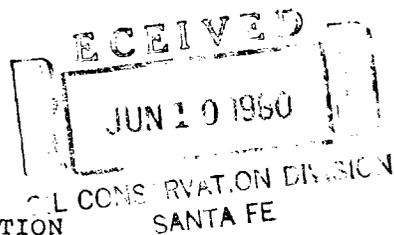


BEFORE EXAMINER _____
 OIL CONSERVATION DIVISION
 EXHIBIT NO. 2
 CASE NO. 6903, 6904, 6921
 SUBMITTED BY Applicant
 HEARING DATE 6/4/80



UNIT AGREEMENT
 FOR THE DEVELOPMENT AND OPERATION
 OF THE

MCDONALD UNIT AREA
LEA COUNTY, NEW MEXICO

THIS AGREEMENT, entered into as of the 2nd day of June
 1980, by and between the parties subscribing, ratifying or consenting hereto,
 and herein referred to as the "parties hereto";

WITNESSETH

WHEREAS, the parties hereto are the owners of working, royalty, or other oil
 or gas interests in the unit area subject to this agreement; and

WHEREAS, the Oil Conservation Division of the Energy and Minerals Depart-
 ment of the State of New Mexico (hereinafter referred to as the "Division"), is
 authorized by an Act of the Legislature (Chap. 72, Laws 1935, as amended, being
 Section 70-2-1 et seq. New Mexico Statutes Annotated, 1978 Compilation) to approve
 this agreement and the conservation provisions hereof; and

WHEREAS, the parties hereto hold sufficient interests in the _____
McDonald Unit Area covering the land hereinafter described to give
 reasonably effective control of operations therein; and

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

NOW THEREFORE, in consideration of the premises and promises herein contained,
 the parties hereto commit to this agreement their respective interests in the
 below defined unit area, and agree severally among themselves as follows:

1. UNIT AREA: The following described land is hereby designated and
 recognized as constituting the unit area:

Township 13 South, Range 36 East N.M.P.M.

Section 33: S/2
 34: SW/4

Township 14 South, Range 36 East, N.M.P.M.

Section 3: W/2
 4: All
 Containing 1,440.22 acres, more or less,

Lea County, New Mexico

Exhibit "A" attached hereto is a map showing the unit area and the boundaries and identity of tracts and leases in said area to the extent known to the Unit Operator. Exhibit "B" attached hereto is a schedule showing to the extent known to the Unit Operator the acreage, percentage and kind of ownership of oil and gas interests in all lands in the unit area. However, nothing herein or in said schedule or map shall be construed as a representation by any party hereto as to the ownership of any interest other than such interest or interests as are shown on said map or schedule as owned by each party. Exhibits "A" and "B" shall be revised by the Unit Operator whenever changes in ownership in the unit area render such revisions necessary.

All land committed to this agreement shall constitute land referred to herein as "unitized land" or "land subject to this agreement".

2. UNITIZED SUBSTANCES: All oil, gas, natural gasoline, and associated fluid hydrocarbons in any and all formations of the unitized land are unitized under the terms of this agreement and herein are called "unitized substances".

3. UNIT OPERATOR: HARVEY E. YATES COMPANY, whose address is Suite 300, Security National Bank Building P. O. Box 1933, Roswell, New Mexico 88201

is hereby designated as Unit Operator and by signature hereto commits to this agreement all interest in unitized substances vested in it as set forth in Exhibit "B", and agrees and consents to accept the duties and obligations of Unit Operator for the discovery, development and production of unitized substances as herein provided. Whenever reference is made herein to the Unit Operator, such reference means the Unit Operator acting in that capacity and not as an owner of interests in unitized substances, and the term "working interest owner" when used herein shall include or refer to Unit Operator as the owner of a working interest when such an interest is owned by it.

4. RESIGNATION OR REMOVAL OF UNIT OPERATOR: Unit Operator shall have the right to resign at any time but such resignation shall not become effective until a successor Unit Operator has been selected and approved in the manner provided for in Section 5 of this agreement. The resignation of the Unit Operator shall not release the Unit Operator from any liability or any default by it hereunder occurring prior to the effective date of its resignation.

Unit Operator may, upon default or failure in the performance of its duties

or obligations hereunder, be subject to removal by the same percentage vote of the owners of working interests determined in like manner as herein provided for the selection of a new Unit Operator.

The resignation or removal of the Unit Operator under this agreement shall not terminate his right, title or interest as the owner of a working interest or other interest in unitized substances, but upon the resignation or removal of the Unit Operator becoming effective, such Unit Operator shall deliver possession of all equipment, materials, and appurtenances used in conducting the unit operations and owned by the working interest owners to the new duly qualified successor Unit Operator, or to the owners thereof if no such new Unit Operator is elected, to be used for the purpose of conducting unit operations hereunder. Nothing herein shall be construed as authorizing removal of any material, equipment and appurtenances needed for the preservation of wells.

5. SUCCESSOR UNIT OPERATOR: Whenever the Unit Operator shall resign as Unit Operator or shall be removed as hereinabove provided, the owners of the working interests according to their respective acreage interests in all unitized land shall by a majority vote select a successor Unit Operator; provided that, if a majority but less than seventy-five percent (75%) of the working interests qualified to vote is owned by one party to this agreement, a concurring vote of sufficient additional parties, so as to constitute in the aggregate not less than seventy-five percent (75%) of the total working interests, shall be required to select a new operator. Such selection shall not become effective until a Unit Operator so selected shall accept in writing the duties and responsibilities of the Unit Operator.

6. ACCOUNTING PROVISIONS: The Unit Operator shall pay in the first instance all costs and expenses incurred in conducting unit operations hereunder, and such costs and expenses and the working interest benefits accruing hereunder shall be apportioned among the owners of the unitized working interests in accordance with an operating agreement entered into by and between the Unit Operator and the owners of such interests, whether one or more, separately or collectively. Any agreement or agreements entered into between the working interest owners and the Unit Operator as provided in this section, whether one or more, are herein referred to as the "Operating Agreement". No such agreement shall be deemed either to modify

any of the terms and conditions of this unit agreement or to relieve the unit operators of any right or obligation established under this unit agreement and in case of any inconsistencies or conflict between this unit agreement and the operating agreement, this unit agreement shall prevail.

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

8. DRILLING TO DISCOVERY: The Unit Operator shall, within sixty (60) days after the effective date of this agreement, commence operations upon an adequate test well for oil and gas upon some part of the lands embraced within the unit area and shall drill said well with due diligence to a depth sufficient to adequately test the Devonian formation or to such a depth as unitized substances shall be discovered in paying quantities at a lesser depth or until it shall, in the opinion of the Unit Operator, be determined that the further drilling of said well shall be unwarranted or impracticable; provided, however, that the Unit Operator shall not, in any event, be required to drill said well to a depth in excess of 14,700 feet. Until a discovery of a deposit of unitized substances capable of being produced in paying quantities (to wit: quantities sufficient to repay the costs of drilling and producing operations with a reasonable profit) the Unit Operator shall continue drilling diligently, one well at a time, allowing not more than six months between the completion of one well and the beginning of the next well, until a well capable of producing unitized substances in paying quantities is completed or until it is reasonably proven to the satisfaction of the Unit Operator that the unitized land is incapable of pro-

ducing unitized substances in paying quantities in the formation drilled hereunder. Any well commenced prior to the effective date of this agreement upon the unit area and drilled to the depth provided herein for the drilling of an initial test well shall be considered as complying with the drilling requirements hereof with respect to the initial well.

9. OBLIGATIONS OF UNIT OPERATOR AFTER DISCOVERY OF UNITIZED SUBSTANCES: After discovery of unitized substances in paying quantities, the Unit Operator shall proceed with diligence to reasonably develop the unitized area as a reasonably prudent operator would develop such area under the same or similar circumstances.

10. PARTICIPATION AFTER DISCOVERY: Upon completion of a well capable of producing unitized substances in paying quantities, the owners of working interests shall participate in the production therefrom and in all other producing wells which may be drilled pursuant hereto in the proportions set out in the Unit Operating Agreement. For the purpose of determining any benefits accruing under this agreement and the distribution of the royalties payable to the lessors, each separate lease shall have allocated to it such percentage of said production as the number of acres in each lease respectively committed to this agreement bears to the total number of acres committed hereto.

Notwithstanding any provisions contained herein to the contrary, each working interest owner shall have the right to take such owner's proportionate share of the unitized substances in kind or to personally sell or dispose of the same, and nothing herein contained shall be construed as giving or granting to the Unit Operator the right to sell or otherwise dispose of the proportionate share of any working interest owner without specific authorization from time to time to do so.

11. ALLOCATION OF PRODUCTION: All unitized substances produced from each tract in the unitized area established under this agreement, except any part thereof used for production or development purposes hereunder, or unavoidably lost, shall be deemed to be produced equally on an acreage basis from the several tracts of the unitized land, and for the purpose of determining any benefits that accrue on an acreage basis, each such tract shall have allocated to it such percentage of said production as its area bears to the entire unitized area. It is hereby agreed that production of unitized substances from the unitized area shall be allocated as provided herein, regardless of whether any wells drilled on any parti-

cular tracts of said unitized area.

12. PAYMENT OF RENTALS, ROYALTIES AND OVERRIDING ROYALTIES: All rentals, if any, due under leases committed to this agreement shall be paid by the respective lease owners in accordance with the terms of their leases and all royalties due under the terms of any such leases shall be paid on the basis of all unitized substances allocated to the respective leases committed hereto.

If the Unit Operator introduces gas obtained from sources other than the unitized substances into any producing formation for the purpose of repressuring, stimulating or increasing the ultimate recovery of unitized substances therefrom, a like amount of gas, if available, with due allowance for loss or depletion from any cause may be withdrawn from the formation into which the gas was introduced royalty free as to dry gas but not as to the products extracted therefrom; provided, that such withdrawal shall be at such time as may be provided in a plan of operation consented to by the Commissioner and approved by the Division as conforming to good petroleum engineering practice; and provided further, that such right of withdrawal shall terminate on the termination of this unit agreement.

If any lease committed hereto is burdened with an overriding royalty, payment out of production or other charge in addition to the usual royalty, the owner of each such lease shall bear and assume the same out of the unitized substances allocated to the lands embraced in each such lease as provided herein.

13. LEASES AND CONTRACTS CONFORMED AND EXTENDED INsofar AS THEY APPLY TO LANDS WITHIN THE UNITIZED AREA;

The terms, conditions and provisions of all leases, subleases, operating agreements and other contracts relating to the exploration, drilling development or operation for oil or gas of the lands committed to this agreement, shall as of the effective date hereof, be and the same are hereby expressly modified and amended insofar as they apply to lands within the unitized area to the extent necessary to make the same conform to the provisions hereof and so that the respective terms of said leases and agreements will be extended insofar as necessary to coincide with the term of this agreement and the approval of this agreement and the respective lessors and lessees shall be effective to conform the provisions and extend the terms of each such lease as to lands within the unitized area to the provisions and terms of this agreement; but otherwise to remain in full force and effect. Each lease committed to this agreement, insofar

as it applies to lands within the unitized area, shall continue in force beyond the term provided therein as long as this agreement remains in effect, provided, drilling operations upon the initial test well provided for herein shall have been commenced or said well is in the process of being drilled by the Unit Operator prior to the expiration of the shortest term lease committed to this agreement. Termination of this agreement shall not effect any lease which pursuant to the terms thereof or any applicable laws would continue in full force and effect thereafter. The commencement, completion, continued operation or production on each of the leasehold interests committed to this agreement and operations or production pursuant to this agreement shall be deemed to be operations upon and production from each leasehold interest committed hereto and there shall be no obligation on the part of the Unit Operator or any of the owners of the respective leasehold interests committed hereto to drill offsets to wells as between the leasehold interests committed to this agreement, except as provided in Section 9 hereof.

14. CONSERVATION: Operations hereunder and production of unitized substances shall be conducted to provide for the most economical and efficient recovery of said substances without waste, as defined by or pursuant to State laws or regulations.

15. DRAINAGE: In the event a well or wells producing oil or gas in paying quantities should be brought in on land adjacent to the unit area draining unitized substances from the lands embraced therein, the Unit Operator shall drill such offset well or wells as a reasonably prudent operator would drill under the same or similar circumstances.

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

1 17. EFFECTIVE DATE AND TERM: This agreement shall become effective upon ap-
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3 proval by the Division and shall terminate in two (2) years after such date unless a
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5 valuable discovery of unitized substances has been made on unitized land during
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7 said initial term or any extension thereof in which case this agreement shall
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9 remain in effect so long as unitized substances are being produced in paying
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11 quantities from the unitized land and, should production cease, so long thereafter
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13 as diligent operations are in progress for the restoration of production or
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15 discovery of new production and so long thereafter as the unitized substances so
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17 discovered can be produced as aforesaid. This agreement may be terminated at any
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19 time by not less than seventy-five percent (75%) on an acreage basis of the owners
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21 of the working interests. Likewise, the failure to comply with the drilling
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23 requirements of Section 8 hereof, may subject this agreement to termination.
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25 18. RATE OF PRODUCTION: All production and the disposal thereof shall be
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27 in conformity with all applicable laws and lawful regulations.
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29 19. APPEARANCES: The Unit Operator shall, after notice to other parties
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31 affected, have the right to appear for and on behalf of any and all interests
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33 affected hereby, before the appropriate governmental regulatory agencies, and
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35 appeal from orders issued under the regulations of such agencies, or to apply for
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37 relief from any of said regulations or in any proceedings on its own behalf
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39 relative to operations pending before such agencies; provided, however, that any
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41 other interest party shall also have the right at his own expense to appear and
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43 to participate in any such proceeding.
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45 20. NOTICES: All notices, demands, or statements required hereunder to be
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47 given or rendered to the parties hereto, shall be deemed fully given, if given in
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49 writing and sent by postpaid registered mail, addressed to such party or parties
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51 at their respective addresses, set forth in connection with the signatures hereto
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53 or to the ratification or consent hereof, or to such other address as any such
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55 party may have furnished in writing to party sending the notice, demand, or state-
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57 ment.
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59 21. UNAVOIDABLE DELAY: All obligations under this agreement requiring the
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61 Unit Operator to commence or continue drilling or to operate on or produce unitized
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63 substances from any of the lands covered by this agreement, shall be suspended
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65 while, but only so long as, the Unit Operator, despite the exercise of due care
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and diligence, is prevented from complying with such obligations, in whole or in part, by strikes, war, act of God, Federal, State, or municipal law or agencies, unavoidable accidents, uncontrollable delays in transportation, inability to obtain necessary materials in open market, or other matters beyond the reasonable control of the Unit Operator, whether similar to matters herein enumerated or not.

22. LOSS OF TITLE: In the event title to any tract of unitized land or substantial interest therein shall fail, and the true owner cannot be induce to join the unit agreement so that such tract is not committed to this agreement, or the operation thereof hereunder becomes impracticable as a result thereof, such tract may be eliminated from the unitized area, and the interest of the parties readjusted as a result of such tract being eliminated from the unitized area. In the event of a dispute as to title to any royalty, working, or other interest subject hereto, the Unit Operator may withhold payment or delivery of the allocated portion of the unitized substances involved on account thereof, without liability for interest until the dispute is finally settled. The Unit Operator, as such, is relieved from any responsibility for any defect or failure of any title hereunder.

23. SUBSEQUENT JOINDER: Any oil or gas interest in lands within the unit area not committed hereto, within sixty (60) days after the date of this agreement may be committed by the owner or owners of such rights by subscribing or consenting to this agreement, or executing a ratification thereof, and if such owner is also a working interest owner, by subscribing to the operating agreement providing for the allocation of costs of exploration, development, and operation. A subsequent joinder shall be effective as of the first day of the month following delivery to the Unit Operator of duly executed counterparts of the instrument or instruments committing the interest of such owner to this agreement, but such joining party or parties, before participating in any benefits hereunder, shall be required to assume and pay to the Unit Operator, their proportionate share of the unit expenses incurred prior to such party's or parties' joinder in the unit agreement, and the Unit Operator shall make appropriate adjustments caused by such joinder, without any retroactive adjustment or revenue.

24. COUNTERPARTS: This agreement may be executed in any number of counterparts, no one of which needs to be executed by all parties, or may be ratified or consented to by separate instrument in writing specifically referring hereto, and

