation of the Joint Property as determined by the selection in Options "A", "B", and "C" of Section III. This optional provision generally permits the various companies in the industry to treat such costs in accordance with their respective established accounting practices.

2. Combined Rates – Well Basis

The well rates specified in the Accounting Procedure and the well status information for the associated jointly owned property are the only elements necessary for the Operator to administer or the Non-Operators to verify.

The use of Combined Rates on a well basis eliminates the fluctuation of indirect charges that frequently occur with District Expense allocations. Consequently, changes in drilling activity or well count on other properties under the Operator's jurisdiction have no effect on the overhead charges to the Joint Account. An Operator may also move, consolidate, or redefine the functions of the various offices indirectly serving the property without affecting the overhead costs chargeable to the Joint Account. Each property is unaffected by the activities of other properties.

3. Combined Rates – Percentage Basis

The Percentage Basis is designed to recover more of the Operator's overhead costs at the time the Operator incurs such costs. Overhead provided by an Operator may fluctuate in direct relation to the fluctuation of Development and Operating costs. Application of percentage overhead rates will result in higher overhead charges when higher drilling or operating costs are incurred. Percentage overhead also has the effect of recovering additional overhead costs during inflationary periods as costs rise. On larger producing properties where the average operating costs per well have been substantially reduced, the average overhead charge per well will usually be less on a percentage basis than on a flat dollar per month per well basis. The problems normally associated with a flat dollar per well basis such as well count, well status and industry wage changes are eliminated which some companies feel reduces their administrative and auditing costs. The base used for applying the agreed percentage

provisions is the total chargeable costs currently billed less certain specific exclusions which are explained under "Application of Administrative Overhead or Combined Rates - Percentage Basis".

4. Application of Administrative Overhead or Combined Rates - Well Basis

The application of per well rates as provided in paragraph 1B. (1) or paragraph 2 of Section II of the COPAS-1968 Accounting Procedure should be on the following bases:

A. Overhead Charges for Drilling Wells

Overhead charges for drilling wells shall begin on the date the well is spudded and terminate when the rig is released, or if the drilling rig is released and a completion rig is used to complete the well, the drilling overhead charges shall terminate when the completion rig is released, except that no charge shall be made during the suspension of drilling or completion operations for 15 or more consecutive days.

It is emphasized that after a completion has been made and the rig has been released, the drilling overhead charges shall terminate on the release date. In the event that the completion proves unsuccessful, and completion work is resumed, drilling overhead shall continue to be charged until the release date of the final rig on location at the time of completion, provided 15 or more consecutive days have not elapsed between periods during which a rig is on location. If at any time during completion operations in which a rig is not on location for a period of 15 or more consecutive days, drilling overhead shall terminate on the date the rig is released immediately prior to such 15 day period.

B. Status of Wells

The status of wells shall be as follows:

- (1) Producing gas wells, injection wells for recovery operations, water supply wells utilized for waterflooding operations, and salt water disposal wells shall be included in the producing well schedule and be considered the same as producing oil wells.
- (2) Wells permanently shut-down but on which plugging operations are deferred shall be dropped from the well schedule at the time the shut-down is effected. The producing overhead rate shall be charged for the entire month during which plugging operations are conducted.

Any well that produced during any portion of a month shall be considered as a producing well for the entire month, regardless of whether there has been a fractional part of the month's drilling overhead rate charged. The same administrative efforts are involved for a producing well in accounting to the various regulatory bodies and bookkeeping for this accounting whether a well produced one day during the month or the complete month. This recommended method of charging producing overhead is based on the functional requirements in accounting for production as opposed to those in accounting for drilling operations. It is felt that the functions involved in the two types of operations tend to separate the administrative level into two separate overhead classifications.

- (3) Wells being plugged back or drilled deeper, either in the same formation or in a new formation, and wells being converted to a source or input well, shall be included in the drilling well overhead schedule. Wells which are under-

going any type of workover that requires a drilling rig or workover rig capable of drilling, and which involves re-working the formation to restore or increase production, shall be considered as drilling wells.

Wells undergoing normal maintenance, such as pulling and rerunning rods, replacing or respacing tubing, repairing or replacing gas lift valve installations and the repair or replacement of production pumps, shall be included in the producing well overhead schedule, unless such work requires the use of a workover rig capable of drilling. In such event, the particular well will be considered the same as a drilling well for overhead application.

While it is understood that the amount of overhead incurred does not necessarily relate to the size of the rig being used, it is felt that this criteria furnishes a more clearly defined breaking point between producing and drilling overhead. It is recognized that the definition of what constitutes a workover rig "capable of drilling" will vary between companies; however, it is generally defined as being:

- (a) the size rig necessary to drill to the formation being reworked, or
- (b) in the event work is being conducted up hole from the formation served by the equipment being serviced, the size of rig necessary to drill to the formation served by such equipment, or
- (c) in the event work is being conducted which has no relation to a particular formation, the size rig which would be required to drill to the deepest producing horizon.

Engineering practices considered generally accepted in the area of operations by the industry should be used in the determination of a rig capable of drilling under the above standards.

- (4) Temporarily shut-down wells, which are not produced or worked upon for a period of a full calendar month, shall not be included in the well schedule, provided however, wells shut in by government regulatory body shall be included in the well schedule only in the event the allowable production is transferred to some other well or wells on the Joint Property. In the event of a unit allowable, shut-in wells shall be counted in determining the charge hereunder for such month if said wells contribute allowable production that is actually produced during such month from one or more unit wells as a result of allowable transfer, inclusion in the unit allowable or other circumstances, but the total shut-in well count shall be limited to the minimum number of shut-in wells necessary to provide the contributed allowable actually produced during the month.

The application of this provision in the event of a unit allowable may present some problems and merits special consideration. The intent of this provision is to allow the Operator to charge overhead for all active wells and for shut-in wells which are contributing unit allowable that is actually produced by other unit wells. This condition can exist for several reasons; however, it exists mainly when the response to an injection program reaches the point that some unit wells are capable of producing more than their prorated unit allowable, thus allowing the Operator the flexibility of producing the overall unit allowable from selective wells which would result in a unit savings in direct operating expense. It is felt the Operator's actual over-

head cost remains the same whether or not all wells in the unit produced during the month, thus justifying the charge for shut-in wells considered as having a transferred allowable.

In determining the number of shut-in wells to be charged, the following steps are necessary, regardless of the method of determining the unit allowable:

- (a) Divide the monthly unit allowable by the total number of wells in the unit that are entitled by the state's proration rules to contribute to the unit allowable to determine the per well monthly unit allowable.
- (b) Multiply the per well monthly unit allowable by the number of wells entitled to contribute to the unit allowable that actually produced or were active injector wells during the month.
- (c) Compare the answer in (b) with the actual production for the month. If the answer in (b) is equal to or greater than the total unit production for the month, then no shut-in wells are eligible for overhead charges. If the answer in (b) is smaller than total unit production, then the difference is divided by the monthly per well unit allowable to determine the number of shut-in wells that may be classified as having transferred allowables and eligible for an overhead charge.

In the above calculations fractional wells are to be counted as whole wells.

In the event the unitized interval includes more than one producing horizon the well count for each horizon shall be calculated separately if each of the horizons is prorated separately by state-wide regulatory authority.

The effect of the above calculations is that 100% of the shut-in wells which were entitled to contribute to the unit allowable shall be counted for overhead purposes only when 100% of the monthly allowable is produced and when less than 100% of the allowable is produced the shut-in well count shall be reduced proportionately.

- (5) Gas wells shall be included in the well schedule if directly connected to a permanent sales outlet even though temporarily shut-in due to overproduction or failure of purchaser to take the allowed production. This provision should not be confused with paragraph (4) above in the reference to wells shut-in by governmental regulatory body.
- (6) Wells completed in multiple horizons, shall be considered as a producing well for each separately producing horizon, providing each completion is considered a separate well by governmental or other state-wide regulatory authority.

At such time as the state regulatory body assigns only one allowable for each well bore of multiple producers due to concurrent-confluent production, then the count for each such well bore shall be one well for overhead purposes.

Multiple injector wells may be counted as multiple wells for overhead purposes as long as separate injection streams are maintained for each producing horizon although the well bore of all producers in the unit may have been assigned one allowable due to concurrent-confluent production.

C. Application to Individual Accounting Leases

The well rates for producing wells shall be applied to the individual accounting leases; provided that, whenever accounting leases are operated as a unitized

project, the well rates shall be applied to the total number of producing wells, irrespective of individual accounting leases.

D. Adjustment of Rates

The adjustment of rates as provided should apply to all agreements effective prior to the first day of April each year. This is considered equitable since the rates applied to agreements effective prior to April 1 each year would be based on the prior year rates, which would not give consideration to the escalation of costs for the current year.

5. Application of Administrative Overhead or Combined Rates – Percentage Basis

Overhead charges under the percentage basis are applied under two general categories as shown below:

A. Development

Costs subject to the Development Overhead rate include all chargeable costs in connection with drilling, redrilling, deepening, or any remedial operations on any wells involving the use of drilling crew and equipment; also, preliminary costs necessary in preparation for drilling and costs incurred in abandonment when wells are not completed as a producer. Well production equipment, flowlines and lease facilities (e.g. tank batteries, heaters, treaters, separators, etc.) are also included. The cost of litigation and claims and all salvage credits are excluded from the amounts subject to Development Overhead Rate.

B. Operating

Chargeable costs other than those classified as Development or Major Construction as defined in paragraph No. 6, Section III, are considered operating and are subject to the Operating Overhead rate. The costs of lease rentals and royalties, litigation and claims, taxes and assessments paid on mineral interests, value of injected substances purchased for secondary recovery and all salvage credits are excluded from the amounts subject to the Operating Overhead rate. When the value of hydrocarbons, water, etc., produced from and used on the same property are charged as an item of expense, the Operator should exclude such values from the amounts subject to overhead.

The term "salvage credits" as used in the Percentage Basis provisions for recovering Operator's overhead is defined as the amount credited to the Joint Account resulting from the disposal of any material and equipment previously installed on the property and charged to the Joint Account. Unless such salvage credits are excluded from current costs and credits when computing the basis to which percentage overhead rates are applied, the Operator would, in effect, be refunding compensation previously earned at the time the disposed-of items were originally installed.

Credits resulting from the return of any unused material and equipment to a supplier or to jointly-owned or 100 percent-owned stores stock should not be considered as salvage credits, but should be used to reduce the basis to which overhead rates are applied.

With respect to the other exclusions indicated above, such items are not included in the overhead calculation because the administrative effort involved is not proportionate to the costs incurred for these items.

6. Major Construction Overhead

During the construction phase of certain projects, hereinafter defined, overhead costs related to the construction project is incurred by the Operator. This cost is commonly

referred to as Construction Overhead, whereas Administrative Overhead normally referred to in Joint Operations applies to the more usual drilling and producing operations. Construction Overhead is defined as those general costs attendant to executive and administrative functions incurred by the Operator at the home, divisional, area, regional or similar administrative office above the operating level serving indirectly the particular construction project in progress. The Construction Overhead charge for Joint Account purposes allows the Operator to recover these overhead costs. Reference is made to paragraph B., Administrative Overhead in Section III for the types of charges that would be included and to paragraph No. 2, Labor, in Section II, for the types of charges that would not be included in the overhead allowance.

A. Projects Covered by Construction Overhead

Construction projects which are covered by the Construction Overhead provision include the following:

(1) Compressor Plant

Compressor plant may consist of a single stage compressor serving a single lease or it may consist of multi-stage compression with several compressors serving many leases. It is not uncommon to include dehydration equipment in conjunction with the compression of the gas, and under these circumstances the cost of such dehydration equipment should be included in the total amount subject to Construction Overhead. It should be noted that ordinarily dehydration equipment (e.g. LTX Units) is considered normal production equipment and not subject to Construction Overhead.

(2) Water Stations

A water station will consist of the pumps, lines, tanks, treaters, and all other equipment necessary for a complete water system. The type of water stations or systems contemplated by paragraph No. 6, Section III of the COPAS-1968 Accounting Procedure would not include water systems and their related equipment used for camps, warehouses or office locations, or drilling locations.

(3) Secondary Recovery or Pressure Maintenance Installations

The below listed facilities should serve as a guide to the types of secondary recovery, additional recovery or pressure maintenance installations subject to Construction Overhead:

- (a) Waterflood
- (b) Gas Injection
- (c) Steam Injection
- (d) Fire Flood
- (e) Miscible Drive (LPG)

(4) Hydrocarbon Recovery Unit

(5) Gas Conditioning Plant

(6) Vapor Recovery Unit

(7) Salt Water Disposal Facilities

Salt Water Disposal facilities would consist of all necessary tanks, earthen reservoirs, pumps, treating equipment and lines.

(8) Other Such Projects

Construction Overhead should be allowed for other construction projects such as drilling and producing platforms and terminals that obligate an Operator to incur design and indirect supervision expenses that are not otherwise covered by Administrative Overhead or Combined Rates which apply to the usual drilling and producing operations.

Two or more of the above projects may be included in a secondary recovery, pressure maintenance or other similar installation, the total cost of which shall be considered as a single project.

B. Projects Not Covered by Construction Overhead

Construction Overhead would not apply to any projects that would be considered routine and usual lease installations including:

- (1) Pumping Units
- (1) Flow Lines
- (3) Tank Batteries
- (4) LACT Units
- (5) Dehydration Units (e.g. LTX)
- (6) Electrical Systems
- (7) Roads, Bridges, Canals

Projects of this nature are normally considered routine and usual lease installations which do not involve a significant amount of design and indirect supervision and for which the Operator receives compensation for such indirect costs through the Administrative Overhead or Combined Rate charges. It should be noted, however, that when the installation of such equipment is an integral part of a major construction project such as water stations, secondary recovery or pressure maintenance installations, and salt water disposal facilities, construction overhead may be applied to such costs.

Whether Construction Overhead may be applied will depend upon the intent of use for which the construction project was designed. For example, if a road and/or bridge was built for use on a lease or well, the indirect costs would be recovered through the Administrative Overhead rate. However, if the road and/or bridge was built for compressor plants, water stations, or other projects covered by construction overhead, the indirect cost of the road and/or bridge would be recovered through the construction overhead rate. Where unusual circumstances exist (such as a large LACT unit serving many different leases having divergent interest, major road construction, major dehydration installations, etc.) a separate agreement should be entered into to cover, among other things, Construction Overhead.

C. Unusual Major Projects

Where major installations or projects are constructed involving several leases, notwithstanding the projects enumerated in A. and B. of this paragraph No. 6, it may be more desirable to enter into a separate agreement covering not only the construction, but also the operations and subsequent changes in investment ownership that may occur.

D. Application of Rates

Rates for Construction Overhead are applied to a total gross cost of a single

project. Total gross cost means all direct costs charged to the project, reduced by the credits for refunds or returns. Additions, modifications, enlargements, etc., required at some date subsequent to the physical completion of the project would constitute a separate project.

7. Amendment of Rates

The rates may be amended by mutual agreement of the Parties or as applicable according to the voting provisions of the operating agreement to which the Accounting Procedure is attached.

IV. BASIS OF CHARGES TO JOINT ACCOUNT

1. Purchases

Operator will make reasonable efforts to take advantage of all discounts available.

2. Material Furnished from Operator's Warehouse or Other Properties

A uniform method of pricing new and used materials is necessary to provide a yardstick by which the Parties can operate with a minimum of difference regarding the pricing of materials.

A. New Material (Condition "A")

(1) Tubular Goods Pricing

Tubular goods, except line pipe, furnished from the Operator's warehouse or other properties, regardless of quantity transferred, should be priced on a maximum carload and/or barge load weight basis effective at date of movement and f.o.b. the Railway Receiving Point or Recognized Barge Terminal which is nearest the Joint Property and where such Material is normally available. The Railway Receiving Point or Recognized Barge Terminal to be used would be that location which a vendor would use in determining the sale price to the Operator for new tubular goods to be delivered to the Joint Property. The intent of this provision is to charge the Joint Account with no more than the prevailing mill base price f.o.b. the Railway Receiving Point or Recognized Barge Terminal nearest the Joint Property, whichever is the lesser, plus the transportation provided in paragraph No. 5 of Section II of the COPAS-1968 Accounting Procedure. Vendors have an established basis for efficient delivered pricing of the finished product to the rail point or barge terminal nearest the Joint Property. This constitutes the proper pricing basis for tubular goods the Operator furnishes from his warehouse or other properties. A "maximum carload basis" is interpreted to mean the minimum freight rate applicable to the area of the Joint Property. This may vary from 70,000 to 100,000 pound carloads depending on the area. A "barge load basis" is interpreted to mean the minimum rate applicable to a 600 ton barge load. The phrase "where such material is normally available" refers to those Railway Receiving Points or Recognized Barge Terminals used by the vendor in determining the price of the tubular goods purchased.

Special tubular goods, such as Hydril threaded, Hardy-Griffin threaded, doped and wrapped, plastic coated, etc., should be priced as defined above, to the Railway Receiving Point or Recognized Barge Terminal nearest the Joint Property, where such material is normally available, plus transportation to the shop or plant where the special service is performed, plus transportation from the shop or plant to the Joint Property. However, in no case shall the amount charged for hauling exceed the actual hauling costs incurred. Costs of the special services should be added to arrive at the delivered price.

(2) Line Pipe Pricing

Line pipe shall be priced at the current replacement cost effective at date of transfer from a Reliable Supply Store nearest the Joint Property, where such material is normally available, if the movement is less than 30,000 pounds. Line pipe is usually utilized on joint producing properties only in small quantities for flow lines and flare lines, the weight of which will not constitute a carload lot of 30,000 pounds. Movements of 30,000 pounds or more shall be priced the same as tubular goods.

The major suppliers will not equalize the cost of line pipe on purchases of less than 30,000 pounds; therefore, it is usually necessary for the Operator to obtain these small amounts of line pipe from a supply store at the higher out-of-stock price.

On the other hand, where there are major installations such as gas gathering systems, salt water disposal systems, and other construction requiring the use of quantities of line pipe, in excess of 30,000 pounds then the Operator could acquire the necessary pipe at the equalized price, and the Non-Operator should receive the benefit of the reduced cost.

(3) Loading and Unloading Costs

If hauling charges are equalized as per paragraph 5 of Section II Operator may include ten cents (10c) per hundredweight on all tubular goods furnished from his stocks in lieu of one loading at the warehouse or other property and one unloading at the Joint Property. If Operator charges ten cents (10c) per hundredweight, the actual cost of all loading and unloading should be absorbed by the Operator.

(4) Other Material - Pricing

Other material should be priced at the current replacement cost of the same kind of material, effective at date of movement and f.o.b. the Railway Receiving Point, as defined above, or the Reliable Supply Store nearest the Joint Property. Prices should be obtained from a reputable supplier's published price list. In some instances price lists are not distributed but are quoted by the supplier or manufacturer. If prices used are f.o.b. location, actual cost of transporting from Operator's warehouse or other properties should not be charged. Discontinued equipment should be priced the same as comparable equipment if manufactured; otherwise, the last available price of the discontinued equipment should be used.

Where current market condition pricing on large items of equipment will result in inequities, it is recommended that the Operator contact Non-Operators in order to arrive at an acceptable pricing basis.

(5) The Joint Account shall not be credited with cash discounts applicable to prices for material furnished from Operator's warehouse or other properties.

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

- (1) Material in sound and serviceable condition and suitable for reuse without reconditioning should be classified as Condition "B" and priced at seventy-five percent (75%) of the current price of new material.
- (2) Material which is not suitable for its original function until after reconditioning may be furnished to the Joint Account under one of the two methods defined below:

- (a) Classified as Condition "B" and priced at seventy-five percent (75%) of the current price of new material. The cost of reconditioning should be absorbed by the Operator or transferring property.
- (b) Classified as Condition "C" and priced at fifty percent (50%) of current price of new material. The cost of reconditioning should also be charged to the receiving property provided Condition "C" value, plus cost of reconditioning, does not exceed Condition "B" value.

Method (a) is preferred and recommended; however, either is acceptable if consistently applied.

- (3) Obsolete material or material which cannot be classified as Condition "B" or Condition "C" should be priced at a value commensurate with its use. Material no longer suitable for its original function, but suitable for some other function, should be priced on a basis commensurate with its use (i.e. casing, or tubing used as line pipe, sucker rods used as reinforcing steel or fencing, etc.)
- (4) Material involving erection costs should be priced at the applicable percentage of the current knocked-down price of new material. If such material is moved erected, the normal cost of erection should be added to the price of the material.

Current replacement costs should include sales tax that would be paid by the Operator if the material were purchased in the state in which the Joint Property is located.

3. Premium Prices

Premium prices shall not be charged prior to Operator notifying Non-Operators of such charge and Non-Operators shall have option of furnishing in kind material acceptable to the Operator.

4. Warranty of Material Furnished by Operator

Operator does not warrant material furnished to the Joint Property.

5. Equipment and Facilities Furnished by Operator

- A. The term "equipment and facilities" is used in the broad sense to include equipment both mobile, semi-mobile and permanent in nature, and also installations which may be semi-permanent or permanent in nature. Examples of such facilities and the recommended basis of charge are as follows:

<u>Facilities</u>	<u>Basis of Charge</u>
1. Mobile Equipment	
Airplanes	Hour
Automobiles	Mile/Hour
Trucks	Mile/Hour
Tractors	Hour
Bulldozers	Hour
Mobile Cranes	Hour
Trailer-mounted Test Separators	Hour
Truck-mounted Paraffin Scraping Units	Hour
Trailer-mounted Cement Mixers	Hour
Boats	Day
House Trailers	Day

<u>Facilities</u>	<u>Basis of Charge</u>
2. Semi-Mobile Equipment	
Drill Rigs	Foot/Day
Workover Rigs	Hour
Pulling Units	Hour
Derricks	Day
Drilling Tender	Day
Barges	Day
3. Semi-Permanent Installations	
Skid-mounted Separators	Day/Volume
Skid-mounted Compressors	Day/Volume
4. Permanent Installations	
Compressor Stations	Volume
Salt Water Disposal Wells	Volume/Wells
Fresh Water Wells and Supply Systems	Volume
Roads	Wells
Production Platform	Volume/Wells
Canals	Wells
Docks	Wells
Oil Storage and Loading Facilities	Volume/Wells
Gathering Systems	Volume/Wells
LACT Systems	Volume/Wells
Laboratory Services (ex- cluding research work)	Hour/Unit
District facilities	Allocation/Fixed Rate
5. Miscellaneous	
Drill Pipe	Foot/Day
Casing Setting Tools	Day
Well Testing Equipment	Day

Normally, the Joint Property rents the use of these facilities when in practice the Joint Property has need for only a small portion of the service available from the facility. As an example, one joint interest well located in proximity to a large number of wells wholly owned by the Operator will normally be furnished the services of a salt water disposal system or compressor system on a cost of service or rental basis. The same practice is true in the case of automobiles, trucks, and drilling equipment where the equipment may be in use only for a short time on the Joint Property.

Where the cost of the service is expected to be material or perhaps involves a greater than normal cost, the Operator is well advised to obtain a separate letter or some other type of agreement authorizing the charge. This is advisable because the Accounting Procedure is general in nature and limits the Operator to charge an amount not in excess of the rates normally prevailing in the fields. In many instances there is no established rate and it is necessary to rely upon Operator's cost in establishing the rates.

Although the rates charged by the Operator should be in line with those normally prevailing in the field, the Operator is also charged with the duties and acts of a

prudent individual experienced in oil field operations and technology; therefore, in cases of bona fide emergencies where time is of the essence, it is felt that the Operator is authorized to exceed the normal prevailing rates where time and circumstances dictate the use of facilities nearest at hand and do not afford the opportunity to shop for the lowest or prevailing cost.

In lieu of rates based on costs of ownership and operation of equipment, other than automotive, Operator may elect to use commercial rates prevailing in the area of the Joint Property less 20%. For automotive equipment, rates as published by the Petroleum Motor Transport Association may be used.

When the Operator's wholly owned facilities are used on the Joint Property and he elects to charge the Joint Account on the basis of costs of ownership and operation, he is entitled to recover the following types of costs prorated on the basis of time actually used on the Joint Property:

Labor, Maintenance, Repair, Depreciation of Investment including Overhead on Construction, Insurance, Interest on Investment and Taxes.

The current consensus is that an Operator should not charge the Joint Account for profit for the use of his equipment. The six percent (6%) interest on investment allowed is considered the cost of money and not a profit.

The greatest difficulty in determining reasonable depreciation is encountered in the case of permanent installations of the type of compressor stations and salt water disposal systems. In order to accommodate the Joint Property along with his own and other Joint Properties, the Operator will frequently install a larger installation than he needs for his own use. If a high rate of depreciation is not charged in the early life of the installation, later the Operator may be left with greater capacity than needed for his remaining wells; and thus the burden of having served the Joint Property is shifted to the Operator's sole account. Neither a depreciation rate based on unit of production nor a rate based on passage of time is entirely adequate to prevent such an inequity. Also, the cost of the foundations of these permanent installations, which are not salvable, is frequently equal to or greater than the equipment itself; therefore, if the installation is expected to be used for a period of one-half its useful life; the foundation, not being movable, must be fully depreciated, while the compressor itself should only be depreciated down to its expected salvage value. The cost of intangibles, such as transportation, dirt work, etc., not salvable, should be fully depreciated.

In those instances when the maintenance and repair cost of the facility is absorbed by the Operator, the depreciation rate should be considered in its appropriate relationship with these costs in establishing the overall rate. In the earlier life of the facility, maintenance and repair costs should be relatively insignificant; whereas, in the later life of the facility (when possibly the facility may be fully depreciated on Operator's books) the maintenance and repair costs would tend to increase substantially. It is, therefore, suggested that an equitable rate be determined to include not only depreciation, but maintenance and repair costs. This logic should be applied in general to categories 1. Mobile Equipment, 2. Semi-Mobile Equipment, 3. Semi-Permanent Installation, and 5. Miscellaneous Equipment. This factor of cost should continue in the rental charge throughout the life of the equipment, regardless of the fact that the facility might be fully depreciated on the Operator's books.

In those instances when the maintenance and repair costs of the facility are charged to the Joint Account, the depreciation rate should be considered separately from the

maintenance and repair costs. After giving proper consideration to salvage value, estimated service life, and other conditions mentioned above, an equitable depreciation rate should be determined to recover the Operator's cost. After such cost (including interest on investment, overhead on construction and other costs originally absorbed by Operator) has been recovered, the depreciation element of rental should be discontinued. This logic should generally be applied to Category 4., Permanent Installations.

The period of time a facility is charged to the Joint Account compared to the time the facility is actually in use is sometimes a matter of controversy and it is not always an easy matter to arrive at an equitable solution. Generally, in the case of categories 1. Mobile Equipment, 2. Semi-Mobile Equipment, 3. Semi-Permanent Installations and 5. Miscellaneous Equipment, charges should be made for the time a facility is at the exclusive disposal and use of the Joint Account and is required to be available on a standby basis to adequately serve the Joint Account. We assume, of course, that the Operator is a prudent one and does not move a facility into the service of a Joint Property before its use is required nor permit the facility to remain on or in the service of the Joint Property when it is not necessary. In the case of category 4. Permanent Installations, the period of time the facility is charged should generally be on the basis of actual time used. This would be appropriate for permanent compressor stations, salt water disposal wells, fresh water wells and supply systems, gathering systems and LACT systems. In other instances charges for facilities in this category (such as roads, canals, docks and oil storage and loading facilities) should be based on their availability for use if the service is of a continuing or permanent nature and by special agreement if the service is of a temporary nature.

The Joint Account should be charged with transportation of the facility to and from the Joint Property except when the facility is transferred to another service location, and charges should also include cost of setting up and dismantling the facility when such services are particularly required for the Joint Property.

In conclusion, where wholly owned facilities are rented to the Joint Property and the costs are anticipated to be equal to or less than the prevailing field price, the Operator can adequately pass these costs on under the provisions of the Accounting Procedure. In instances where the costs are expected to exceed the charge prevailing in the field or normal in industry in the area, the Operator should obtain prior agreement from the Non-Operators.

- B. Whenever requested, Operator shall inform Non-Operators in advance of the rates it proposes to charge.
- C. Rates for equipment shall be based on current costs of ownership.

V. DISPOSAL OF MATERIAL GENERAL

The Operating Agreement provides for the disposal of surplus material by the following methods:

1. Purchase by Operator or Non-Operators
2. Division in Kind
3. Sales to Outsiders

Proper credits to the Joint Account resulting from the disposition of surplus material by any one of the above methods should be reflected in the monthly statement covering the

period in which the transaction occurred. Material should not be removed from the Joint Property without a transfer or similar source document being prepared initiating credit to the Joint Account. Credit to the Joint Account is determined by the condition of the material and pricing provisions as set forth in the Operating Agreement, or as to sales, by the actual selling price, or by separate agreement of the Parties.

Junk material is normally held by Operator for the Joint Property until a reasonable quantity is accumulated and then sold to an outsider. The operating agreement usually provides that junk shall be disposed of by transfer or sale, indicating that Operator has the right to take such material into its 100 percent account; however, the most acceptable practice in the industry is to sell to an outsider.

1. Material Purchased by Operator or Non-Operators

The Operator has the prerogative, subject to contract limitations, to purchase for its own account surplus Condition "A" or "B" Material without approval of Non-Operators.

Reference to Condition "C" and "D" Material has been omitted from Section V of the COPAS-1968 Accounting Procedure. When Condition "C" Material is repaired or reconditioned for use under its original function and the Operator desires to take the Material into its 100 percent account, the most equitable method of handling this type Material is for the Joint Account to be charged with repair costs and for the Operator to grant credit at Condition "B" value in those instances where the cost of repairs, plus the value at Condition "C", do not exceed the value at Condition "B".

It is pertinent that any disposition of Controllable Material, regardless of condition value (except as to junk), which is not purchased by Operator, subject to limitations in the operating agreement, requires approval of Non-Operators. Occasionally Operator may desire to acquire a piece of equipment from a Joint Property that is properly of Condition "B" value, thereby requiring credit to the Joint Account at 75 percent of new value if the Material was new when charged to the Joint Account or 65 percent if originally charged as Condition "B" value Material; however, due to the age of the equipment and the fact that it is obsolete material, Operator may feel that 75 or 65 percent of new value is not equitable. Nevertheless, if Operator acquires the Material, it must grant credit in accordance with the provisions of the Accounting Procedure or obtain prior approval of Non-Operators for a stipulated value.

2. Division in Kind

Operator and Non-Operators may elect to divide, in proportion to each party's interest, surplus Material from the Joint Property. Due to the time, expense and inconvenience involved, such division of Material will be infrequent except as to shortage of Material or in secondary recovery projects where large quantities of Material often become surplus. At such time as a division does occur, Operator should bill the party or parties acquiring the Material as if it were a sale to an outsider and, upon receipt of payment, credit the Joint Account with the proceeds therefrom. In the event the Material or equipment involved is of such nature that division in kind would be impractical or impossible, the parties desiring the Material must agree as to its disposition; or if unable to do so, Operator shall sell the material as provided below.

3. Sales to Outsiders

Disposition of Material by this method is accomplished on the basis of competitive bidding in writing from outsiders. This will normally occur after it has been determined that neither Operator nor Non-Operators have need for the Material and approval has been obtained by Operator to dispose of the Material at the best price possible.

In the absence of explanatory detail in the operating agreement covering the disposition of Material, it is recommended that after approval has been obtained by the Operator to dispose of the Material, the interest owners, as well as outsiders, be allowed the opportunity to submit bids. If the high bid is satisfactory, the sale shall be made to the high bidder.

VI. BASIS OF PRICING MATERIAL TRANSFERRED FROM JOINT ACCOUNT

No Comments Necessary.

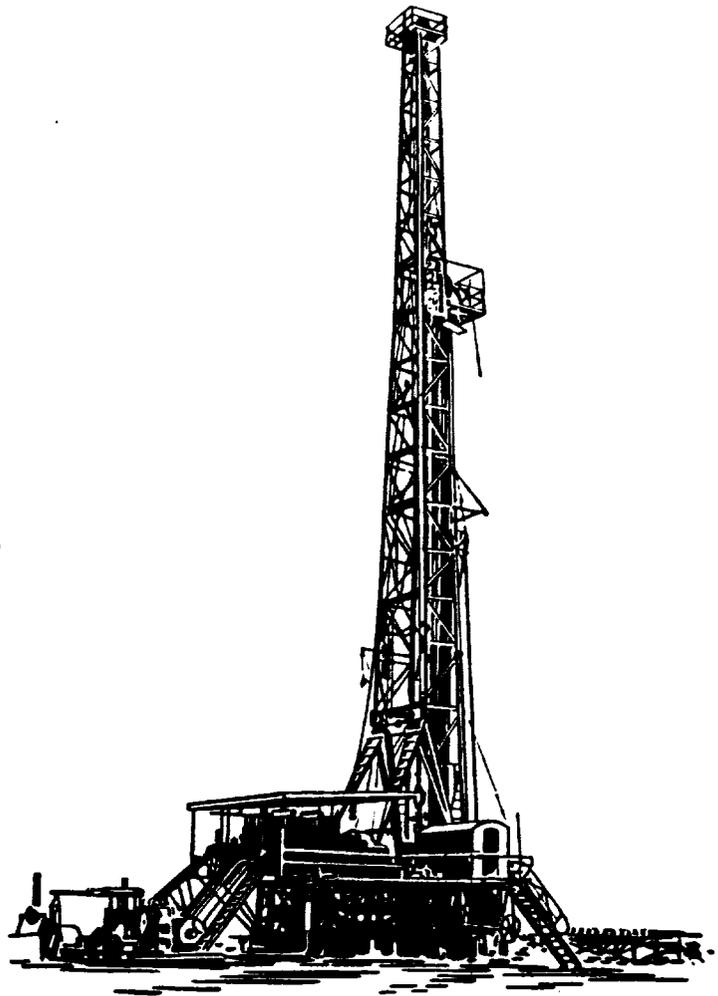
VII. INVENTORIES

No Comments Necessary.

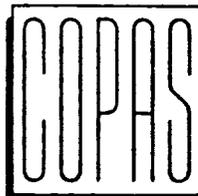
BULLETIN NO.

13

ACCOUNTING PROCEDURE
JOINT OPERATIONS
1975



RECOMMENDED BY



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May be purchased direct from the publisher
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October, 1975

FOREWORD

In view of the latest trends and requirements of accounting for the activities of the Petroleum Industry, the Petroleum Accountants Societies, through representation on the Council of Petroleum Accountants Societies of North America have reviewed and revised the Accounting Procedure for Joint Operations and recommend the COPAS-1974 Accounting Procedure.

This bulletin is to explain, interpret and elaborate on the provisions of the COPAS-1974 Accounting Procedure and to acquaint the user with the intent which the COPAS-1974 writers attempted to set forth.

The COPAS-1974 Accounting Procedure has been simplified and the numerous options which appeared in the previous Accounting Procedure have been eliminated. The new procedure should simplify Joint Interest Accounting Procedures throughout the country.

It is recommended that this bulletin be used as a guide to Joint Interest Operations Accounting in connection with all agreements to which COPAS-1974 is attached.

The bulletin does not replace COPAS Bulletins No. 5 and No. 8 which pertain to the COPAS 1962 and 1968 Accounting Procedures and it is not intended that the provisions of the COPAS-1974 Accounting Procedure replace the provisions of any other Accounting Procedure which is presently a part of any existing agreement except by agreement between the Parties to such agreement.

The Council is grateful to all of the Petroleum Accountants Societies for the work contributed to the finalization of this bulletin. Special consideration is due the Petroleum Accountants Society of Los Angeles for their work in preparing the initial draft of the bulletin.

EXHIBIT " "

Attached to and made a part of

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**ACCOUNTING PROCEDURE
JOINT OPERATIONS**

I. GENERAL PROVISIONS

1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

2. Statement and Billings

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

3. Advances and Payments by Non-Operators

Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the rate of twelve percent (12%) per annum or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts.

4. Adjustments

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

5. Audits

A. Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct joint or simultaneous audits in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operator's audit cost incurred under this paragraph unless agreed to by the Operator.

6. Approval by Non-Operators

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

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. Rentals and Royalties

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

2. Labor

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

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

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

- B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II. Such costs under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 2A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.
- C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II.
- D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II.

3. Employee Benefits

Operator's current costs of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II shall be Operator's actual cost not to exceed twenty per cent (20%).

4. Material

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

5. Transportation

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

- A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by the Parties.
- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.
- C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking cost of \$200 or less excluding accessorial charges.

6. Services

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 9 of Section II and Paragraph 1. ii of Section III. The cost of professional consultant services and contract services of technical personnel directly engaged on the Joint Property if such charges are excluded from the Overhead rates. The cost of pro-

fessional consultant services or contract services of technical personnel not directly engaged on the Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.

7. Equipment and Facilities Furnished by Operator

- A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on investment not to exceed eight per cent (8%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.
- B. In lieu of charges in Paragraph 7A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

8. Damages and Losses to Joint Property

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

9. Legal Expense

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

10. Taxes

All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof, or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties.

11. Insurance

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

12. Other Expenditures

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

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

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

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

Unless otherwise agreed to by the parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 2A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the Overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

- ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property shall () shall not () be covered by the Overhead rates.

A. Overhead - Fixed Rate Basis

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

Drilling Well Rate \$ _____

Producing Well Rate \$ _____

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

(a) Drilling Well Rate

- [1] Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.
- [2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.
- [3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

- [1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.
- [2] Each active completion in a multi-colored well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.

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

B. Overhead - Percentage Basis

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

- (a) Development _____ Percent (%) of the cost of Development of the Joint Property exclusive of costs provided under Paragraph 9 of Section II and all salvage credits.
- (b) Operating _____ Percent (%) of the cost of Operating the Joint Property exclusive of costs provided under Paragraphs 1 and 9 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.

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

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

2. Overhead - Major Construction

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess of \$ _____:

- A. _____ % of total costs if such costs are more than \$ _____ but less than \$ _____; plus

- B. _____% of total costs in excess of \$_____ but less than \$1,000,000; plus
C. _____% of total costs in excess of \$1,000,000.

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

3. Amendment of Rates

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

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

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

1. Purchases

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

2. Transfers and Dispositions

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

A. New Material (Condition A)

- (1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.
- (2) Line Pipe
 - (a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.
 - (b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

B. Good Used Material (Condition B)

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

(1) Material moved to the Joint Property

(a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV.

(2) Material moved from the Joint Property

(a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged to the Joint Account as new Material, or

(b) at sixty-five percent (65%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged to the Joint Account as good used Material at seven-five percent (75%) of current new price.

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

C. Other Used Material (Condition C and D)

(1) Condition C

Material which is not in sound and serviceable condition and not suitable for its original function until after reconditioning shall be priced at fifty percent (50%) of current new price as determined by Paragraph 2A of this Section IV. The cost of reconditioning shall be charged to the receiving property, provided Condition C value plus cost of reconditioning does not exceed Condition B value.

(2) Condition D

All other Material, including junk, shall be priced at a value commensurate with its use or at prevailing prices. Material no longer suitable for its original purpose but usable for some other purpose, shall be priced on a basis comparable with that of items normally used for such other purpose. Operator may dispose of Condition D Material under procedures normally utilized by the Operator without prior approval of Non-Operators.

D. Obsolete Material

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

E. Pricing Conditions

(1) Loading and unloading costs may be charged to the Joint Account at the rate of fifteen cents (15¢) per hundred weight on all tubular goods movements, in lieu of loading and unloading costs sustained, when actual hauling cost of such tubular goods are equalized under provisions of Paragraph 5 of Section II.

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

3. Premium Prices

Whenever Material is not readily obtainable at published or listed prices because of national emergencies, strikes or other unusual causes over which the Operator has no control, the Operator may charge the Joint Account for the required Material at the Operator's actual cost incurred in providing such Material, in making it suitable for use, and in moving it to

the Joint Property; provided notice in writing is furnished to Non-Operators of the proposed charge prior to billing Non-Operators for such Material. Each Non-Operator shall have the right, by so electing and notifying Operator within ten days after receiving notice from Operator, to furnish in kind all or part of his share of such Material suitable for use and acceptable to Operator.

4. Warranty of Material Furnished by Operator

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

V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

Reconciliation of a physical inventory with the Joint Account shall be made, and a list of overages and shortages shall be furnished to the Non-Operators within six months following the taking of the inventory. Inventory adjustments shall be made by Operator with the Joint Account for overages and shortages, but Operator shall be held accountable only for shortages due to lack of reasonable diligence.

3. Special Inventories

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

4. Expense of Conducting Periodic Inventories

The expense of conducting periodic Inventories shall not be charged to the Joint Account unless agreed to by the Parties.

I. GENERAL PROVISIONS

1. Definitions

No comments necessary

2. Statement and Billings

Charges and credits should be classified to enable Non-Operator to meet government requirements and make proper distribution between capital expenditures (segregated by tangibles and intangibles) and operating expenses, and further identified as labor, Material, transportation, contract services, employee benefits, Overhead by type and other such classifications.

The statement should detail Controllable Material as to quantity, description, price, sales tax, condition and other appropriate information for accounting purposes.

The statement should detail any unusual charges and credits applicable to the Joint Account. Examples of such transactions would be lease rentals, ad valorem taxes, legal expenses, damages, well contributions, audit adjustments and audit expenses. Each authority for expenditure should be identified by AFE number and further identified by well number, facility, project or other appropriate identification.

3. Advances and Payments by Non-Operators

Remittances should be made promptly by the Non-Operators in accordance with the terms of the contract. If such remittances are not made timely, interest should accrue monthly on the unpaid balance at the stipulated rate. It is recognized, subject to provisions to the contrary, that the Operator has advanced his money to finance the operations; and, if the remittances by Non-Operator are timely, or if interest payments are made on delinquent accounts, the Non-Operator still enjoys a more favorable financial position. It is suggested that interest applied by Operators when applicable should be accepted without reservation or criticism by Non-Operators who do not remit in accordance with the provisions of the contract. To encourage the enforcement of this provision, any policy by the Operator of placing a notation on his billings to the effect that the interest provision is to be applied is hereby sanctioned. Attention is directed to the maximum contract interest rates permitted by the applicable usury laws.

When the Non-Operators are required by Operator to advance their share of the estimated cash outlay for the succeeding month's operation, the amount of such cash advances paid in excess of actual expenditures shall be adjusted by Operator on the next monthly billing. Cash advances may be requested in the case of major capital projects, abnormally high costs of an unusual nature, or for expense work involving extraordinarily large expenditures and not necessarily used on a continuing basis for the routine operations.

4. Adjustments

The monthly Joint Account billing should be paid as rendered by the Operator. If any item on the Operator's statement is questionable, the payment for such item should be included by the Non-Operator with the remainder of the billing. A request for an adjustment or explanation of the item in question should be directed promptly to the Operator. The Operator should answer such request promptly; and if an adjustment is in order, he should issue a credit (or debit) memorandum or advise the Non-Operator of the corrections on the next monthly billing. A request for adjustment or explanation shall not change the normal two-year formal audit limitation unless agreed to by the Operator.

When the total monthly billing to a particular Non-Operator's account reflects a credit balance, the Operator's check should accompany the billing to settle the account, except where inventory and/or ownership adjustments are involved. In these instances some Operators effect distribution after collection of sufficient funds from the Non-Operators.

5. Audits

Reference is made to the COPAS Bulletin No. 3, "The Initiation of Joint Account Audits, Audit Protocol and Auditing Guides in the Petroleum Industry".

Replies to audits should be made on a timely basis to avoid long delays in resolving exceptions.

6. Approval by Non-Operators

This provision prohibits a minority in interest of the Non-Operators from vetoing approval by a majority in interest of the Non-Operators. This provision does not apply to Section III Overheads, Paragraph 3 Amendment of Rates, which requires mutual agreement of the Parties.

II. DIRECT CHARGES

1. Lease Rentals and Royalties

No comments necessary

2. Labor

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

Field employees are defined as employees below First Level Supervisor directly employed on the Joint Property. In most instances the original time sheets or some other written documentation should show the time spent on any particular job or Joint Property; and the charge should be based upon such time shown. In some instances, however, certain employees may directly serve a number of properties, each having one or more wells, and it may not be practical nor equitable to use time as a basis for the charge due to location of employees' headquarters (dog houses, etc.), travel time required, common facilities serving properties manned by the employee and other reasons. In such instances, it is sometimes more feasible to allocate the charge to all properties served on a well, or other equitable basis, than on the time spent on the individual properties.

- (2) Salaries of First Level Supervisors in the field".

In addition to supervising basic lease and facility operation and maintenance, the First Level Supervisors may spend part of their time supervising special construction projects and overseeing drilling and well remedial work.

The First Level Supervisors do not have an engineering or administrative staff and rely upon the staff associated with an administrative or functional office above the first level of supervision for these services, which are included in the Overhead.

The salaries and wages incurred by the First Level Supervisors may be charged direct or apportioned to all properties served on an equitable basis consistent with the Operator's accounting practices. Due to the variation in job classifications assigned to First Level Supervisors by the various Operators, it is recommended that the Parties be in agreement as to which job classifications are to be considered as First Level Supervisors at the time the agreement is negotiated.

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

Time worked under this provision is generally charged in increments of a full work day. It is not intended that the Joint Account will be charged for the salaries and wages of Technical Employees after the specific operating condition or problem requiring their service ceases to exist. Technical Employees usually have no supervisory authority except that required to resolve the particular problem to which they are assigned.

- B. Operator's cost of holiday, vacation, sickness, disability benefits, jury duty and excused allowances are recognized Joint Account costs, chargeable on a "when and as paid" basis or by "percentage assessment". Unless an employee is regularly assigned to a particular property for the entire year, it is very difficult to make an equitable charge by the "when and as paid" basis. It is generally agreed that the "percentage assessment" provides a more equitable distribution of these costs. It is recommended that the "percentage assessment" be reviewed currently and that proper adjustments be made in the rate to provide, over a period of time, that actual costs are distributed to the properties served. This may require that any balance in the accrual account be used in determining the new adjusted rate.

- C. Costs pursuant to governmental authority are recognized Joint Account costs. Since these costs are limited, being based upon a maximum amount earned by each employee and the maximum earnings may be different for each category of charge, the cost terminates at various times during the year for individual employees. Although it is acceptable to determine the average time for payout of each category and discontinue such charges at the expiration of that period, this usually produces inequities in charges to the individual properties. This is particularly true if a property is discontinued in the early part of the year, or begins operations in the latter part of the year. For this reason, it is recommended that a percentage be determined for twelve months to spread the costs over the entire year.
- D. Travel and reimbursable Personal Expenses of those employees serving the Joint Property should be charged equitably and consistent with wages and salaries as provided under "A" above. Personal Expenses may include relocation expenses such as real estate fees, closing costs, compensation for loss on sale of home, carpeting and drapery expenses, etc., unless such move is for the primary benefit of the Operator.

3. Employee Benefits

Employee benefits are generally considered to be a part of the employer's total labor cost. The operating agreement usually provides that the Operator shall charge the Joint Account with the current cost of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus and other benefit plans of a like nature applicable to Operator's labor cost, provided however, the total of such charges shall not exceed the contract limitations. Employee benefits may be generally defined as the types of plans enumerated above and other established plans, such as supplemental or catastrophic medical insurance for employees and dependents, accident and disability insurance and military service benefits which provide for the welfare of the Operator's employees, their families or beneficiaries, and which are made available to all employees of the Operator on an equitable basis. The cost of such plans may be borne entirely by the Operator or jointly by the Operator and the employees. Only the Operator's share of these costs is chargeable to the Joint Account.

Established plans are those made available to all employees on a regular basis. Such plans may be established in accordance with and subject to collective bargaining agreements.

Costs which are primarily beneficial to the Operator should be excluded from employee benefits and treated as Overhead, for which the Operator is compensated under the provisions of Section III. Such costs to be borne by the Operator would include industrial nurse or doctor, safety awards, service awards, employees' credit union, company magazines and periodicals, social functions, dinners and programs for retirements, safety, etc., recreational programs, and facilities, Christmas bonuses given to selected employees and other special benefits available only to executives, certain employees or groups on a selective basis.

Charges may be made to the Joint Account for benefit plans expense on a "when and as paid" basis or by "percentage assessment" on the amount of the labor costs. It is generally agreed that the "percentage assessment" provides a more equitable distribution of these costs. If the "percentage assessment" method is used, it should be based on the Operator's actual cost experience, however, the application of a rate determined from the preceding year's experience may be considered as compliance with the "current cost" requirement. Under either method the Operator's own cost of administering such plans should be excluded. In determination of actual cost experience, any dividends or refunds received which are applicable to insurance or annuity policies should be used to reduce the cost of such policies.

There is considerable variation in the actual cost of benefit plans in various companies in the industry. Some of the factors causing these variations are number of employees; average age of employees; types of plans established; methods of funding (contributory or non-contributory, trustee or insured) and collective bargaining agreement requirements. Since

these wide variations exist, a limitation of twenty percent (20%) is established. The Operator should determine annually whether his costs equal or exceed the stipulated percent of labor before continuing to make charges at that rate. The "percentage assessment" or "when and as paid" rate is applicable to the Operator's labor costs under Section II, Paragraphs 2A and 2B which are chargeable directly to the Joint Account but not applicable to Overhead charges or contract labor.

4. Material

No comments necessary,

5. Transportation

Transportation expense can be defined as the "cost incurred from the point where Material and/or personnel is ready for movement until the cargo reaches its destination or delivery point." This activity is largely of a physical or mechanical nature and is readily adaptable to standardization and control.

Transportation shall include all costs incurred in the transportation of employees, equipment, Material and supplies necessary for the development, maintenance, and operation of the Joint Property.

Transportation cost of employees directly engaged on the Joint Property should be charged as a direct cost. Transportation cost for employees serving all properties in the operating area shall be allocated on the same basis as their salaries and wages. Transportation costs of transferred employees directly employed on the Joint Property, including the cost of moving their household goods and personal effects, shall be a direct charge unless such move is for the primary benefit of the Operator.

Transportation costs of Material necessary for the Joint Operations shall be charged to the Joint Account. In Paragraphs 5A and 5B of the Accounting Procedure the following definitions are applicable:

Reliable supply store shall mean a recognized source or common stock point for the particular Material involved.

Railway receiving point or recognized barge terminal shall mean that location which a vendor would use in determining the sale price to the Operator of new Material to be delivered to the Joint Property.

6. Services

Professional consulting services and contract services of technical personnel are charged direct under the provisions of this paragraph if under the same circumstances Technical Employees of the Operator would be charged direct. Charges under any other circumstances require prior agreement by the Parties.

7. Equipment and Facilities Furnished by Operator

The term equipment and facilities is used in the broad sense to include equipment which may be mobile or semi-mobile and also installations which may be semi-permanent or permanent in nature. Examples of such facilities and the recommended basis of charge are as follows:

<u>Equipment/Facilities</u>	<u>Basis of Charge</u>
1. Mobile Equipment	
Aircraft	Hour
Automobiles	Mile/Hour
Trucks	Mile/Hour
Tractors	Hour
Bulldozers	Hour
Mobile Cranes	Hour
Trailer-mounted Test Separators	Hour
Truck-mounted Paraffin Scraping Units	Hour
Trailer-mounted Cement Mixers	Hour
Boats	Day
House Trailers	Day
2. Semi-Mobile Equipment	
Drill Rigs	Foot/Day
Workover Rigs	Hour
Pulling Units	Hour
Derricks	Day
Drilling Tender	Day
Barges	Day
3. Semi-Permanent Installations	
Skid-mounted Separators	Day/Volume
Skid-mounted Compressors	Day/Volume
4. Permanent Installations	
Compressor Stations	Volume
Salt Water Disposal Wells	Volume/Wells
Fresh water Wells and Supply Systems	Volume
Roads	Wells
Production Platform	Volume/Wells
Canals	Wells
Docks	Wells
Oil Storage and Loading Facilities	Volume/Wells
Gathering Systems	Volume/Wells
LACT Systems	Volume/Wells
Laboratory Services (excluding research work)	Hour/Unit
5. Miscellaneous	
Drill Pipe	Foot/Day
Casing Setting Tools	Day
Well Testing Equipment	Day

Normally, the Joint Property rents the use of these facilities when in practice the Joint Property has need for only a small portion of the service available from the facility. As an example, one joint interest well located in proximity to a large number of wells wholly owned by the Operator will normally be furnished the services of a salt water disposal system or compressor system on a cost of service or rental basis. The same practice is true in the case of automobiles, trucks, and drilling equipment where the equipment may be in use only for a short time on the Joint Property.

Where the cost of the service is expected to involve a greater than normal cost, the Operator is well advised to obtain a separate letter or some other type of agreement authorizing the charge. This is advisable because the Accounting Procedure is general in nature and limits the Operator to charge an amount not in excess of the rates normally prevailing in the field. In many instances there is no established rate and it is necessary to rely upon Operator's cost in establishing the rates.

Although the rates charged by the Operator should be in line with those normally prevailing in the field, the Operator is also charged with the duties and acts of a prudent individual experienced in oil field operations and technology; therefore, in cases of bona fide emergencies where time is of the essence, it is felt that the Operator is authorized to exceed the normal prevailing rates where time and circumstances dictate the use of facilities nearest at hand and do not afford the opportunity to shop for the lowest or prevailing cost.

When the Operator's wholly owned facilities are used on or serve the Joint Property and he elects to charge the Joint Account on the basis of costs of ownership and operation, he is entitled to recover his costs including interest on investment less depreciation prorated on the basis of time actually used on or serving the Joint Property. Such costs should include labor, maintenance, repair, depreciation of investment including overhead on construction, insurance, interest on investment less depreciation and applicable taxes.

The current consensus is that an Operator should not charge the Joint Account a profit for the use of his equipment. The eight percent (8%) interest allowed on investment less depreciation is considered the cost of money and not a profit.

The greatest difficulty in determining reasonable depreciation is encountered in the case of permanent installations of the type of compressor stations and salt water disposal systems. In order to accommodate the Joint Property along with his own and other Joint Properties, the Operator will frequently install a larger installation than he needs for his own use. If a high rate of depreciation is not charged in the early life of the installation, later the Operator may be left with greater capacity than needed for his remaining wells; and thus the burden of having served the Joint Property is shifted to the Operator's sole account. Neither a depreciation rate based on unit of production nor a rate based on passage of time is entirely adequate to prevent such an inequity. Also, the cost of the foundations of these permanent installations, which are not salvable, is frequently equal to or greater than the equipment itself; therefore, if the installation is expected to be used for a period of one-half its useful life; the foundation, not being movable, must be fully depreciated, while the compressor itself should only be depreciated down to its expected salvage value. The cost of intangibles, such as transportation, dirt work, etc., not salvable, should be fully depreciated.

In those instances when the maintenance and repair cost of the facility is absorbed by the Operator, the depreciation rate should be considered in its appropriate relationship with these costs in establishing the overall rate. In the earlier life of the facility, maintenance and repair costs should be relatively insignificant; whereas, in the later life of the facility (when possibly the facility may be fully depreciated on Operator's books) the maintenance and repair costs would tend to increase substantially. It is, therefore, suggested that an equitable rate be determined, the elements of cost to include not only depreciation, but maintenance and repair costs. These elements of cost should continue in the rental charge throughout the life of the equipment, regardless of the fact that the facility might be fully depreciated on the Operator's books. This logic should be applied in general to categories 1. Mobile Equipment, 2.

Semi-Mobile Equipment, 3. Semi-Permanent Installation, and 5. Miscellaneous equipment.

In those instances when the maintenance and repair costs of the facility are charged to the Joint Account, the depreciation rate should be considered separately from the maintenance and repair costs. After giving proper consideration to salvage value, estimated service life, and other conditions mentioned above, an equitable depreciation rate should be determined to recover the Operator's cost. After such cost (including interest on investment, Overhead on construction and other costs originally absorbed by Operator) has been recovered, the depreciation element of rental should be discontinued. This logic should be generally applied to Category 4., Permanent Installations.

The period of time a facility is charged to the Joint Account compared to the time the facility is actually in use is sometimes a matter of controversy and it is not always an easy matter to arrive at an equitable solution. Generally, in the case of categories 1. Mobile Equipment, 2. Semi-Mobile Equipment, 3. Semi-Permanent Installations and 5. Miscellaneous Equipment, charges should be made for the time a facility is at the exclusive disposal and use of the Joint Account and is required to be available on a standby basis to adequately serve the Joint Account. We assume, of course, that the Operator is a prudent one and does not move a facility into the service of a Joint Property before its use is required nor permit the facility to remain on or in the service of the Joint Property when it is not necessary. In the case of category 4. Permanent Installations, the period of time the facility is charged should be generally on the basis of actual time used. This would be appropriate for permanent compressor stations, salt water disposal wells, fresh water wells and supply systems, gathering systems and LACT systems. In other instances charges for facilities in this category (such as roads, canals, docks and oil storage and loading facilities) should be based on their availability for use if the service is of a continuing or permanent nature and by special agreement if the service is of a temporary nature.

The Joint Account should be charged with transportation of the facility to and from the Joint Property except when the facility is transferred to another service location, and charges should also include cost of setting up and dismantling the facility when such services are particularly required for the Joint Property.

Where wholly owned facilities are rented to the Joint Property and the costs are anticipated to be equal to or less than the prevailing field price, the Operator can adequately pass these costs on under the provisions of the Accounting Procedure. In instances where the costs are expected to exceed the charge prevailing in the field or normal in industry in the area, the Operator should obtain prior agreement from the Non-Operators.

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

8. Damages and Losses to Joint Property

The generally accepted operating agreement provides that cost incurred for repairs or replacement of Joint Property because of damage or loss shall be borne by the Joint Account. Damages or losses to the Joint Property because of fire, lightning, windstorm, hurricane, hail, smoke, explosion, flood, theft, accident, vandalism, malicious mischief or any other cause are recognized Joint Account costs except to the extent that the damages or losses resulted from gross negligence or wilful misconduct on the part of the Operator.

As soon as practicable the Operator should notify Non-Operators in writing of the damage or loss giving the time, cause, extent and the estimated charge to the Joint Account. The Operator should also give immediate notice to the insurance carrier, if the Joint Property is covered by insurance, and protect the property from further damage. If the loss results from theft, vandalism or malicious mischief, the proper law enforcement agency should be notified.

If any equipment is destroyed or removed from the Joint Property, the Operator should furnish Non-Operators enough information to enable them to make proper entries to their investment records.

Any settlement received from an insurance carrier should be credited to the parties participating in any Joint Property insurance coverage.

9. Legal Expense

Expenses, other than attorneys' services, incurred in handling, investigating and settling litigation or claims arising by reason of Joint Operations, or necessary to protect or recover the Joint Property, including court costs, costs of investigation or procuring evidence and amounts paid in settlement or satisfaction of any litigation or claim, are recognized as direct Joint Account costs. It should be recognized that these direct costs are subject to the limitation on expenditures provided in the operating agreement. These charges expressly relate only to such costs in connection with litigation and claims.

No charge shall be made for services of Operator's legal staff or fees and expenses of outside counsel unless agreed to by the Parties. Otherwise, costs of such services are considered covered by the Overhead. An exception is those costs in connection with the collection of unpaid amounts as provided in Section I, Paragraph 3, of the Accounting Procedure.

There are, however, other legal expenses which arise by reason of the Joint Operations, such as drilling contracts and other contracts of all kinds, title examination and curative activities, gas and oil sales and other disposition, division orders and many other activities relating to the Joint Property. All of these are considered to be covered by the Overhead, whether rendered by staff or outside attorneys, unless agreed to by the Parties.

If some unusual and special activity occurs requiring legal services for the benefit of the Parties to the operating agreement, it would be anticipated that the Parties would consent, as necessary, to a direct charge for such services.

Through the use of the procedures outlined in the above paragraphs, an Operator with little or no legal staff and an Operator who has such a staff but uses outside counsel for all or some of such functions will be treated equally with an Operator who has and uses such a staff.

10. Taxes

No comments necessary.

11. Insurance

The costs of net premiums for insurance required to be carried for the Joint Operations for the protection of the Parties are chargeable to the Joint Account. The types and amounts of insurance are to be agreed upon by the Parties and are usually included in the operating agreement. Net premiums are those premiums paid by the Operator less any refunds or rebates.

The following are types of insurance commonly required to be carried:

- A. Workmen's Compensation and Employer's Liability Insurance which is designed to cover a company's liability to its employees for on-the-job injuries. This obligation to be insured is required by law in most states; however, some permit self-insurance in which case actual cost should be charged not to exceed state manual rates.

It should be noted that there is no Federal Administration or regulation of the insurance requirements offshore, other than the coverage required under the Longshoremen and Harbor Workers Act and the Seamen's Coverage under the Jones Act, etc. Consequently, there are no manual rates specifically applicable to offshore operations beyond the jurisdiction of the adjacent states. With respect to the computation of costs under an Operator's self-insurance program for offshore operations, the common practice is to add the cost of additional specific coverages required offshore to the current manual rates applicable to the adjacent state.

An equitable charge, based on direct labor of all employees assigned to operations conducted for all business activities of the Operator within a state requiring a deposit fund, allocating an imputed interest allowance at eight (8%) per annum of the amount of the deposit fund required would be an acceptable method of determining this element of cost plus actual losses associated with the Joint Operation.

- B. Comprehensive Automobile Liability Insurance which protects the Operators from damages resulting from the use of jointly owned vehicles. In addition to the liability coverage in the policy, there is usually an endorsement adding fire, theft and additional comprehensive coverage which provides protection for physical damage to, or loss of, the vehicles.
- C. Comprehensive General Liability Insurance which provides protection to the Parties from claims by third parties. The primary coverage in this base policy may be supplemented by additions to cover specific risks.

An Operator having an insurance program providing wide coverage to all types of business activities with varying degrees of risk of which even portions of all risks may be or may not be self-insured for the Joint Account may charge the Joint Account on an equitable basis the combined self-insured portion and premium cost not to exceed the manual rates established by the regulatory agency of the state in which Joint Operations are conducted.

- D. Additional insurance may be required for offshore operations, such as:
 - 1. Longshoremen and Harbor Workers Compensation Insurance under the United States Longshoremen and Harbor Worker's Compensation Act, Marine and voluntary coverage or similar coverage which may be required for operations outside the continental limits of the United States.
 - 2. Vessels, Hull and Machinery Insurance to the extent of sound value.
 - 3. Waterborne Cargo Insurance to the extent of sound value.

No charge for insurance premiums on automotive equipment owned exclusively by Operator should be made to the Joint Account except as otherwise provided in the operating agreement.

12. Other Expenditures

No comments necessary

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

- i. This section provides that other costs not provided for as Direct Charges under Section II shall be recovered under the Overhead provisions on the basis of either a fixed rate or percentage rate and is adequately explained in Paragraph i of the Accounting Procedure.
- ii. This paragraph provides for the election of charging Technical Employees direct or including these costs in the Overhead rate. Costs of professional consultant services and contract services of technical personnel are closely related and should be treated the same as Technical Employees.

Including these costs in the Overhead rate eliminates areas of controversy on the propriety of some Direct Charges and additional audit costs. However, if the election is made to charge Technical Employees direct, it is recommended that the Parties be in agreement as to what Technical Employees are to be included as Direct Charges at the time the agreement is negotiated.

A. Overhead - Fixed Rate Basis

The well rates specified in the Accounting Procedure and the well status information for the associated jointly owned property are the only elements necessary for the Operator to administer or the Non-Operators to verify.

The basis for determining commencement and termination of Overhead charges at the Drilling Well Rates for offshore wells differs from that used for onshore wells. With respect to those properties located in bays and along the coastal areas, the Parties should be in agreement as to which Overhead basis will apply before the operating agreement is approved.

The use of Fixed Rate Basis eliminates the fluctuation of indirect charges that frequently occur with district expense allocations. Consequently, changes in drilling activity or well count on other properties under the Operator's jurisdiction have no effect on the Overhead charges to the Joint Account. An Operator may also move, consolidate, or redefine the functions of the various offices indirectly serving the property without affecting the Overhead costs chargeable to the Joint Account. Each property is unaffected by the activities of other properties.

In applying the Overhead adjustment, the adjustment should be applied to the Overhead rates applicable to the wells being drilled or produced during the period beginning April 1st without regard to the calendar month in which the adjustment is recorded or billed by the Operator.

B. Overhead - Percentage Basis

The Percentage Basis is designed to recover more of the Operator's Overhead costs at the time the Operator incurs such costs. Overhead provided by an Operator may fluctuate in direct relation to the fluctuation of Development and Operating costs. Application of percentage Overhead rates will result in higher Overhead charges when higher drilling or operating costs are incurred. Percentage Overhead also has the effect of recovering additional Overhead costs during inflationary periods as costs rise. On large producing properties where the average operating costs per well have been substantially reduced, the average Overhead charge per well will usually be less on a Percentage Basis than on a Fixed Rate Basis. The base used for applying the agreed percentage provisions is the total chargeable costs currently billed less certain specific exclusions which are explained under Paragraphs (1) (a) and (1) (b) of the Accounting Procedure.

The term "salvage credits" as used in the Percentage Basis provisions for recovering Operator's Overhead is defined as the amount credited to the Joint Account resulting from the disposal of any Material and equipment previously installed on the property and charged to the Joint Account. Unless such salvage credits are excluded from current costs and credits when computing the basis to which percentage Overhead rates are applied, the Operator would, in effect, be refunding compensation previously earned at the time the disposed-of items were originally installed.

Credits resulting from the return of any unused Material and equipment to a supplier or transfers to jointly-owned or 100 percent-owned stores stock should not be considered as salvage credits, but should be used to reduce the basis to which Overhead rates are applied.

Injected substances purchased and all taxes and assessments which are levied on the mineral interests are excluded from the Overhead calculation since the administrative effort involved is not proportionate to the costs incurred for these items.

2. Overhead - Major Construction

The provisions of this paragraph permit the Parties to establish a minimum amount before any construction project qualifies as Major Construction to which the appropriate rate would be applied as further defined in the paragraph. Overhead on any project costing less than the

minimum amount would be included in the Fixed Rate Basis if that basis for Overhead was elected, or in the case of the Percentage Basis the Development rate would apply. This procedure eliminates many auditing problems and controversies over whether or not a specific project is Major Construction.

In negotiating construction Overhead rates, special consideration should be given as to whether construction projects including engineering design and specifications, etc. will be performed wholly or in part by a third party contractor as opposed to being performed by Operator.

Overhead rates are applied to total gross cost of a single project. Total gross cost means all direct costs charged to the project, reduced by the credits for refunds or returns. Additions, modifications, enlargements, etc., required at some date subsequent to the physical completion of the project would constitute a separate project.

At the time of negotiations, special consideration should be given to provide for an appropriate Overhead rate for major repair projects, such as: subsea pipeline breaks, oil spills or other major catastrophies, platform dismantling, etc. whether performed by the Operator or wholly or in part by a third party contractor.

3. Amendment of Rates

No comments necessary

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

Division of Material in kind, if made between Operator and Non-Operators, shall be in proportion to the respective interests in such Material. The Parties will thereupon be charged individually with the value of the Material received or receivable. Proper credits shall be made by the Operator to the Joint Account.

1. Purchases

Operator will make reasonable efforts to take advantage of all discounts available.

2. Transfers and Dispositions

A. New Material (Condition "A")

(1) Tubular Goods Pricing

Tubular goods, except line pipe, furnished from the Operator's warehouse or other properties, regardless of quantity transferred, should be priced on a maximum carload or barge load weight basis effective at date of movement and f.o.b. the railway receiving point or recognized barge terminal which is nearest the Joint Property and where such Material is normally available. The railway receiving point or recognized barge terminal to be used would be that location which a vendor would use in determining the sale price to the Operator for new tubular goods to be delivered to the Joint Property. The intent of this provision is to charge the Joint Account with no more than the prevailing mill base price f.o.b. the railway receiving point or recognized barge terminal nearest the Joint Property, whichever is the lesser, plus the transportation provided in Paragraph No. 5 of Section II of the Accounting Procedure. Vendors have an established basis for efficient delivered pricing of the finished product to the rail point or barge terminal nearest the Joint Property. This constitutes the proper pricing basis for tubular goods which the Operator furnishes from his warehouse or other properties. A "maximum carload basis" is interpreted to mean the minimum freight rate applicable to the area of the Joint

Property. This may vary from 70,000 to 100,000 pound carloads depending on the area. A "barge load basis" is interpreted to mean the minimum rate applicable to a 600 ton barge load. The phrase "where such Material is normally available" refers to those railway receiving points or recognized barge terminals used by the vendor in determining the price of the tubular goods purchased.

Certain tubular goods, such as specially threaded, doped and wrapped, plastic coated, etc., should be priced as defined above, i.e., to the railway receiving point or recognized barge terminal nearest the Joint Property, where such Material is normally available, plus transportation to the shop or plant where the special service is performed, plus transportation from the shop or plant to the Joint Property, including intermediate storage point when applicable. However, in no case shall the amount charged for hauling exceed the actual hauling cost incurred. Costs of the special services should be added to arrive at the delivered price.

(2) Line Pipe Pricing

Line pipe shall be priced at the current new price effective at date of transfer from a reliable supply store nearest the Joint Property, where such Material is normally available, if the movement is less than 30,000 pounds. Line pipe is usually utilized on joint producing properties only in small quantities for flow lines and flare lines, the weight of which will not constitute a carload lot of 30,000 pounds. Movements of 30,000 pounds or more shall be priced the same as tubular goods.

The major suppliers will not equalize the cost of line pipe on purchases of less than 30,000 pounds; therefore, it is usually necessary for the Operator to obtain these small amounts of line pipe from a supply store at the higher out-of-stock price.

On the other hand, where there are major installations such as gas gathering systems, salt water disposal systems and other construction requiring the use of quantities of line pipe in excess of 30,000 pounds, the Operator should acquire the necessary pipe at the equalized price, and the Non-Operator should receive the benefit of the reduced cost.

(3) Other Material Pricing

Other Material should be priced at the current new price of the same kind of Material, effective at date of movement and f.o.b. the railway receiving point, or the reliable supply store nearest the Joint Property, as defined above. Prices should be obtained from a reputable supplier's published price list. In some instances price lists are not distributed but are quoted by the supplier or manufacturer. If prices used are f.o.b. location, actual cost of transporting from Operator's warehouse or other properties should not be charged. Discontinued equipment should be priced the same as comparable equipment if still manufactured, otherwise, the last available price of the discontinued equipment should be used.

Where current market condition pricing on large items of equipment will result in inequities, it is recommended that the Operator contact Non-Operators in order to arrive at an acceptable pricing basis.

B. Good Used Material (Condition B)

No comments necessary.

C. Other Used Material (Condition C and D)

No comments necessary.

D. Obsolete Material

No comments necessary.

E. Pricing Conditions

If hauling charges are equalized (i.e. adjusted) as per Paragraph 5 of Section II of the Accounting Procedure, Operator may include fifteen cents (15¢) per hundredweight on all tubular goods furnished from his stocks in lieu of one loading at the warehouse or other property and one unloading at the Joint Property. If Operator charges fifteen cents (15¢) per hundredweight, the actual cost of all loading and unloading should be absorbed by the Operator.

3. Premium Price

No comments necessary

4. Warranty of Material Furnished by Operator

No comments necessary

V. INVENTORIES

No comments necessary

EXHIBIT " C "

Attached to and made a part of the Operating Agreement dated August 11, 1981 and covering the S/2 Section 17, T-24-S, R-37-L, Lea County, New Mexico between DOYLE HARTMAN as Operator and GULF OIL COMPANY, CITIES SERVICE COMPANY, KATHLEEN CONE et al as Non-Operators.

ACCOUNTING PROCEDURE
JOINT OPERATIONS

I. GENERAL PROVISIONS

1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

2. Statement and Billings

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

3. Advances and Payments by Non-Operators

Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

Prime Rate plus 1.25%

Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the rate of ~~twelve percent (12%)~~ per annum or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts.

4. Adjustments

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

5. Audits

A. Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct joint or simultaneous audits in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator.

6. Approval by Non-Operators

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

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. Rentals and Royalties

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

2. Labor

- A. (1) Salaries and wages of Operator's field employees directly employed on the Joint Property in the conduct of Joint Operations.
 (2) Salaries and related expenses of First Level Supervisors in the field.
 (3) Salaries and wages of Technical Employees directly employed on the Joint Property if such charges are excluded from the Overhead rates.
- B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II. Such costs under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 2A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.
- C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II.
- D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II.

3. Employee Benefits

Operator's current costs of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II shall be Operator's actual cost not to exceed twenty - six percent (26%), or percent most recently recommended by the Council of Petroleum Accounts Societies of North America.

4. Material

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

5. Transportation

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

- A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by the Parties.
- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.
- C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking cost of \$200 or less excluding accessorial charges.

6. Services

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 9 of Section II and Paragraph 1. ii of Section III. The cost of professional consultant services and contract services of technical personnel directly engaged on the Joint Property if such charges are excluded from the Overhead rates. The cost of professional consultant services or contract services of technical personnel not directly engaged on the Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.

7. Equipment and Facilities Furnished by Operator

- A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on investment not to exceed eight per cent (8%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.
- B. In lieu of charges in Paragraph 7A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

8. Damages and Losses to Joint Property

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

9. Legal Expense

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

10. Taxes

All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof, or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties.

11. Insurance

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

12. Other Expenditures

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

III. OVERHEAD

*per COGAS Bulletin quote. **

1. Overhead - Drilling and Producing Operations

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

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

①

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 2A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the Overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property shall () shall not (X) be covered by the Overhead rates.

A. Overhead - Fixed Rate Basis

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

Drilling Well Rate \$ 3,500.00
 Producing Well Rate \$ 350.00

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

(a) Drilling Well Rate

- [1] Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.
- [2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days
- [3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

- [1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.
- [2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.
- [3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.
- [4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.
- [5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

(3) The well rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Fields Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

B. Overhead - Percentage Basis

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

(a) Development

_____ Percent (%) of the cost of Development of the Joint Property exclusive of costs provided under Paragraph 9 of Section II and all salvage credits.

(b) Operating

_____ Percent (%) of the cost of Operating the Joint Property exclusive of costs provided under Paragraphs 1 and 9 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.

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

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

~~3. Overhead - Major Construction~~ If applicable, will be negotiated.

~~To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess of \$ _____:~~

~~A. _____ % of total costs if such costs are more than \$ _____ but less than \$ _____; plus~~

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

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

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

3. Amendment of Rates

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

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

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

1. Purchases

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

2. Transfers and Dispositions

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

A. New Material (Condition A)

- (1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.
- (2) Line Pipe
 - (a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.
 - (b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

B. Good Used Material (Condition B)

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

- (1) Material moved to the Joint Property
 - (a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV.
- (2) Material moved from the Joint Property
 - (a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged to the Joint Account as new Material, or

- (b) at sixty-five percent (65%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged to the Joint Account as good used Material at seventy-five percent (75%) of current new price.

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

C. Other Used Material (Condition C and D)

(1) Condition C

Material which is not in sound and serviceable condition and not suitable for its original function until, after reconditioning shall be priced at fifty percent (50%) of current new price as determined by Paragraph 2A of this Section IV. The cost of reconditioning shall be charged to the receiving property, provided Condition C value plus cost of reconditioning does not exceed Condition B value.

(2) Condition D

All other Material, including junk, shall be priced at a value commensurate with its use or at prevailing prices. Material no longer suitable for its original purpose but usable for some other purpose, shall be priced on a basis comparable with that of items normally used for such other purpose. Operator may dispose of Condition D Material under procedures normally utilized by the Operator without prior approval of Non-Operators.

D. Obsolete Material

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

E. Pricing Conditions

- (1) Loading and unloading costs may be charged to the Joint Account at the rate of fifteen cents (15¢) per hundred weight on all tubular goods movements, in lieu of loading and unloading costs sustained, when actual hauling cost of such tubular goods are equalized under provisions of Paragraph 5 of Section II.
- (2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

3. Premium Prices

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

4. Warranty of Material Furnished by Operator

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

V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

Reconciliation of a physical inventory with the Joint Account shall be made, and a list of overages and shortages shall be furnished to the Non-Operators within six months following the taking of the inventory. Inventory adjustments shall be made by Operator with the Joint Account for overages and shortages, but Operator shall be held accountable only for shortages due to lack of reasonable diligence.

3. Special Inventories

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

4. Expense of Conducting Periodic Inventories

The expense of conducting periodic Inventories shall not be charged to the Joint Account unless agreed to by the Parties.