

UNIT OPERATING AGREEMENT

NORTH MESCALERO UNIT

LEA COUNTY, NEW MEXICO

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BEFORE EXAMINER STAMETS
OIL CONSERVATION DIVISION
EXHIBIT NO. 9
CASE NO. 7565
Submitted by Delta
Hearing Date 5/12/82

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EXHIBITS

- EXHIBIT "A" - PLAT
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- EXHIBIT "C" - BENEFICIAL SCHEDULE
- EXHIBIT "D" - ACCOUNTING PROCEDURE
- EXHIBIT "E" - WORKING INTEREST SCHEDULE
- EXHIBIT "F" - GAS BALANCING AGREEMENT
- EXHIBIT "G" - EQUAL EMPLOYMENT OPPORTUNITY AND
CERTIFICATION OF NON-SEGREGATED
FACILITIES

1 Operating Agreement to be made and entered into by and bet- 1
2 ween the Unit Operator and the Working Interest Owners 2
3 having interests committed to said Unit Agreement. This 3
4 agreement is the Unit Operating Agreement which is entered 4
5 into in conformity with the provisions of said Unit 5
6 Agreement; 6

7 NOW, THEREFORE, in consideration of mutual covenants and 7
8 agreements hereinafter contained, the parties hereto do 8
9 hereby covenant, contract and agree as follows: 9

10 I. 10

11 UNIT AGREEMENT CONFIRMED 11

12 The Unit Agreement and exhibits attached thereto are 12
13 hereby confirmed and made a part of this agreement. If 13
14 there is any conflict between the Unit Agreement and this 14
15 agreement, the Unit Agreement shall govern. 15

16 II. 16

17 DEFINITIONS 17

18 As used in this agreement, the terms herein contained 18
19 shall have the following meanings: 19

20 A. Any definitions contained in the Unit Agreement are 20
21 adopted for all purposes of this agreement. 21

22 B. Working Interest means an interest in the Unit Area 22
23 by virtue of a lease, operating agreement, fee title or 23
24 otherwise, including a carried interest, which interest is 24
25 chargeable with and obligated to pay or bear, either in cash 25
26 or out of production or otherwise, all or a portion of the 26
27 cost of drilling, developing, producing, and operating the 27
28 Unit Area. A schedule of the allocation of costs to such 28
29 Working Interests in the Unit Area is attached hereto as 29
30 Exhibit "E". Any interest in the Unit Area which is a 30
31 Working Interest as of the date the owner thereof executes 31
32 or ratifies this agreement shall thereafter be treated as a 32
33 Working Interest for all purposes of this agreement. 33

1 words used in the singular include the plural, the plural 1
2 include the singular, and the neuter gender include the 2
3 masculine and the feminine. 3

4 III. 4

5 EXHIBITS 5

6 The following Exhibits are incorporated herein by 6
7 reference: 7

8 A. Exhibits "A" and "B" of the Unit Agreement. 8

9 B. Exhibit "C", attached hereto, which is a Schedule 9
10 showing the Beneficial Interest of each Working Interest 10
11 Owner. 11

12 C. Exhibit "D", attached hereto, which is the 12
13 Accounting Procedure applicable to all operations conducted 13
14 on the Unit Area. If there is any conflict between this 14
15 agreement and Exhibit "D", this agreement shall govern. 15

16 D. Whenever Exhibits "A" and "B" are revised, Exhibits 16
17 "C" and "E" shall be revised accordingly and be effective as 17
18 of the same date. Unit Operator shall also revise Exhibits 18
19 "C" and "E" from time to time as required to conform to 19
20 changes in ownership, of which the Unit Operator has been 20
21 notified as provided in the Unit Agreement. 21

22 E. Exhibit "E", attached hereto, which is a Schedule 22
23 showing the Working Interest of each Working Interest Owner. 23

24 F. Exhibit "F", attached hereto, is a Gas Storage and 24
25 Balancing Agreement. 25

26 G. Exhibit "G", attached hereto, is an Equal 26
27 Employment Opportunity Provision and Certification of 27
28 Non-Segregated Facilities. 28

29 IV. 29

30 INTEREST OF THE PARTIES 30

31 A. Exhibit "C" is a Beneficial Interest Schedule 31
32 showing the Beneficial Interest owner of each Working 32
33 Interest Owner as of the date hereof. Said Beneficial 33

1	Interests were computed on the basis of the following	1
2	formulae:	2
3	1. For the purposes hereof:	3
4	a. represents the number of acres in each Tract as	4
5	shown in Exhibit "B".	5
6	b. represents the basic royalty in percentage in each	6
7	Tract as shown in Exhibit "B".	7
8	c. represents the total of all overriding royalties	8
9	and production payments in excess of b (hereinafter	9
10	referred to as Lease Burdens) and which affect the	10
11	respective Tracts as of the date hereof and shall	11
12	include, but not be limited to, the Lease Burdens	12
13	that are not deemed to be carved-out interests	13
14	under the provisions of Section D of this Article	14
15	IV.	15
16	d. represents the number of royalty acres in each	16
17	Tract.	17
18	e. represents the number of overriding royalty acres	18
19	in each Tract.	19
20	f. represents the total number of Beneficial Acres in	20
21	each Tract.	21
22	g. represents the total number of Beneficial Acres.	22
23	h. represents the percentage of the Working Interest	23
24	of each Working Interest Owner in each Tract as	24
25	set forth in Exhibit "B".	25
26	x. represents each Working Interest Owner's Tract	26
27	Beneficial Interest stated in a percentage.	27
28	2. For the purpose of determining x:	28
29	$d = a \times b$	29
30	$e = a \times c$	30
31	$f = a - (d + e)$	31
32	$x = f/g \times h$	32
33	3. Each Working Interest Owner's Beneficial Interest shall	33

1 be equal to the sum of such Working Interest Owner's Tract 1
2 Beneficial Interest in each Tract. 2

3 B. In the event the Unit Area is expanded or 3
4 contracted as provided in the Unit Agreement, the Beneficial 4
5 Interest and the Working Interest of the Working Interest 5
6 Owners, insofar as the same pertain to the Tracts remaining 6
7 in the Unit Area and which were within the Unit Area prior 7
8 to the enlargement or reduction shall remain in the same 8
9 ratio one to another. 9

10 C. Except as provided in Section D of this Article IV 10
11 and in separate agreements between the Unit Operator and the 11
12 several Working Interest Owners pertaining to the drilling 12
13 of the initial well, all costs and liabilities incurred in 13
14 operations under this agreement and the Unit Agreement shall 14
15 be borne and paid, and all equipment and material acquired 15
16 hereunder, shall be owned by the parties hereto in propor- 16
17 tion to their Working Interest as reflected in Exhibit "E". 17
18 All Unitized Substances produced from the Unit Area shall be 18
19 owned by the parties hereto, in proportion to their respec- 19
20 tive Beneficial Interests, as reflected in Exhibit "C", 20
21 after payment of royalties, overriding royalties and other 21
22 leasehold burdens. 22

23 D. In the event any Working Interest Owner shall, 23
24 after executing the Unit Agreement and this agreement, 24
25 create or cause to be created any Lease Burden or other 25
26 interest out of its interest then subject to the Unit 26
27 Agreement and this agreement, such carved-out interest shall 27
28 be subject to the terms and provisions of this agreement 28
29 (any Lease Burden which affects any Working Interest Owner's 29
30 interest but which may not have been actually conveyed to 30
31 the party entitled thereto prior to the date of this 31
32 agreement shall not be deemed to be a carved-out interest 32
33 within the meaning of this Section D; provided, that such 33

1 Lease Burden was utilized in computing the Beneficial 1
2 Interest of each Working Interest Owner as of the date 2
3 hereof). In the event the Working Interest Owner owning the 3
4 interest out of which the carved-out interest was created 4
5 withdraws from this agreement under the provisions of 5
6 Article XXII hereof, or fails to pay any Unit Expense 6
7 chargeable to such Working Interest Owner under this 7
8 agreement and if the Unitized Substances attributable to the 8
9 credit of such Working Interest Owner are insufficient for 9
10 the purpose, the owner of the carved-out interest will be 10
11 liable for its pro rata portion of all costs and expenses 11
12 for which the Working Interest Owner that created such 12
13 carved-out interest would have been liable hereunder by vir- 13
14 tue of such Working Interest Owner's entire original 14
15 interest, just as if such carved-out interest had not been 15
16 created. In such event, the lien provided for in Article 16
17 XII hereof may be enforced against such carved-out interest 17
18 in the same manner as the lien was enforceable against the 18
19 original interest out of which the carved-interest was 19
20 created. 20

21 V. 21

22 ESTABLISHMENT, REVISION AND CONSOLIDATION 22
23 OF PARTICIPATING AREA 23

24 A. Unit Operator shall initiate each proposal for the 24
25 establishment or revision of a participating area by sub- 25
26 mitting the proposal therefor in writing to each Working 26
27 Interest Owner at least thirty (30) days before filing the 27
28 same with the Supervisor and the Land Commissioner. The date 28
29 of the proposed filing shall be shown on the proposal. If 29
30 the proposal receives the approval of the Working Interest 30
31 Owners as provided in Article IX hereof, then such proposal 31
32 shall be filed on the date specified in the notice. 32
33 B. Prior to the proposed filing date, any Working 33

1 Interest Owner may submit to all other Working Interest 1
2 Owners and Unit Operator written objections to such 2
3 proposal. If, despite such objections, the proposal 3
4 receives the approval of the Working Interest Owners, then 4
5 the Working Interest Owner making such rejection may renew 5
6 its objections before the Supervisor and the Land 6
7 Commissioner. 7

8 C. If the proposal does not receive the approval of 8
9 such Working Interest Owners, then the Unit Operator shall 9
10 submit a revised proposal taking into account the objections 10
11 made to the first proposal. If no proposal received the 11
12 approval of said Working Interest Owners within thirty (30) 12
13 days from the submission of the first proposal, the Unit 13
14 Operator shall then file with the Supervisor and the Land 14
15 Commissioner a proposal reflecting as nearly as practicable 15
16 the various views expressed by the affected Working Interest 16
17 Owners. 17

18 D. If a proposal filed by the Unit Operator as above 18
19 provided is rejected by the Supervisor and/or the Land 19
20 Commissioner, the Unit Operator shall initiate a new propo- 20
21 sal in the same manner as provided in Section C of this 21
22 Article V and the procedure with respect thereto shall be 22
23 the same as in the case of an initial proposal. 23

24 E. Two (2) or more participating areas may be combined 24
25 as provided in the Unit Agreement. 25

26 VI. 26

27 PLANS OF DEVELOPMENT 27

28 A. Each plan for the development and operation of the 28
29 Unit Area which is submitted by the Unit Operator to the 29
30 Supervisor and the Land Commissioner in accordance with the 30
31 Unit Agreement shall make provisions only for such drilling, 31
32 deepening or plugging back operations and such other pro- 32
33 jects as Unit Operator has been authorized to conduct by the 33

1 Working Interest Owners pursuant to this agreement. 1

2 B. At least ten (10) days before submitting any such 2
3 proposed plan to the Supervisor and the Land Commissioner, 3
4 Unit Operator shall give each party written notice thereof 4
5 together with a copy of the proposed plan. 5

6 C. If and when a proposed plan has been approved or 6
7 disapproved by the Supervisor and the Land Commissioner, 7
8 Unit Operator shall give prompt written notice thereto to 8
9 each Working Interest Owner. In the event of disapproval, 9
10 the Unit Operator shall state in such notice the reasons 10
11 therefor. 11

12 D. If any Working Interest Owner or Working Interest 12
13 Owners shall have elected to proceed with drilling, 13
14 deepening or plugging back operations in accordance with the 14
15 provisions of this agreement, and such operations are not 15
16 provided for in the then current plan of development as 16
17 approved by the Supervisor and the Land Commissioner, the 17
18 Unit Operator shall either 18

19 1. Request the Supervisor and the Land 19
20 Commissioner to approve an amendment to such plan which will 20
21 provide for such operations, or 21

22 2. Request the Supervisor and the Land 22
23 Commissioner to consent to such operations if their consents 23
24 are sufficient. 24

25 E. If any such plan as approved by the Supervisor and 25
26 the Land Commissioner provides for the cessation of any 26
27 drilling or other operations on the happening of a con- 27
28 tingency and if such contingency occurs, Unit Operator shall 28
29 promptly cease such drilling or other operations and shall 29
30 not incur any additional Unit Expense in connection 30
31 therewith unless and until such drilling or other operations 31
32 are again authorized in accordance with the agreement of the 32
33 Working Interest Owners. 33

VII.

REQUIRED WELLS

A. For the purposes of this Article VII, a well shall be deemed to be a required well if the drilling thereof is required by the final order of an authorized representative of the Department of the Interior in the case of Federal lands or of the Land Commissioner in the case of State lands. Such an order shall be deemed to be final upon the expiration of the time allowed for an appeal therefrom without commencement of appropriate appeal proceedings, or if such proceedings are commenced within said time, upon the final disposition of the appeal. Whenever Unit Operator receives any such order, Unit Operator shall promptly mail a copy thereof to each of the Working Interest Owners. If any such order is appealed, the party appealing such order shall give prompt written notice thereof to Unit Operator and to each of the other Working Interest Owners, and upon final disposition of the appeal, Unit Operator shall give each of the other Working Interest Owners prompt written notice of the results of such appeal.

B. Any Working Interest Owner desiring to drill, or to participate in the drilling of, a required well shall give Unit Operator written notice thereof within thirty (30) days after the order requiring such well becomes final or within such lesser time as may be required by such order. If such notice is given within said period, Unit Operator, subject to the provisions of Article XV Section j, shall drill the required well for the account of the Working Interest Owner or Working Interest Owners giving such notice who shall bear all costs and expenses which may be incurred in connection therewith. The rights and obligations of such Working Interest Owner or Working Interest Owners with respect to the ownership of such well, the operating rights therein,

1 the production therefrom and the bearing of all costs and 1
2 expenses incurred in connection therewith shall be the same 2
3 as if the well had been drilled for the account of such 3
4 Working Interest Owner or Working Interest Owners under the 4
5 provisions of Article XV hereof. 5

6 C. If no Working Interest Owner elects to drill a 6
7 required well within the period allowed for such election, 7
8 and if any of the following alternatives is available, the 8
9 first of such alternatives which is available shall be 9
10 followed: 10

11 1. If compensatory royalties may be paid in lieu 11
12 of drilling the well and if payment thereof receives, within 12
13 said period, the approval of the Working Interest Owners, 13
14 Unit Operator shall pay such compensatory royalties for the 14
15 account of said Working Interest Owners, or 15

16 2. If the drilling of the well may be avoided, 16
17 without other penalty, by contraction of the Unit Area, Unit 17
18 Operator shall make a reasonable effort to effect such 18
19 contraction with the approval of the Director and the Land 19
20 Commissioner, or 20

21 3. If the Unit Agreement may be terminated by 21
22 reason of the failure to drill such required well, all 22
23 Working Interest Owners shall join in the termination of the 23
24 Unit Agreement in accordance with the provisions thereof. 24

25 D. If none of the alternatives set forth in Section C 25
26 of this Article VII is available, Unit Operator shall drill 26
27 the required well for the account of the Working Interest 27
28 Owners. 28

29 VIII. 29

30 SUPERVISION OF OPERATIONS BY WORKING INTEREST OWNERS 30

31 A. The Working Interest Owners shall exercise overall 31
32 supervision and control of all matters pertaining to Unit 32
33 Operations pursuant to this agreement and the Unit 33

1 Agreement. In the exercise of such authority, each Working 1
2 Interest Owner shall act solely in its own behalf in the 2
3 capacity of an individual owner and not on behalf of the 3
4 owners as an entirety. 4

5 B. The matters with respect to which the Working 5
6 Interest Owners shall decide and take action shall include, 6
7 but not be limited to, the following: 7

8 1. The establishment or revision of a par- 8
9 ticipating area or participating areas. 9

10 2. The approval of any plan of development which 10
11 is to be submitted by the Unit Operator to the Supervisor 11
12 and the Land Commissioner. 12

13 3. The drilling of all wells whether for the pro- 13
14 duction of Unitized Substances, for use as an injection 14
15 well, or for other purposes except the drilling of the ini- 15
16 tial well which shall be covered by separate agreements bet- 16
17 ween Unit Operator and the Working Interest Owners. 17

18 4. The recompletion, abandonment, or change of 18
19 status of any well, or the use of any well for injection or 19
20 other purposes. 20

21 5. The making of any single expenditure in excess 21
22 of Ten Thousand Dollars (\$10,000.00); provided that, appro- 22
23 val by Working Interest Owners of the drilling, reworking, 23
24 deepening or plugging back of any well shall include appro- 24
25 val of all necessary expenditures required therefor, and for 25
26 completing, testing, and equipping the same through the well 26
27 head. 27

28 6. The selling or otherwise disposing of any 28
29 major item of surplus Unit Equipment, if the current list 29
30 price of new equipment similar thereto is Five Thousand 30
31 Dollars (\$5,000.00), or more. 31

32 7. The designating of a representative to appear 32
33 before any court or regulatory agency in matters pertaining 33

1 to Unit Operations; provided that, such designation shall 1
2 not prevent any Working Interest Owner from appearing in 2
3 person or from designating another representative in its own 3
4 behalf and at its own expense. 4

5 8. The auditing of the accounts of Unit Operator 5
6 pertaining to Unit Operations hereunder; provided that, the 6
7 audits shall 7

8 a) not be conducted more than once each 8
9 year except upon the resignation or 9
10 removal of Operator, and 10

11 b) be made at the expense of all Working 11
12 Interest Owners other than the Working 12
13 Interest Owner designated as Unit 13
14 Operator, and 14

15 c) be made upon not less than thirty (30) 15
16 days' written notice to Unit Operator, 16
17 and 17

18 d) be conducted in accordance with Exhibit 18
19 "D". 19

20 9. The authorizing of charges to the joint 20
21 account for services by consultants or Unit Operator's tech- 21
22 nical personnel not covered by the overhead charges provided 22
23 by Exhibit "D". 23

24 10. The appointment of committees to study any 24
25 problems in connection with Unit Operations. 25

26 11. The removal of Unit Operator and the selection 26
27 of a successor. 27

28 12. The expansion or contraction of the Unit Area. 28

29 13. The adjustment and readjustment of 29
30 investments. 30

31 14. The termination of the Unit Agreement. 31

32 IX. 32

33 MANNER OF EXERCISING SUPERVISION 33

1 A. Each Working Interest Owner shall in writing inform 1
2 Unit Operator of the names and addresses of the represen- 2
3 tative and alternate who are authorized to represent and 3
4 bind such Working Interest Owner with respect to Unit 4
5 Operations. The representative or alternate may be changed 5
6 from time to time by written notice to Unit Operator. 6

7 B. All meetings of Working Interest Owners shall be 7
8 called by Unit Operator upon its own motion or at the 8
9 request of one or more Working Interest Owners having a 9
10 total Working Interest of not less than ten percent (10%). 10
11 No meeting shall be called on less than fourteen (14) days' 11
12 advance written notice, with agenda for the meeting 12
13 attached. Working Interest Owners who attend the meeting 13
14 shall not be prevented from amending items presented at the 14
15 meeting. The representative of Unit Operator shall be 15
16 chairman of each meeting. 16

17 C. Working Interest Owners shall decide all matters 17
18 coming before them as follows: 18

19 1. On matters affecting the Unit Area, each 19
20 Working Interest Owner shall have a voting interest equal to 20
21 its Working Interest within the Unit Area. 21

22 2. Except as otherwise provided herein or except 22
23 as provided in the Unit Agreement, the Working Interest 23
24 Owners shall decide all matters by an affirmative vote of 24
25 seventy percent (70%) or more voting interest; provided, 25
26 however, that should any one Working Interest Owner have 26
27 thirty percent (30%) or more voting interest, its negative 27
28 vote, or failure to vote, must be supported by the vote of 28
29 one or more Working Interest Owners having a combined voting 29
30 interest of at least five percent (5%) and the resulting 30
31 vote shall be binding upon all Working Interest Owners 31
32 affected by such vote. 32

33 3. Any expansion or contraction of the Unit Area 33

1 or the initiation of any secondary recovery or pressure 1
2 maintenance program shall require the affirmative vote of 2
3 eighty percent (80%) or more voting interest; provided that, 3
4 should any one Working Interest Owner have twenty percent 4
5 (20%) or more voting interest, its negative vote, or failure 5
6 to vote, must be supported by the vote of one or more 6
7 Working Interest Owners having a combined voting interest of 7
8 at least five percent (5%) and the resulting vote shall be 8
9 binding on all parties. 9

10 4. Any Working Interest Owner who is not repre- 10
11 sented at a meeting may vote by letter or telegram addressed 11
12 to the representative of the Unit Operator if its vote is 12
13 received prior to the vote on the item. 13

14 5. Working Interest Owners may vote on and 14
15 decide, by letter or telegram, any matter submitted in 15
16 writing to Working Interest Owners, if no meeting is 16
17 requested, as provided in Section B of this Article within 17
18 seven (7) days after the proposal is sent to Working 18
19 Interest Owners. Unit Operator will give prompt notice of 19
20 the results of the voting to all Working Interest Owners 20
21 affected by such voting. 21

22 X. 22

23 INDIVIDUAL RIGHTS OF WORKING INTEREST OWNERS 23

24 A. Working Interest Owners severally reserve to them- 24
25 selves all rights, except as otherwise provided in this 25
26 agreement and the Unit Agreement. 26

27 B. Each Working Interest Owner shall have, among 27
28 others, the following specific rights: 28

29 1. Access to the Unit Area, at such party's sole 29
30 risk, at all reasonable times to inspect Unit Operations, 30
31 all wells, and the records and data pertaining thereto. 31

32 2. The right to receive from Unit Operator, upon 32
33 written request, copies of all reports to any governmental 33

1 agency, reports of crude oil runs and stocks, inventory 1
2 reports, and all other information pertaining to Unit 2
3 Operations. The cost of gathering and furnishing infor- 3
4 mation not ordinarily furnished by Unit Operator to all 4
5 Working Interest Owners shall be charged to the Working 5
6 Interest Owner who requests the information. 6

7 XI. 7

8 UNIT OPERATOR AND DUTIES OF UNIT OPERATOR 8

9 A. Delta Drilling Company, a corporation, is hereby 9
10 designated as the Unit Operator. 10

11 B. Unit Operator may resign at any time. Working 11
12 Interest Owners may remove Unit Operator at any time by the 12
13 affirmative vote of at least eighty percent (80%) of the 13
14 voting interest remaining after excluding the voting interest 14
15 of Unit Operator. A Unit Operator that resigns or is 15
16 removed shall not be released from its obligations hereunder 16
17 for a period of three (3) months after the resignation or 17
18 discharge, unless a successor Unit Operator has taken over 18
19 Unit Operations prior to the expiration of such period. 19

20 C. In the event of the resignation or removal of a 20
21 Unit Operator, a successor Unit Operator shall be selected 21
22 by Working Interest Owners. If the Unit Operator that is 22
23 removed votes only to succeed itself, or fails to vote, the 23
24 successor Unit Operator may be selected by an affirmative 24
25 vote of at least fifty-one percent (51%) of the voting 25
26 interest remaining after excluding the voting interest of 26
27 the Unit Operator that was removed. 27

28 D. Subject to the provisions of this agreement and the 28
29 Unit Agreement and to instructions from Working Interest 29
30 Owners, Unit Operator shall have the exclusive right and be 30
31 obligated to conduct Unit Operations. 31

32 E. Unit Operator shall conduct Unit Operations in a 32
33 good and workmanlike manner as would a prudent operator 33

1 under the same or similar circumstances. Unit Operator 1
2 shall freely consult with Working Interest Owners and keep 2
3 them informed of all matters which Unit Operator, in the 3
4 exercise of its best judgment, considers important. Unit 4
5 Operator shall not be liable to Working Interest Owners for 5
6 damages, unless such damages result from Unit Operator's 6
7 gross negligence or willful misconduct. 7

8 F. Unit Operator shall endeavor to keep the lands and 8
9 leases in the Unit Area free from all liens and encumbrances 9
10 occasioned by Unit Operations, except the lien of Unit 10
11 Operator granted hereunder. 11

12 G. The number of employees used by Unit Operator in 12
13 conducting Unit Operations, their selection, their hours of 13
14 labor, and their compensation shall be determined by Unit 14
15 Operator. Such employees shall be the employees of Unit 15
16 Operator. 16

17 H. Unit Operator shall keep correct books, accounts 17
18 and records of Unit Operations. 18

19 I. Unit Operator shall furnish to Working Interest 19
20 Owners periodic reports of Unit Operations. 20

21 J. Unit Operator shall make all reports to governmen- 21
22 tal authorities that it has the duty to make as Unit 22
23 Operator. 23

24 K. Unit Operator shall furnish to any Working Interest 24
25 Owner, upon written request, a copy of the log and engi- 25
26 neering and geological data pertaining to wells drilled for 26
27 Unit Operations. 27

28 L. Unit Operator shall comply with the terms, provi- 28
29 sions and conditions of the Unit Agreement and all valid 29
30 applicable Federal, State and local laws, orders, rules and 30
31 regulations. 31

32 M. Unit Operator is authorized to make single expen- 32
33 ditures not in excess of Ten Thousand Dollars (\$10,000.00) 33

1 without prior approval of Working Interest Owners. If any 1
2 emergency occurs, Unit Operator may immediately make or 2
3 incur such expenditures as in its opinion are required to 3
4 deal with the emergency. Unit Operator shall report to 4
5 Working Interest Owners, as promptly as possible, the nature 5
6 of the emergency and the action taken. 6

7 N. All wells drilled by Unit Operator shall be at the 7
8 usual rates prevailing in the area. Unit Operator may 8
9 employ its own tools and equipment, but the charge therefor 9
10 shall not exceed the prevailing rate in the area, and the 10
11 work shall be performed by Unit Operator under the same 11
12 terms and conditions as are usual in the area in contracts 12
13 of independent contractors doing work of a similar nature. 13

14 XII. 14

15 UNIT EXPENSE AND UNIT OPERATORS LIEN 15

16 A. Unit Operator initially shall pay all Unit Expense. 16
17 Each Working Interest Owner shall reimburse Unit Operator 17
18 for its share of Unit Expense. All charges, credits, and 18
19 accounting for Unit Expense shall be in accordance with 19
20 Exhibit "D". 20

21 B. As soon as is practical after the effective date 21
22 hereof, Unit Operator shall prepare a budget of estimated 22
23 Unit Expense for the remainder of the calendar year, and, on 23
24 or before the first day of each October thereafter, shall 24
25 prepare such a budget for the next ensuing calendar year. 25
26 Each budget shall set forth the estimated Unit Expense by 26
27 quarterly periods. Budgets shall be estimates only, and 27
28 shall be adjusted or corrected by Working Interest Owners 28
29 whenever an adjustment or correction is proper. A copy of 29
30 each budget and adjusted budget shall promptly be furnished 30
31 to each Working Interest Owner. 31

32 C. Unit Operator shall have the right to require 32
33 Working Interest Owners to advance their respective shares 33

1 of estimated Unit Expense by submitting to Working Interest 1
2 Owners, on or before the fifteenth (15th) day of any month, 2
3 an itemized estimate thereof for the succeeding month, with 3
4 a request for payment in advance. Within fifteen (15) days 4
5 thereafter, each Working Interest Owner shall pay to Unit 5
6 Operator its share of such estimate. Adjustments between 6
7 estimated and actual Unit Expense shall be made by Unit 7
8 Operator at the close of each calendar month, and the 8
9 accounts of Working Interest Owners shall be adjusted 9
10 accordingly. 10

11 D. No funds received by the Unit Operator under this 11
12 agreement need be segregated or maintained by it as a 12
13 separate fund, but may be commingled with its own funds. 13

14 E. Each Working Interest Owner grants to Unit Operator 14
15 a lien upon its leasehold rights in each tract, its share of 15
16 Unitized Substances when produced, and its interest in all 16
17 Unit Equipment, as security for payment of its share of Unit 17
18 Expense, together with interest thereon at the rate of ten 18
19 percent (10%) per annum. To the extent that the Unit 19
20 Operator has a security interest under the Uniform 20
21 Commercial Code of the State of New Mexico, Unit Operator 21
22 should be entitled to exercise the rights and remedies of a 22
23 secured party under the Code. The bringing of a suit and 23
24 the obtaining of a judgment by the Unit Operator for the 24
25 secured indebtedness should not be deemed an election of 25
26 remedy or otherwise affect the lien rights or security 26
27 interest as security for the payment thereof. In addition, 27
28 upon default by any Working Interest Owner in the payment of 28
29 its share of Unit Expense, Unit Operator shall have the 29
30 right to collect from the purchaser the proceeds from the 30
31 sale of such Working Interest Owner's share of Unitized 31
32 Substances until the amount owed by such Working Interest 32
33 Owner, plus interest as aforesaid, has been paid. Each 33

1 purchaser shall be entitled to rely upon Unit Operator's 1
2 written statement concerning the amount of any default. 2
3 Each Non-Operator shall likewise have a lien on Unit 3
4 Operator's leasehold rights in each tract, its share of 4
5 Unitized Substances when produced, and its interest in all 5
6 Unit Equipment to secure the payment of any amount that may 6
7 at any time become due and payable by Unit Operator to such 7
8 Non-Operator under the terms of this agreement, together 8
9 with interest thereon as herein provided. 9

10 XII. 10

11 INSURANCE 11

12 As to all operations hereunder, Unit Operator shall 12
13 carry for the benefit and protection of the parties hereto 13
14 Workmen's Compensation Insurance in accordance with the laws 14
15 of the State of New Mexico. The Unit Operator shall not be 15
16 required to carry any other insurance for the Joint Account. 16
17 The liability, if any, of the parties hereto in damages for 17
18 claims growing out of personal injury to or death of third 18
19 persons or injury or destruction of property of third per- 19
20 sons resulting from the operation and development of the 20
21 Unit Area shall be borne by the parties hereto in the pro- 21
22 portions of their participation as shown on Exhibit "E"; and 22
23 each party individually may acquire such insurance as it 23
24 deems proper to protect itself against such claims. Unit 24
25 Operator shall require all third party contractors per- 25
26 forming work in or on the Unit Area to carry insurance for 26
27 the benefit and protection of the Working Interest Owners 27
28 consistent with Unit Operator's then existing requirement. 28

29 XIV. 29

30 TAXES 30

31 A. Commencing with the first calendar year after the 31
32 effective date hereof, Unit Operator shall make and file all 32
33 necessary ad valorem tax renditions and returns with the 33

1 proper taxing authorities covering all real and personal 1
2 property of each Working Interest Owner used or held by Unit 2
3 Operator in Unit Operations. Unit Operator shall settle 3
4 assessments arising therefrom. Unless otherwise provided in 4
5 a separate agreement between the Unit Operator and the 5
6 respective Working Interest Owners, all such ad valorem 6
7 taxes shall be paid by Unit Operator and charged to the 7
8 joint account; provided, that, if the interest of a Working 8
9 Interest Owner is subject to a separately assessed 9
10 overriding royalty interest, production payment or other 10
11 interest in excess of one-eighth (1/8th) royalty, such 11
12 Working Interest Owner shall be given credit for the reduc- 12
13 tion in taxes paid resulting therefrom. If any assessment 13
14 is considered unreasonable by Unit Operator, Unit Operator 14
15 may protest such valuation within the time and manner pro- 15
16 vided by law, and may, with the approval of the Working 16
17 Interest Owners, prosecute such protest to a final 17
18 determination. When any such protested valuation is finally 18
19 determined, Unit Operator shall pay the taxes and any 19
20 accrued interest and penalty and charge such payments to the 20
21 joint account. 21

22 B. Each Working Interest Owner shall pay or cause to 22
23 be paid all production, severance, gathering and other taxes 23
24 imposed upon or in respect of the production or handling of 24
25 its share of Unitized Substances. 25

26 XV. 26

27 OPERATIONS BY LESS THAN ALL PARTIES 27

28 A. If all of the Working Interest Owners cannot 28
29 mutually agree upon the drilling of any well other than the 29
30 initial test well to be drilled thereon, or upon the 30
31 reworking, deepening or plugging back of a dry hole drilled 31
32 at the joint expense of said Working Interest Owners, or a 32
33 well jointly owned by all of the Working Interest Owners and 33

1 not then producing in paying quantities, any Working 1
2 Interest Owner or Working Interest Owners wishing to drill, 2
3 rework, deepen or plug back such a well shall give the other 3
4 Working Interest Owners written notice of the proposed 4
5 operation, specifying the work to be performed, the location 5
6 of such well, the proposed depth, the objective formation 6
7 and the estimated cost of such operations. The Working 7
8 Interest Owners receiving such notice shall have thirty (30) 8
9 days (except as to reworking, plugging back or drilling 9
10 deeper, where a drilling rig is on location, the period 10
11 shall be limited to forty-eight (48) hours, exclusive of 11
12 Saturdays, Sundays and Legal holidays) after receipt of the 12
13 notice within which to notify the Working Interest Owner of 13
14 Working Interest Owners wishing to conduct such operations 14
15 whether or not the Working Interest Owners receiving such 15
16 notice elect to participate in the cost of the proposed 16
17 operations. Any failure of a Working Interest Owner 17
18 receiving such notice to reply to said notice within the 18
19 period above fixed shall constitute an election by such 19
20 Working Interest Owner not to participate in the cost of the 20
21 proposed operations. 21

22 B. If any Working Interest Owner receiving such notice 22
23 elects not to participate in the proposed operations (such 23
24 Working Interest Owner or Working Interest Owners being 24
25 hereinafter referred to as "Non-Consenting Party", whether 25
26 one or more), then in order to be entitled to the benefits 26
27 of this Article, the Working Interest Owner or Working 27
28 Interest Owners giving such notice and such other Working 28
29 Interest Owners as shall have elected to participate in the 29
30 proposed operations (all such parties being hereinafter 30
31 referred to as "Consenting Parties", whether one or more), 31
32 shall, within thirty (30) days after the expiration of the 32
33 aforesaid notice period (or as promptly as possible after 33

1 the expiration of the forty-eight (48) hour notice period in 1
2 the case where a drilling rig is on location), actually com- 2
3 mence the proposed operations and complete the same with due 3
4 diligence. 4

5 C. The entire cost and risk of conducting such opera- 5
6 tions shall be borne by the Consenting Parties in the pro- 6
7 portion that their Working Interests as shown in Exhibit "E" 7
8 bear to the total Working Interests of all Consenting 8
9 Parties. Said Consenting Parties shall keep the leasehold 9
10 estates involved in such operations free and clear of all 10
11 liens and encumbrances of every kind, character or nature 11
12 which may be created by or arise out of the operations of 12
13 the Consenting Parties. If such operations result in a dry 13
14 hole, the Consenting Parties shall plug and abandon the well 14
15 at their sole risk, cost and expense and in accordance with 15
16 all laws, rules and regulations. If any well drilled, 16
17 reworked, deepened or plugged back pursuant to the provi- 17
18 sions of this Article results in a producer of oil or gas in 18
19 paying quantities, the Consenting Parties shall complete and 19
20 equip said well at their sole risk, cost and expense and 20
21 said well, if not drilled by the Unit Operator, shall be 21
22 turned over to the Unit Operator and shall be operated by 22
23 Unit Operator at the expense and for the account of the 23
24 Consenting Parties pursuant to this agreement. 24

25 D. Upon the commencement of operations for drilling, 25
26 reworking, deepening or plugging back of any well by the 26
27 Consenting Parties pursuant to the provisions of this 27
28 Article, each Non-Consenting Party shall be deemed to have 28
29 relinquished to the Consenting Parties, and the Consenting 29
30 Parties shall own and be entitled to receive, in proportion 30
31 to their respective interests, all of such Non-Consenting 31
32 Party's interest in the well, its leasehold operating 32
33 rights, and the share of production therefrom until the 33

1 amount received from the sale thereof (after deducting pro- 1
2 duction taxes, royalty, overriding royalty and other 2
3 interests payable out of or measured by the production from 3
4 such well accruing with respect to such interest until the 4
5 same reverts) shall equal the total of the following: 5
6 1. One hundred percent (100%) of each such 6
7 Non-Consenting Party's share of the cost of any newly 7
8 acquired surface equipment beyond the wellhead connections 8
9 (including, but not limited to, flowlines, stock tanks, 9
10 separators, treaters and pumping equipment) plus one hundred 10
11 percent (100%) of each of such Non-Consenting Party's share 11
12 of the cost of operating such well commencing with first 12
13 production and continuing until each such Non-Consenting 13
14 Party's relinquished interest shall revert to said party 14
15 under other provisions of this Article. It is understood 15
16 and agreed that each Non-Consenting Party's share of such 16
17 costs will be that share which would have been chargeable to 17
18 each Non-Consenting Party had such party participated in 18
19 said well from the beginning of the proposed operations; and 19
20 2. Three hundred percent (300%) of that portion 20
21 of the costs and expenses of drilling, reworking, deepening, 21
22 plugging back, testing, completing and three hundred percent 22
23 (300%) of that cost of the newly acquired equipment in the 23
24 well (to and including the wellhead connections) which would 24
25 have been chargeable to such Non-Consenting Party had such 25
26 party participated in such operations. 26
27 E. In the case of reworking, plugging back or deeper 27
28 drilling operations, the Consenting Party shall be permitted 28
29 to use, free of cost, all casing, tubing and other equipment 29
30 in the well, but the ownership of all such equipment shall 30
31 remain unchanged; upon the abandonment of a well after such 31
32 reworking, plugging back or deeper drilling, the Consenting 32
33 Parties shall account for all such equipment to the owners 33

1 thereof, each party receiving its proportionate part in kind 1
2 or value. 2

3 F. Within sixty (60) days from the completion of any 3
4 operations pursuant to this Article, the Working Interest 4
5 Owner conducting the operations for the Consenting Parties 5
6 shall furnish each Non-Consenting Party with an Inventory of 6
7 the Equipment in and connected to the well on which such 7
8 operations were conducted, and an itemized statement of the 8
9 cost of drilling, deepening, plugging back, testing and 9
10 completing the well for production; or, at such Working 10
11 Interest Owner's option, such Working Interest Owner, in 11
12 lieu of an itemized statement of such costs of operation, 12
13 may submit a detailed statement of monthly billings. Each 13
14 month thereafter, during the time the Consenting Parties are 14
15 being reimbursed as provided above, the Unit Operator shall 15
16 furnish the Non-Consenting Parties an itemized statement of 16
17 all costs, expenses and liabilities incurred in connection 17
18 with the operation of such well, together with a statement 18
19 as to the quantities of oil and gas produced from such well 19
20 and the amount of proceeds realized from the sale of said 20
21 well's Beneficial Interest production during the preceding 21
22 month. Any amount realized from the sale or other disposi- 22
23 tion of equipment newly acquired in connection with any such 23
24 operations which would have been owned by Non-Consenting 24
25 Party had it participated in such operations shall be cre- 25
26 dited against the total unreturned cost of such operations 26
27 and of the equipment purchased in determining when the 27
28 interest of such Non-Consenting Party shall revert to such 28
29 party as above provided; if there is a credit balance, such 29
30 balance shall be paid to such Non-Consenting Party. 30

31 G. If and when the Consenting Parties recover from a 31
32 Non-Consenting Party's relinquished interest, the amounts 32
33 provided for hereinabove, the relinquished interest of such 33

1 Non-Consenting party shall automatically revert to such 1
2 party and from and after such reversion, such Non-Consenting 2
3 Party shall own the same interest in such well, the operating 3
4 rights and working interest therein, the material and equip- 4
5 ment in or pertaining thereto and the production therefrom 5
6 that such Non-Consenting Party would have owned had such 6
7 party participated in the drilling, reworking, deepening or 7
8 plugging back of said well. Thereafter, such Non-Consenting 8
9 Party shall be charged with and shall pay its proportionate 9
10 share of all future costs which may be incurred in connec- 10
11 tion with said well in accordance with the terms of this 11
12 agreement. 12

13 H. Notwithstanding the provisions of this Article, it 13
14 is understood and agreed that without the mutual consent of 14
15 all parties, no wells shall be completed in or produced from 15
16 a source of supply from which a well located elsewhere is 16
17 producing unless the proposed well conforms to the then 17
18 existing well spacing pattern for such source of supply. 18

19 I. The provisions of this Article shall have no appli- 19
20 cation whatsoever to the drilling of the initial test well 20
21 but shall apply to the reworking, deepening or plugging back 21
22 of such initial test well after said well has been drilled 22
23 to the depth specified in the respective agreements between 23
24 Unit Operator and the Working Interest Owners, if such well 24
25 is or thereafter shall prove to be a dry hole or a non- 25
26 commercial well. 26

27 J. Notwithstanding anything contained in this Article 27
28 to the contrary, all wells drilled hereunder shall be 28
29 drilled by the Unit Operator for the account of the 29
30 Consenting Parties unless Unit Operator is a Non-Consenting 30
31 party, in which event, the majority of the Consenting 31
32 Parties shall elect another Working Interest Owner as 32
33 Sub-Operator and upon receipt of written notice of such 33

1 election, the Unit Operator shall designate the elected 1
2 party as Sub-Operator for the sole purpose of drilling any 2
3 such well and operating said well until payout. 3

4 K. Any provisions of this agreement to the contrary 4
5 notwithstanding, consent to the drilling of a well by any 5
6 party hereto shall not be deemed as consent to the setting 6
7 of casing and a completion attempt. After any well drilled 7
8 pursuant to this agreement has reached its authorized depth, 8
9 Operator shall give immediate notice to all Non-Operators 9
10 participating in the drilling of such well. The parties 10
11 receiving such notice shall have forty-eight (48) hours 11
12 (exclusive of Saturday or Sunday or legal holidays and after 12
13 appropriate well information, including applicable electric 13
14 logs, have been furnished by Unit Operator to the Working 14
15 Interest Owners participating in the drilling of the par- 15
16 ticular well involved at the address of the representative 16
17 of each such Working Interest Owner as furnished to Unit 17
18 Operator in accordance with Article IX hereof) in which to 18
19 elect whether or not they desire to set casing and to par- 19
20 ticipate in a completion attempt. Failure of a party 20
21 receiving such notice so to reply within the period above 21
22 fixed shall constitute an election by that party not to par- 22
23 ticipate in the cost of a completion attempt. If all par- 23
24 ticipating parties elect to plug and abandon the well, 24
25 Operator shall plug and abandon same at the expense of the 25
26 participating parties. If one or more, but less than all, 26
27 of the participating parties elect to set pipe and to 27
28 attempt a completion, the provisions of this agreement as to 28
29 operations by less than all parties shall thereafter apply. 29

30 XVI. 30

31 ESTABLISHMENT OF PARTICIPATING AREA FOR PAYMENT OF ROYALTIES 31

32 All Unitized Substances produced, saved and marketed 32
33 from a participating area established pursuant to the Unit 33

1 Agreement and this agreement shall be allocated to the lands 1
2 comprising such participating area on an acreage basis as 2
3 provided in the Unit Agreement for the purpose of deter- 3
4 mining and paying royalties, overriding royalties and pro- 4
5 duction payments under the terms of the instruments which 5
6 provide for the payment thereof as to the production from 6
7 the lands that are within said participating area; provided, 7
8 however, that as between the Working Interest Owners in 8
9 which such participating area is located, all production 9
10 from such participating area shall be owned by the Working 10
11 Interest Owners in the proportion to their respective 11
12 Beneficial Interests in effect at the time such production 12
13 is obtained. 13

14 XVII. 14

15 RIGHT TO TAKE PRODUCTION IN KIND 15

16 A. Each Working Interest Owner shall have the right to 16
17 take in kind or separately dispose of its proportionate 17
18 share of all Unitized Substances produced from the Unit 18
19 Area, exclusive of production which may be used in develop- 19
20 ment and producing operations and in preparing and treating 20
21 oil for marketing purposes and production unavoidably lost. 21
22 Any extra expenditure incurred in the taking in kind or 22
23 separate disposition by any Working Interest Owner of its 23
24 proportionate share of Unitized Substances shall be borne by 24
25 such party. 25

26 B. Each Working Interest Owner shall execute all divi- 26
27 sion orders and contracts of sale pertaining to its interest 27
28 in Unitized Substances produced from the Unit Area, and 28
29 shall be entitled to receive payment direct from the 29
30 purchaser or purchasers thereof for its share of Unitized 30
31 Substances. 31

32 C. In the event any Working Interest Owners shall fail 32
33 to make the arrangements necessary to take in kind or 33

1 separately dispose of its proportionate share of the 1
2 Unitized Substances produced from the Unit Area, Unit 2
3 Operator shall have the right, subject to revocation at will 3
4 by the Working Interest Owner owning such share of Unitized 4
5 Substances, but not the obligation, to purchase such 5
6 Unitized Substances or sell the same to others for the time 6
7 being, at not less than the market price prevailing in the 7
8 area, which shall in no event be less than the price which 8
9 Unit Operator receives for its portion of the Unitized 9
10 Substances produced from the Unit Area. Any such purchase or 10
11 sale by Unit Operator shall be subject always to the right 11
12 of the owner of such Unitized Substances not previously 12
13 delivered to a purchaser. Notwithstanding the foregoing, 13
14 Unit Operator shall not make a sale into interstate commerce 14
15 of any Working Interest Owner's share of gas produced from 15
16 the Unit Area without first giving such Working Interest 16
17 Owner sixty (60) days notice of such intended sale. Any 17
18 such sale by Operator shall be for such reasonable periods 18
19 of time only as is consistent with the minimum needs of the 19
20 industry, and shall in no event exceed one year. 20

21 D. The provisions of this Article XVII are expressly 21
22 subject to the provisions of the Gas Balancing Agreement 22
23 attached hereto as Exhibit "F". 23

24 XVIII. 24

25 RENTALS, RENEWALS AND EXTENSIONS OF LEASES 25

26 A. Working Interest Owners in each Tract shall pay all 26
27 rentals which may become due and payable under the leases 27
28 covering such Tract. If any lease is a Federal lease, the 28
29 Working Interest Owners committing such lease to this 29
30 agreement shall obtain such renewals and extensions thereof 30
31 as may be permitted by applicable Federal statutes and regu- 31
32 lations and shall promptly furnish to Unit Operator evidence 32
33 that such renewals and extensions have been so obtained. If 33

1 any Working Interest owner in any Tract elects not to pay 1
2 any such rentals or to obtain any such renewal or extension, 2
3 such Working Interest Owner shall notify Unit Operator not 3
4 less than sixty (60) days before the date that the rental 4
5 payment is due or the date that an application for renewal 5
6 or extension must be filed. Such Working Interest Owners 6
7 shall tender an assignment to all other Working Interest 7
8 Owners; provided, however, that any assignment to be ten- 8
9 dered pursuant to this Article XVIII shall be subject to all 9
10 obligations pertaining to reassignments, if any, of the 10
11 Working Interest Owner making such assignment theretofore 11
12 created in favor of the predecessor or predecessors in title 12
13 to the Working Interest Owner tendering said assignment. If 13
14 all of the Working Interest Owners are not willing to accept 14
15 the foregoing assignment, such assignment shall be made to 15
16 those Working Interest Owners that are willing to accept 16
17 said assignment in the proportions that their respective 17
18 Working Interests bear to the aggregate of all such Working 18
19 Interest Owners' Working Interests. In the event any Working 19
20 Interest Owner inadvertently fails to pay, or makes an 20
21 improper payment of, any rental or inadvertently fails to 21
22 obtain any renewal or extension where such rental, renewal 22
23 or extension is required to continue the lease in force, 23
24 there shall be no money liability on the part of the Working 24
25 Interest Owner or Working Interest Owners failing to pay 25
26 such rental or to obtain such renewal or extension; 26
27 provided, that such Working Interest Owner or Working 27
28 Interest Owners shall make a bona fide effort to secure a 28
29 new lease and commit such lease to the Unit Agreement and to 29
30 this agreement. In the event such Working Interest Owner 30
31 fails, or Working Interest Owners fail, to secure a new 31
32 lease within a reasonable time, the Working Interest and the 32
33 Beneficial Interest of the Working Interest Owners shall be 33

1 revised so that the Working Interest Owner or Working 1
2 Interest Owners who failed to pay such rental or to obtain 2
3 such renewal or extension shall not be credited with the 3
4 ownership of the lease as to which such rental was not paid 4
5 or such renewal or extension was not obtained. In the event 5
6 the party who failed to pay the rental or failed to obtain 6
7 such renewal or extension, shall not have been fully 7
8 reimbursed, at the time of the loss, from the proceeds of 8
9 the sale of oil and gas attributable to the lost interest 9
10 for the development and operating costs therefore paid on 10
11 account of such interest, it shall be reimbursed for unreco- 11
12 vered actual costs theretofore paid by it (but not for its 12
13 share of the cost of any dry hole previously drilled or 13
14 wells previously abandoned) from so much of the following as 14
15 is necessary to effect reimbursement. 15

16 (1) Proceeds of oil and gas, less operating 16
17 expenses, theretofore accrued to the credit of the 17
18 lost interest, up to the amount of unrecovered costs; 18

19 (2) Proceeds, less operating expenses thereafter 19
20 incurred attributable to the lost interest of that por- 20
21 tion of oil and gas thereafter produced and marketed 21
22 (excluding production from any wells thereafter drilled) 22
23 which would, in the absence of such lease termination, 23
24 be attributable to the lost interest on an acreage 24
25 basis, up to the amount of unrecovered costs, the pro- 25
26 ceeds of said portion of the oil and gas to be contri- 26
27 buted by the other parties in proportion to their 27
28 respective interests; and 28

29 (3) any monies, up to the amount of unrecovered 29
30 costs, that may be paid by any party who is, or becomes, 30
31 the owner of the interest lost, for the privilege of 31
32 participating in the Unit Area or becoming a party to 32
33 this contract. 33

1 Unit Operator shall incur no liability for failure to pay 1
2 any rental due under the terms of any lease committed to the 2
3 Unit Agreement; however, if any rentals are paid by the Unit 3
4 Operator, the Working Interest Owner or Working Interest 4
5 Owners responsible for the payment of such rentals shall 5
6 promptly reimburse Unit Operator upon being billed therefor. 6

7 B. Unit Operator shall use its best efforts to 7
8 promptly notify each of the Working Interest Owners of the 8
9 date on which any gas well located on the Unit Area is shut- 9
10 in and the reason therefor; however, Unit Operator shall not 10
11 be subject to any liability for any failure to do so. 11

12 XIX. 12

13 TITLES 13

14 A. Each Working Interest Owner represents and warrants 14
15 that, as of the date hereof, it is the owner of the respec- 15
16 tive interests set forth opposite its name in Exhibit "B", 16
17 and hereby agrees to indemnify and hold harmless the other 17
18 Working Interest Owners from any loss due to failure, in 18
19 whole or in part, of its title to any such interest, except 19
20 failure of title arising out of Unit Operations; provided 20
21 that such indemnity shall be limited to an amount equal to 21
22 the net value that such Working Interest Owner has received 22
23 from the sale or receipt of Unitized Substances attributed 23
24 to the interest as to which title failed. Each failure of 24
25 title will be deemed to be effective, insofar as this 25
26 agreement is concerned, as of 7:00 A.M. local time on the 26
27 first day of the calendar month in which such failure is 27
28 finally determined, and there shall be no retroactive 28
29 adjustment of Unit Expense, or retroactive allocation of 29
30 Unitized Substances or the proceeds therefrom, as a result of 30
31 title failure. 31

32 B. The failure of title to any Working Interest in any 32
33 Tract by reason of Unit Operations, including non-production 33

1 from such Tract, shall not change the Working Interest or 1
2 the Beneficial Interest of the Working Interest Owner whose 2
3 title failed in relation to the Working Interest and 3
4 Beneficial Interests of the other Working Interest Owners at 4
5 the time of the title failure. 5

6 XX. 6

7 TITLE EXAMINATIONS 7

8 A. Upon request by Unit Operator, each Working 8
9 Interest Owner shall promptly submit to Operator all 9
10 abstracts of title together with copies of all leases, 10
11 copies of all title opinions and other title papers, in its 11
12 possession relating to the lease(s) committed by the respec- 12
13 tive Working Interest Owners to the Unit Agreement and this 13
14 agreement. 14

15 B. Prior to commencing the initial well, Unit Operator 15
16 shall cause the title to the drillsite lease(s) to be exa- 16
17 mined by attorneys acceptable to Unit Operator. A copy of 17
18 such title opinion will be furnished by Unit Operator to all 18
19 Working Interest Owners who elect to pay their proportionate 19
20 share of all costs incurred in drilling, testing, completing 20
21 and equipping or plugging and abandoning of the initial 21
22 well. All costs, including, but not limited to, attorney's 22
23 fees paid to outside attorneys and costs of obtaining the 23
24 necessary abstracts, shall be charged to the account of the 24
25 Working Interest Owners who pay the costs of drilling such 25
26 well. All costs, including, but not limited to, attorney's 26
27 fees paid to outside attorneys and costs of obtaining the 27
28 necessary abstracts, shall be charged to the account of the 28
29 Working Interest Owners who pay the costs of drilling such 29
30 well. 30

31 C. In the event the initial well is completed as a 31
32 well capable of producing Unitized Substances in paying 32
33 quantities and a participating area is created as the result 33

1 of such well, Unit Operator shall cause a division order 1
2 title opinion to be rendered covering all leases pertaining 2
3 to the lands within such participating area. Unit Operator 3
4 shall furnish a copy of such opinion to all Working Interest 4
5 Owners. All costs incurred by the Unit Operator in securing 5
6 said title opinion shall be charged to the joint account of 6
7 the Working Interest Owners. 7

8 D. In the event any Working Interest Owner elects, or 8
9 Working Interest Owners elect, to drill any well subsequent 9
10 to the initial well, Unit Operator shall cause the title to 10
11 the lease on which such well is to be located to be 11
12 examined, if the title to such lease has not previously been 12
13 examined pursuant to the terms of this agreement. A copy of 13
14 such title opinion shall be furnished to each Working 14
15 Interest Owner paying the costs incurred in the drilling of 15
16 such well. All costs incurred by the Unit Operator in con- 16
17 nection with such title examination shall be charged to the 17
18 account of the Working Interest Owners participating in the 18
19 cost of drilling of such well. In the event any such well 19
20 is completed as a well capable of producing Unitized 20
21 Substances in paying quantities, Unit Operator shall obtain 21
22 a division order title opinion and the cost thereof shall be 22
23 borne and paid as provided in Section C of this Article XX. 23

24 E. If any well drilled on any Tract is completed as a 24
25 well capable of producing Unitized Substances, but not in 25
26 paying quantities, and if any of the Working Interest Owners 26
27 who participated in drilling such well, elect to operate and 27
28 produce said well on a Tract basis as provided in the Unit 28
29 Agreement, any subsequent title examination pertaining to 29
30 the proration or spacing unit allocated to such well shall 30
31 be borne and solely paid by the Working Interest Owner or 31
32 Working Interest Owners electing to so operate such well. 32

33 F. It is understood and agreed that Unit Operator 33

1 shall not be deemed to warrant the accuracy or correctness 1
2 of any title opinion obtained hereunder and any reliance 2
3 placed thereon by any Working Interest Owner shall be at 3
4 such Working Interest Owner's sole risk and liability. 4

5 XXI. 5

6 TRANSFERS OF INTEREST 6

7 A. Any Working Interest Owner may, at any time and 7
8 from time to time, sell, transfer or assign all of such 8
9 Working Interest Owner's interest in the Unit Area to any 9
10 other Working Interest Owner who is a party to the Unit 10
11 Agreement and to this agreement or to any other person or 11
12 party who is not a party to the Unit Agreement and this 12
13 agreement provided that any assignment is made expressly 13
14 subject to the terms, provisions and conditions of the Unit 14
15 Agreement and of this agreement. 15

16 B. If Unit Operator sells all of its Working Interest 16
17 committed to the Unit Agreement and to this agreement, Unit 17
18 Operator shall resign and a new Unit Operator shall be 18
19 selected as provided in the Unit Agreement and this 19
20 agreement. 20

21 C. No transfer of any interest by any Working Interest 21
22 Owner shall be effective unless the same is made expressly 22
23 subject to the Unit Agreement and to this Agreement and the 23
24 transferee agrees in writing to assume and perform all of 24
25 the obligations of the transferor under the Unit Agreement 25
26 and this Agreement insofar as said agreements relate to the 26
27 interests assigned. Such assumption of obligations by such 27
28 transferee shall not be required in case of a transfer by 28
29 mortgage or deed of trust as security for indebtedness. 29

30 D. A transfer of any interest by any Working Interest 30
31 Owner hereunder shall not be effective as between the par- 31
32 ties hereto until the first day of the month following deli- 32
33 very to the Unit Operator of the original or a certified 33

1 copy of the instrument of transfer conforming to the 1
2 requirements of this Article. In no event shall a transfer 2
3 of any interest by any Working Interest Owner relieve the 3
4 transferring Working Interest Owner of any obligations which 4
5 accrue or have accrued hereunder prior to said effective 5
6 date. Any obligations assumed by the transferring Working 6
7 Interest Owner to participate in any drilling, deepening, 7
8 plugging back or reworking operations prior to the effective 8
9 date of such transfer shall be deemed to be an accrued obli- 9
10 gation and shall be binding upon the transferring Working 10
11 Interest Owner unless the transferee expressly assumes, in 11
12 writing, all of such obligations. 12

13 XXII. 13

14 WITHDRAWAL OF A WORKING INTEREST OWNER 14

15 Any Working Interest Owner may withdraw from this 15
16 agreement by transferring, without warranty of title, either 16
17 express or implied, to the other Working Interest Owners who 17
18 do not desire to withdraw, all of such withdrawing Working 18
19 Interest Owner's leasehold rights together with such Working 19
20 Interest Owner's interest in all Unit Equipment and in all 20
21 wells used in Unit Operations. Such transfer shall not 21
22 relieve the withdrawing Working Interest Owner of or from 22
23 any obligation or liability incurred prior to the date of 23
24 the delivery of the transfer, which delivery may be made to 24
25 the Unit Operator as agent for the transferees. The 25
26 interest transferred shall be owned by the transferees in 26
27 proportion to their respective Working Interest Ownership 27
28 and the consideration paid for such interest in such Unit 28
29 Equipment shall be the net salvage value thereof as 29
30 estimated and fixed by the Working Interest Owners. 30
31 After the date of the delivery of the transfer, the 31
32 withdrawing Working Interest Owner shall, as to such trans- 32
33 ferred interest, be relieved from all further obligations 33

1 and liabilities hereunder and under the Unit Agreement, and 1
2 the rights of such Working Interest Owner hereunder and 2
3 under the Unit Agreement shall cease insofar as such rights 3
4 existed by virtue of the interest so transferred. Should a 4
5 second well be drilled prior to payout of the initial 5
6 earning well, it will be as if all Overriding Royalty 6
7 Interests have been converted to Working Interests. 7

8 XXIII. 8

9 SUBSEQUENT JOINDER 9

10 Prior to the commencement of any operations under the 10
11 Unit Agreement, all owners of working interest within the 11
12 Unit Area who have not become bound by the terms of the Unit 12
13 Agreement shall have the right to join in this Agreement by 13
14 subscribing to the Unit Agreement and this Agreement and in 14
15 the event of such joinder, the Working Interests and the 15
16 Beneficial Interests of the parties hereto shall be revised 16
17 on the basis set forth in Article IV hereof to reflect the 17
18 joinder by such additional Working Interest Owner or Working 18
19 Interest Owners and Exhibits "C" and "E" shall be revised 19
20 accordingly. After commencement of any operations on the 20
21 Unit Area under the Unit Agreement and/or this Agreement, 21
22 any subsequent joinder to the Unit Agreement and to this 22
23 Agreement by any party owning a working interest in the Unit 23
24 Area shall be on such reasonable terms and conditions as the 24
25 Working Interest Owners who are then signatory parties 25
26 hereto and to the Unit Agreement may require under the cir- 26
27 cumstances existing at the time that such subsequent joinder 27
28 is requested. 28

29 XXIV. 29

30 LIABILITY, CLAIMS AND SUITS 30

31 A. The duties, obligations and liabilities of Working 31
32 Interest Owners shall be several and not joint or 32
33 collective; and nothing herein contained shall ever be 33

1 construed as creating a partnership of any kind, joint 1
2 venture, association or trust among Working Interest Owners. 2
3 B. Unit Operator may settle any single damage claim or 3
4 suit involving Unit Operations but not involving an expen- 4
5 diture in excess of Two Thousand, Five Hundred Dollars 5
6 (\$2,500.00) provided the payment is in complete settlement 6
7 of such claim or suit. If the amount required for settle- 7
8 ment exceeds the above specified amount, Working Interest 8
9 Owners shall assume and take over the further handling of 9
10 the claim or suit unless such authority is expressly dele- 10
11 gated to Unit Operator. All costs and expense of handling, 11
12 settling or otherwise discharging such claim or suit shall 12
13 be an item of Unit Expense chargeable to the Working 13
14 Interest Owners. If a claim is made against any Working 14
15 Interest Owner or if any Working Interest Owner is sued on 15
16 account of any matter arising from Unit Operations and over 16
17 which such Working Interest Owner individually has no 17
18 control because of the rights given Working Interest Owners 18
19 and Unit Operator by this Agreement and the Unit Agreement, 19
20 the Working Interest Owner shall immediately notify the Unit 20
21 Operator, and the claim or suit shall be treated as any 21
22 other claim or suit involving Unit Operations. 22

23 XXV. 23

24 INTERNAL REVENUE PROVISIONS 24

25 Notwithstanding any provisions herein that the rights 25
26 and liabilities of the parties hereunder are several and not 26
27 joint or collective, or that this Agreement and operations 27
28 hereunder shall not constitute a partnership, if for Federal 28
29 income tax purposes this Agreement and the operations 29
30 hereunder shall not constitute a partnership, if for Federal 30
31 income tax purposes this Agreement and the operations 31
32 hereunder are regarded as a partnership, then each of the 32
33 parties hereto elects to be excluded from the application of 33

1 all of the provisions of Subchapter K, Chapter 1, Subtitle 1
2 A, of the Internal Revenue Code of 1954, as permitted and 2
3 authorized by Section 761 of the Code and the regulations 3
4 promulgated thereunder. Unit Operator is hereby authorized 4
5 and directed to execute on behalf of each of the parties 5
6 hereto such evidence of this election as may be required by 6
7 the Secretary of Treasury of the United States or the 7
8 Federal Internal Revenue Service, including specifically, 8
9 but not by way of limitation, all of the returns, 9
10 statements, and the data required by Federal Regulations 10
11 1.761-2(b). Should there be any requirement that each party 11
12 hereto further evidence this election, each party hereto 12
13 agrees to execute such documents and furnish such other evi- 13
14 dence as may be required by the Federal Internal Revenue 14
15 Service or as may be necessary to evidence this election. 15
16 Each party hereto further agrees not to give any notices or 16
17 take any other action inconsistent with the election made 17
18 hereby. If any present or future income tax laws of the 18
19 state or states in which the Unit Area is located, or any 19
20 future income tax law of the United States, contain provi- 20
21 sions similar to those in Subchapter K, Chapter 1, Subtitle 21
22 A, of the Internal Revenue Code of 1954, under which an 22
23 election similar to that provided by Section 761 of the Code 23
24 is permitted, each of the parties agrees to make such elec- 24
25 tion as may be permitted or required by such laws. In 25
26 making this election, each of the parties states that the 26
27 income derived by such party from the operations under this 27
28 agreement can be adequately determined without the com- 28
29 putation of partnership taxable income. 29

30 XXVI. 30

31 NOTICES 31

32 All notices required hereunder shall be in writing and 32
33 shall be deemed to have been properly served when sent by 33

1 mail or telegram with postage or charges prepaid to the 1
2 address of the representative of each Working Interest Owner 2
3 as furnished to Unit Operator in accordance with Article IX 3
4 hereof. 4

5 XXVII. 5

6 SURRENDER OR TERMINATION OF INTEREST 6

7 No lease committed to the Unit Agreement or to this 7
8 Agreement shall be surrendered in whole or in part unless 8
9 all Working Interest Owners signatory hereto consent to such 9
10 surrender. In the event any Working Interest Owner should 10
11 at any time desire to surrender any committed lease, or any 11
12 part thereof, and the other Working Interest Owners do not 12
13 agree or consent to such surrender, the Working Interest 13
14 Owner desiring to surrender shall tender an assignment, 14
15 without any warranty, express or implied, of all of such 15
16 surrendering Working Interest Owner's interest in such lease 16
17 to the other Working Interest Owners in the proportions of 17
18 such Working Interest Owner's Working Interests. The 18
19 Working Interest Owner desiring to so surrender its interest 19
20 pursuant to this Article XXVII shall give sixty (60) days' 20
21 written notice of such intention to all other Working 21
22 Interest Owners. On or before the expiration of said sixty 22
23 (60) day period, each Working Interest Owner shall notify 23
24 the Unit Operator whether or not such Working Interest Owner 24
25 desires to accept the interest sought to be assigned. If 25
26 all of the Working Interest Owners are not willing to accept 26
27 the assignment of such interest, such assignment shall be 27
28 made to those Working Interest Owners willing to accept said 28
29 assignment in proportion to their respective Working 29
30 Interest. Such assignment shall be free and clear of all 30
31 liens and encumbrances created after the date of this 31
32 Agreement. Upon the delivery thereof, the assigning Working 32
33 Interest Owner shall be relieved of all further obligations 33

1 with respect to the lease so assigned, but such assignment 1
2 shall not relieve the assigning party of any obligations 2
3 which accrued or which such assigning Working Interest Owner 3
4 assumed with respect to such lease prior to the assignment 4
5 thereof pursuant to this Article. Any assignment or 5
6 surrender made under the provisions of this Article XXVII 6
7 shall not operate to reduce or change the interest of the 7
8 assigned Working Interest Owner, as it was immediately 8
9 before the assignment, in the balance of the Unit Area. 9
10 Operations relating to any lease assigned under the provi- 10
11 sions of this Article XXVII shall thereafter be conducted by 11
12 Unit Operator for the account and at the expense of the 12
13 Working Interest Owners who accepted such assignment. 13

14 XXVIII. 14

15 RELATIONSHIP OF THE PARTIES 15

16 No partnership, joint venture or mining partnership or 16
17 any other entity is intended or created by this agreement, 17
18 and no act by any Working Interest Owner or Working Interest 18
19 Owners shall operate to create such a relationship, nor 19
20 shall any of the provisions of this agreement be construed 20
21 or implied as creating such relationship for any purpose 21
22 whatsoever. 22

23 XXIX. 23

24 LAWS, RULES AND REGULATIONS 24

25 A. All of the provisions of this agreement are 25
26 expressly subject to all applicable laws, orders, rules and 26
27 regulations of any governmental body or agency having juris- 27
28 diction in the premises, and all operations contemplated 28
29 hereby shall be conducted in conformity therewith. Any pro- 29
30 vision of this agreement which is inconsistent with any 30
31 such laws, orders, rules and regulations is hereby modified 31
32 so as to conform therewith, and this Agreement, as so 32
33 modified, shall continue in full force and effect. 33

1 B. In connection with the performance of work under 1
2 this agreement, Unit Operator agrees to comply with all of 2
3 the provisions of Section 202 (1) to (7) inclusive of 3
4 Executive Order 11246 (30 F.R. 12319), as amended, a copy of 4
5 which is attached hereto as Exhibit "G". 5

6 XXX. 6

7 FORCE MAJEURE 7

8 A. In the event any Working Interest Owner is rendered 8
9 unable, wholly or in part, by force majeure, to carry out 9
10 its obligations under this agreement other than the obliga- 10
11 tion to make money payments due hereunder, it is agreed that 11
12 upon such Working Interest Owner giving notice with reaso- 12
13 nably full particulars of the force majeure, in writing or 13
14 by telephone to the other Working Interest Owners within a 14
15 reasonable time after the occurrence of the cause relied 15
16 upon, then the obligations of the Working Interest Owner 16
17 giving such notice, insofar as such obligations are affected 17
18 by such force majeure, shall be suspended during the con- 18
19 tinuance of such force majeure, but for no longer. The 19
20 cause of the force majeure shall, so far as is reasonably 20
21 possible be remedied with all reasonable dispatch by the 21
22 Working Interest Owner giving such notice. The term "force 22
23 majeure" as employed herein shall mean an act of God, 23
24 strike, lockout, or other industrial disturbance, act of the 24
25 public enemy, war, blockage, public riot, lightening, fire, 25
26 storm, flood, explosion, governmental restraint, unavailabi- 26
27 lity of equipment, and any other cause, whether of the kind 27
28 specifically enumerated above or otherwise, which is not 28
29 reasonably within the control of the party claiming suspen- 29
30 sion. 30

31 B. The settlement of strikes, lockouts or other labor 31
32 disputes shall be entirely within the discretion of the 32
33 Working Interest Owner having such difficulty and the 33

1 requirement that any force majeure shall be remedied with 1
2 all reasonable dispatch shall not require the settlement of 2
3 strikes, lockouts, or other labor difficulty against the 3
4 will of the Working Interest Owner having such difficulty. 4

5 C. The term Working Interest Owner as used herein 5
6 shall also include the Unit Operator acting in its capacity 6
7 as Unit Operator. 7

8 XXXI. 8

9 ABANDONMENT OF OPERATIONS 9

10 Upon the termination of the Unit Agreement, the 10
11 following will occur: 11

12 A. All leasehold rights in each Tract committed hereto 12
13 shall no longer be affected by this agreement and thereafter 13
14 the Working Interest Owners contributing each such Tract 14
15 shall be governed by the terms, provisions and conditions of 15
16 the lease(s), contract(s) and other instrument(s) affecting 16
17 the separate tracts. 17

18 B. The Working Interest Owners of any Tract that 18
19 desire to take over and continue to operate any wells 19
20 located thereon may do so by paying to the Unit Operator, 20
21 for the credit of the joint account of the Working Interest 21
22 Owners owning any such well upon the termination of this 22
23 agreement, the net salvage value of the casing and equipment 23
24 in and on the wells taken over as such value is estimated by 24
25 Working Interest Owners owning such well upon the ter- 25
26 mination of this Agreement. The Working Interest Owners 26
27 taking over such well agree to plug each well in accordance 27
28 with applicable rules and regulations at such time as it is 28
29 abandoned. 29

30 C. The Unit Operator shall salvage as much of the 30
31 casing and equipment in and on the wells not taken over by 31
32 Working Interest Owners of the separate Tracts as can econo- 32
33 mically and reasonably be salvaged and shall cause the wells 33

1 to be plugged and abandoned in accordance with applicable 1
2 rules and regulations. 2

3 D. The Working Interest Owners owning any interest in 3
4 any salvaged material and equipment at the termination 4
5 hereof shall share in the cost of plugging and abandoning 5
6 operations, salvaging, liquidation or other distribution of 6
7 such assets and properties in the proportion to their 7
8 respective ownership in such assets and property at the time 8
9 of the termination of this agreement. 9

10 XXXII. 10

11 EFFECTIVE DATE AND TERM 11

12 A. This agreement shall become effective on the date 12
13 and at the time that the Unit Agreement becomes effective. 13

14 B. This agreement shall continue in effect so long as 14
15 the Unit Agreement remains in effect and thereafter until 15

16 1. All Unit wells have been plugged and abandoned 16
17 or turned over to the Working Interest Owners in accordance 17
18 with Article XXXI hereof, and 18

19 2. All Unit Equipment and real property acquired 19
20 for operations hereunder have been disposed of by the Unit 20
21 Operator in accordance with instructions of the Working 21
22 Interest Owners owning an interest in such Unit Equipment 22
23 and real property, and 23

24 3. There has been final accounting between the 24
25 parties hereto. 25

26 XXXIII. 26

27 COUNTERPART EXECUTION 27

28 A party may become a party to this agreement by exe- 28
29 cuting the original of this instrument, a counterpart 29
30 thereof, or other instrument, agreeing to be bound by the 30
31 provisions hereof and this agreement shall be binding upon 31
32 all parties who have agreed to be bound by the terms hereof 32
33 regardless of whether this agreement is executed by all par- 33

1 ties owning an oil and gas leasehold interest in the Unit 1
2 Area. The execution of any such instrument shall have the 2
3 same effect as if all the parties had signed one and the 3
4 same instrument. 4

5 XXXIV. 5

6 HEADINGS 6

7 The headings set forth above any Article of this 7
8 agreement are for convenience only and shall in no manner be 8
9 used in construing or interpreting any provision of this 9
10 agreement. 10

11 XXXV. 11

12 COVENANTS RUN WITH THE LAND 12

13 The terms, provisions and conditions hereof shall be 13
14 covenants running with the lands, leases, and interests 14
15 covered hereby, and shall be binding upon and inure to the 15
16 benefit of the respective heirs, devisees, legal 16
17 representatives, successors, and assigns of the parties 17
18 hereto. 18

19 XXXVI. 19

20 INITIAL WELL 20

21 On or before _____, Unit Operator shall 21
22 commence operations for the drilling of the "Initial Test 22
23 Well" at a lawful location of Operator's selection in the 23
24 ___ Section __, Township __ South, Range __ East, N.M.P.M., 24
25 Lea County, New Mexico, and thereafter prosecute the 25
26 drilling of said well with due diligence and in a good 26
27 and workmanlike manner to a depth of 18,000 feet below the 27
28 surface, or to a depth sufficient to adequately test the 28
29 Mississippian formation, whichever is the lesser, with the 29
30 option to continue drilling to a depth of 22,000 feet below 30
31 the surface, or to a depth to adequately test the 31
32 _____ formation, whichever is the lesser depth. In 32
33 the drilling of the initial test well, Unit Operator shall 33

1 make reasonable tests of all formations encountered during 1
2 drilling and which give indication of containing oil and gas 2
3 in quantities sufficient to test. Such well shall be 3
4 drilled and completed by operator in a good and workmanlike 4
5 manner and completed if a producer, or plugged and abandoned 5
6 if a dry hole. 6

7 If, in the drilling of the Initial Test Well, Unit 7
8 Operator loses the hole or encounters mechanical or other 8
9 difficulties rendering it impracticable in the opinion of 9
10 Unit Operator to drill the well to the objective depth, then 10
11 Operator shall have the option of commencing a "Substitute 11
12 Test Well" at a lawful location of Operator's selection on 12
13 the Unit Area. Such Substitute Well shall be deemed to 13
14 comply with the drilling obligation herein and shall be 14
15 deemed in compliance with the terms for drilling the well 15
16 which it became necessary to junk or abandon. 16

17 Working Interest Owners shall bear the entire cost, risk 17
18 and expense of drilling and completing or plugging and aban- 18
19 doning the Initial Test Well (or Substitute Test Well) in 19
20 accordance with the Working Interest Schedule set forth on 20
21 Exhibit "E" attached hereto and made a part hereof for all 21
22 purposes, subject to the Farmout Agreement provisions spe- 22
23 cified in Article XXXVII. 23

24 XXXVII. 24

25 FARMOUT PROVISIONS 25

26 26
27 27
28 28
29 XXXVIII. 29

30 INTERESTS IN SUBSEQUENT WELLS 30

31 If a well is proposed subsequent to the drilling of the 31
32 initial test well, although such may be prior to the payout 32
33 of the same, the interests of the parties hereto in connec- 33
tion with the drilling of said subsequent well and the allo-

EXHIBIT A

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28

26

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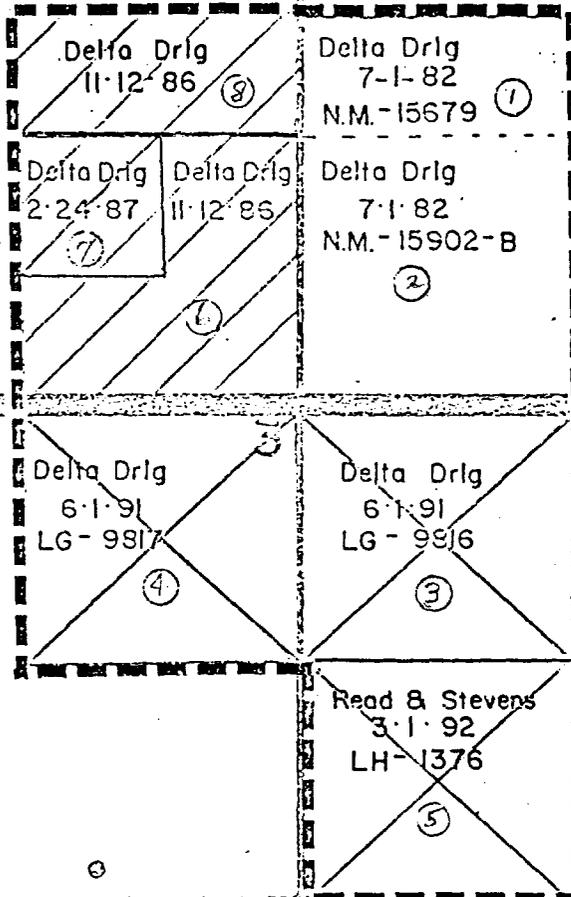
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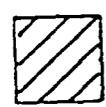
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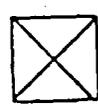
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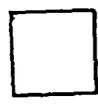
LEA COUNTY, NEW MEXICO



- FEE LAND



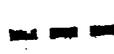
- STATE LAND



- FEDERAL LAND



- TRACT NUMBER



- NORTH MESCALERO UNIT OUTLINE - 959.77 acres

EXHIBIT "B" TO UNIT OPERATING AGREEMENT

Tract No.	Description of Land	No. of Acres	Lease Serial No. or State Lease No. and Expiration Date	Basic Royalty		Owner of Record/Lessee of Record		Overriding Royalty		Working Interest	
				Owner	%	Owner	%	Owner	%	Owner	%
1	S $\frac{1}{4}$ NW $\frac{1}{4}$ Section 35 T9S, R32E	80	NM 15679 7-1-82	USA	12.5%	Petroleum Development Corporation	100%	Albert Z. Mellon, Jr. et ux Juanita Mellon, Robert L. Pegram, Mrs. Robert L. Pegram Dalton Kincheloe et ux Gladys Kincheloe Texas Crude, Inc.	4.00% 4.25% 4.25%	Petroleum Development Corporation	100%
2	SW $\frac{1}{4}$ Section 35 T9S, R32E	160	NM 15902 7-1-82	USA	12.5%	Petroleum Development Corporation	100%	Cynthia E. Perkins et vir Marshall R. Perkins Dalton Kincheloe et ux Gladys Kincheloe Robert W. Becker et ux Marion D. Becker Texas Crude, Inc.	4.00% 2.125% 2.125% 4.250%	Petroleum Development Corporation	100%
3	Lots 3 (39.85), 4 (39.91), S $\frac{1}{4}$ NW $\frac{1}{4}$ Section 2, T10S, R32E	159.76	IG-9816 6-1-91	State of New Mexico	12.5%	Delta Drilling Company	100%			Delta Drilling Company	100%
4	Lots 1, (39.97), 2 (40.04), S $\frac{1}{4}$ NE $\frac{1}{4}$ Section 3, T10S, R32E	160	LH-9817 6-1-91	State of New Mexico	12.5%	Delta Drilling Company	100%			Delta Drilling Company	100%
5	SW $\frac{1}{4}$ Section 2, T10S, R32E	160	LH-1376 3-1-92	State of New Mexico	12.5%	Read & Stevens, Inc.	100%			Read & Stevens, Inc.	100%
6	S $\frac{1}{4}$ SE $\frac{1}{4}$, NE $\frac{1}{4}$ SE $\frac{1}{4}$ Section 34, T9S, R32E	120	Fee	Ronald W. Broadrick, Linda Jo Broadrick, and Ingrid Broadrick	1/10 of 3/16	Centerfire Resources Inc.	100%			Centerfire Resources, Inc.	100%

Tract No.	Description of Land	No. of Acres	Lease Serial No. or State Lease No. and Expiration Date	Basic Royalty		Owner of Record/Lessee of Record		Overriding Royalty		Working Interest	
				Owner	\$	Owner	\$	Owner	\$	Owner	\$
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee	Unleased Mineral Interest		Charles B. Read	1/40			Charles B. Read	1/40
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee	Richard L. Moore, Michael H. Moore, and Steven S. Moore	1/20 of						
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee	H. W. Puckett et ux Mary R. Puckett	1/200 of 3/16	Russell B. Ward	100%			Russell B. Ward	100%
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee	R. P. Fisher et ux Zella Fisher	1/200 of 3/16	Russell B. Ward	100%			Russell B. Ward	100%
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee	Charles B. Morgan, same as C. B. Morgan, a single man	1/200 of 3/16	Russell B. Ward	100%			Russell B. Ward	100%

Tract No.	Description of Land	No. of Acres	Lease Serial No. or State Lease No. and Expiration Date	Basic Royalty		Owner of Record/Lessee of Record		Overriding Royalty		Working Interest	
				Owner	Basic Royalty %	Owner	Lessee of Record	Owner	Overriding Royalty %	Owner	Working Interest %
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee 1/200 of 3/16	J. F. Read et ux Thelma M. Read	100%	Russell B. Ward	Russell B. Ward			Russell B. Ward	100%
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee 1/200 of 3/16	A. W. Wood et ux Margaret P. Wood	100%	Russell B. Ward	Russell B. Ward			Russell B. Ward	100%
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee 1/200 of 3/16	F. H. McGuigan et ux Fern G. McGuigan	100%	Russell B. Ward	Russell B. Ward			Russell B. Ward	100%
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee 1/200 of 3/16	Warren D. Barton, same as W. D. Barton, et ux Mary A. Barton	100%	Russell B. Ward	Russell B. Ward			Russell B. Ward	100%
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee 1/200 of 3/16	J. B. Chase et ux Nancy C. Chase	100%	Russell B. Ward	Russell B. Ward			Russell B. Ward	100%
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee 1/200 of 3/16	Margaret L. Davis, a widow	100%	Russell B. Ward	Russell B. Ward			Russell B. Ward	100%

Tract No.	Description of Land	No. of Acres	Serial No. of State Lease and Expiration Date	Basic Royalty		Owner of Record/Lessee of Record		Overriding Royalty		Working Interest	
				Owner	%	Owner	%	Owner	%	Owner	%
6	S $\frac{1}{4}$ SE $\frac{1}{4}$, NE $\frac{1}{4}$ SE $\frac{1}{4}$ Section 34, T9S, R32E	120	Fee	Unleased Mineral Interest		W. T. Leisk	1/200	W. T. Leisk		W. T. Leisk	1/200
6	S $\frac{1}{4}$ SE $\frac{1}{4}$, NE $\frac{1}{4}$ SE $\frac{1}{4}$ Section 34, T9S, R32E	120	Fee	OREXCO	3/10 of 3/16	Delta Drilling Company	100%	Delta Drilling Company		Delta Drilling Company	100%
6	S $\frac{1}{4}$ SE $\frac{1}{4}$, NE $\frac{1}{4}$ SE $\frac{1}{4}$ Section 34, T9S, R32E	120	Fee	Robert P. Turpin, Trustee of Minnie Moore Turpin Trust	1/20 of 1/5	Russell B. Ward	100%	Russell B. Ward		Russell B. Ward	100%
6	S $\frac{1}{4}$ SE $\frac{1}{4}$, NE $\frac{1}{4}$ SE $\frac{1}{4}$ Section 34, T9S, R32E	120	Fee	Thomas P. Barton I/E of the Estate of Clark N. Barton	13/200 of 3/16	Russell B. Ward	100%	Russell B. Ward		Russell B. Ward	100%
6	S $\frac{1}{4}$ SE $\frac{1}{4}$, NE $\frac{1}{4}$ SE $\frac{1}{4}$ Section 34, T9S, R32E	120	Fee	T. K. Barton as his separate property	13/200 of 3/16	Russell B. Ward	100%	Russell B. Ward		Russell B. Ward	100%
6	S $\frac{1}{4}$ SE $\frac{1}{4}$, NE $\frac{1}{4}$ SE $\frac{1}{4}$ Section 34, T9S, R32E	120	Fee	Billy B. Clifton et ux Faye Clifton	1/200 of 3/16	Russell B. Ward	100%	Russell B. Ward		Russell B. Ward	100%
6	S $\frac{1}{4}$ SE $\frac{1}{4}$, NE $\frac{1}{4}$ SE $\frac{1}{4}$ Section 34, T9S, R32E	120	Fee	F. J. Danglade	1/8 of 1/4	Russell B. Ward	100%	Russell B. Ward		Russell B. Ward	100%

Tract No.	Description of Land	No. of Acres	Lease Serial No. or State Lease No. and Expiration Date	Basic Royalty		Owner of Record/Lessee of Record		Overriding Royalty		Working Interest	
				Owner	\$	Owner	\$	Owner	\$	Owner	\$
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee	E. H. Muhlbach	1/200 of						
6	S½SE¼, NE½SE¼ Section 34, T9S, R32E	120	Fee	Arlean Parker	1/200 of						
6	S½SE¼, NE½SE¼ Section 34 T9S, R32E	120	Fee	Susie Shelton	1/200 of						
6	S½SE¼, NE½SE¼ Section 34 T9S, R32E	120	Fee	Unleased Mineral Interest		Yeager & Armstrong	3/20	Yeager & Armstrong			3/20
7	NW¼SE¼ Section 24 T9S, R32E	40	Fee	Unleased Mineral Interest		Ronald J. Byers	1/2	Ronald J. Byers			1/2
7	NW¼SE¼ Section 24 T9S, R32E	40	Fee	James M. Nixon	1/4 of 1/4	Russell B. Ward	100%	Russell B. Ward			100%

Tract No.	Description Of Land	No. of Acres	Lease Serial No. or State Lease No. and Expiration Date	Basic Royalty		Owner of Record/Lessee of Record		Overriding Royalty		Working Interest	
				Owner	Amount	Owner	Amount	Owner	Amount	Owner	Amount
7	NW¼SE¼ Section 24 T9S, R32E	40	Fee	Harvey A. Heller, Jr. 1/4 and Frank Keating of Co-Trustees of the Heller Company Revocable Trust	100%	Russell B. Ward	100%	Russell B. Ward	100%	Russell B. Ward	100%
8	S¼NE¼ Section 34	80	Fee	Unleased Mineral Interest	5/16	Yeager & Armstrong	5/16	Yeager & Armstrong	3/20	Yeager & Armstrong	3/20
8	S¼NE¼ Section 34 T9S, R32E	80	Fee	J. Clyde Tomlinson	8/32 of 1/4	Russell B. Ward	100%	Russell B. Ward	100%	Russell B. Ward	100%
8	S¼NE¼ Section 34 T9S, R32E	80	Fee	Clark Sample Estate	7/32 of 3/16	Russell B. Ward	100%	Russell B. Ward	100%	Russell B. Ward	100%
8	S¼NE¼ Section 34 T9S, R32E	80	Fee	Roy G. Barton, Jr.	1/128 of						
8	S¼NE¼ Section 34 T9S, R32E	80	Fee	Opal Barton	1/128 of						

Tract No.	Description of Land	No. of Acres	Lease Serial No. or State Lease No. and Expiration Date	Basic Royalty		Owner of Record/Lessee of Record		Overriding Royalty		Working Interest	
				Owner	%	Owner	%	Owner	%	Owner	%
8	S $\frac{1}{2}$ NE $\frac{1}{4}$ Section 34 T9S, R32E	80	Fee	Moore Brothers	1/32 of	Owner		Owner			
8	S $\frac{1}{2}$ NE $\frac{1}{4}$ Section 34 T9S, R32E	80	Fee	Unleased Mineral Interest		Lario Oil and Gas	7/128	Lario Oil and Gas			7/128
8	S $\frac{1}{2}$ NE $\frac{1}{4}$ Section 34 T9S, R32E	80	Fee	Adam K. Grafe & Association	73/4000 of 1/4	Russell B. Ward	100%	Russell B. Ward			100%
8	S $\frac{1}{2}$ NE $\frac{1}{4}$ Section 34 T9S, R32E	80	Fee	Unleased Mineral Interest		Richard Englander	21/4000	Richard Englander			21/4000
8	S $\frac{1}{2}$ NE $\frac{1}{4}$ Section 34 T9S, R32E	80	Fee	Roger B. Owings	1/16 of 1/4	Russell B. Ward	100%	Russell B. Ward			100%

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 usury 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 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 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 Operator's

..... 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

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

- (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	RATE PER WELL PER MONTH			
	DRILLING WELL RATE (Use Total Depth) Each Well	First Five	PRODUCING WELL RATE (Use Current Producing Depth) 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 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.

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 waterflood-ing 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 effected. 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 event of a unit allowable, shut-in wells shall be counted in determining the charge hereunder for such month if said wells contribute allow-able 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 state-wide 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 Weekly 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, 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 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 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 (10¢) 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 receiving 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 in 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.

EXHIBIT "E" TO UNIT OPERATING AGREEMENT

NORTH MESCALERO UNIT

WORKING INTEREST SCHEDULE

Before
Payout

After
Payout

EXHIBIT "F"
GAS BALANCING AGREEMENT
FOR GAS WELL PRODUCTION

1. Each party shall have the right to take in kind and separately dispose of its proportionate share of the gas produced from the Unit Area and shall be entitled to an opportunity to produce its fair share of the allowable production from a gas well (including lawful tolerances) established by appropriate regulatory authority.

2. It is the intent that each party be entitled to gas produced in the proportion that its ownership interest bears to the sum of the ownership interests. It is the intent that the Unit Operator have the duty of controlling gas well production and the responsibility of administering the provisions of this agreement. Unit Operator shall cause deliveries to be made to the gas purchasers at such rates as may be required to give effect to the intent that the gas production accounts of all parties are to be brought into balance under the provisions contained herein.

3. To give effect to the intent of this agreement, the Unit Operator shall be governed by the following rights of each party:

(a) When the well's current production is less than the well allowable due to either the capacity of the well to produce or the Unit Operator causing the well to produce below allowable in order to properly balance well allowable overproduction:

(1) Each underproduced party (a party who has taken a lesser volume of gas than the quantity such party is herein entitled) shall have the right to take a greater amount of gas than its proportionate share of the well's current production, provided that the right to take such greater amount shall be in proportion that its interest bears to the total interest of all underproduced parties desiring to take more than their proportionate share of the well's current production.

(2) Each overproduced party (a party who has taken a greater volume of gas than the quantity such party is herein entitled) shall reduce its respective take in the proportion that such party's interest bears to the total interest of all overproduced parties, but in no event shall any overproduced party be required to reduce its take to less than seventy-five percent (75%) of such overproduced party's proportionate share of the well's current production.

(b) When the well's current production is less than the well allowable due to combined pipeline takes or for reasons other than in subparagraph (a)(1) above:

(1) Each underproduced party shall have the right as in subparagraph (a)(1) above.

(2) Each overproduced party shall reduce its respective take in the proportion that such party's interest bears to the total interest of all overproduced parties, but in no event shall any overproduced party be required to reduce its take to less than seventy-five percent (75%) of such overproduced party's proportionate share of the well allowable.

(c) When the well's current production is equal to or greater than the well allowable:

(1) Each underproduced party shall have the right to take a greater amount of gas than its proportionate share of the well allowable, provided that the right to take such greater amount shall be in proportion that its interest bears to the total interests of all underproduced parties desiring to take more than their proportionate share of the well allowable.

(2) Each overproduced party shall have the right as in paragraph (a)(2) above.

(d) The Unit Operator, at the request of any party, may produce the entire well stream, if necessary, for a deliverability test not to exceed seventy-two (72) hours duration required under such requesting party's gas sales contract and may overproduce in any other situation provided that such overproducing would be consistent with prudent operations.

4. Each party taking gas shall furnish the Unit Operator a monthly statement of gas taken. After commencement of production, Unit Operator shall furnish a current account monthly of the gas balance between parties hereto including the total quantity of gas produced, the portion thereof used in Unit operations, vented or lost, and the total quantity of gas delivered to a market.

5. Each party producing and/or delivering gas to its purchaser shall pay any and all production taxes due on such gas.

6. The provisions of this agreement shall be separately applicable to each well and each reservoir to the end that production from one reservoir in a gas well may not be utilized for the purpose of balancing underproduction from other reservoirs.

7. When gas sales from a gas well permanently cease, Unit Operator shall make a final determination of the volumes of the last accrued over and underproduction, if any, as of the date of such cessation of sales and the identity of the party or parties who are over or underproduced. A cash balancing adjustment shall be made by the overproduced party, or parties, to the underproduced party, or parties, for the overproduced volumes which have been taken or sold; the price to be paid for such adjustment shall be the actual price received for the last accrued overproduction by the overproduced party, or parties, less appropriate deductions for taxes and/or royalties paid on such production by the overproduced party.

8. This agreement may be executed in counterparts but will not be binding on any party unless and until all working interest parties in a gas well have accepted this Gas Balancing Agreement without exception.

9. This shall constitute a separate agreement as to each well and as to each reservoir.

EXHIBIT "G" TO UNIT OPERATING AGREEMENT

EQUAL EMPLOYMENT OPPORTUNITY PROVISION

During the performance of this contract, the Operator agrees as follows:

- (1) The Operator will not discriminate against any employee or applicant for employment because of race, color, religion, national origin or sex. The Operator will take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without regard to their race, color, religion, national origin or sex. Such action shall include, but not be limited to the following: Employment, upgrading, demotion, or transfer, recruitment or recruitment advertising; layoff or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. The Operator agrees to post in conspicuous places, available to employees and applicants for employment notices to be provided for the contracting officer setting forth the provisions of this non-discrimination clause.
- (2) The Operator will, in all solicitations or advertisements for employees placed by or on behalf of the Operator, state that all qualified applicants will receive consideration for employment without regard to race, color, religion, national original or sex.
- (3) The Operator will send to each labor union or representative of workers with which it has a collective bargaining agreement or other contract or understanding, a notice to be provided by the agency contracting officer, advising the labor union or workers' representative of the Operator's commitments under Section 202 of Executive Order 11246 of September 24, 1965, and shall post copies of the notice in conspicuous places available to employees and applicants for employment.
- (4) The Operator will comply with all provisions of Executive Order 11246 of September 24, 1965, and of the rules, regulations, and relevant orders of the Secretary of Labor.
- (5) The Operator will furnish all information and reports required by Executive Order 11246 of September 24, 1965, and by the rules, regulations, and orders of the Secretary of Labor, or pursuant thereto, and will permit access to its books, records, and accounts by the contracting agency and the Secretary of Labor for purposes of investigation to ascertain compliance with such rules, regulations, and orders.
- (6) In the event of the Operator's non-compliance with the nondiscrimination clauses of this contract or with any of such rules, regulations, or orders, this contract may be cancelled, terminated or suspended in whole or in part and the Operator may be declared ineligible for further Government contracts in accordance with procedures authorized in Executive Order 11246 of September 24, 1965, and such other sanctions may be imposed and remedies invoked as provided in Executive Order 11246 of September 24, 1965, or by rule, regulation, or order of the Secretary of Labor, or as otherwise provided by law.

(7) The Operator will include the provisions of paragraphs (1) through (7) in every subcontract or purchase order unless exempted by rules, regulations, or order of the Secretary of Labor issued pursuant to Section 204 of Executive Order 11246 of September 24, 1965, so that such provisions will be binding upon each subcontractor or vendor. The Operator will take such action with respect to any subcontract or purchase order as the contracting agency may direct as a means of enforcing such provisions including sanctions for non-compliance: Provided, however, that in the event the Operator becomes involved in, or is threatened with, litigation with a subcontractor or vendor as a result of such direction by the contracting agency, the Operator may request the United States to enter into such litigation to protect the interests of the United States.

Operator acknowledges that it may be required to file Standard Form 100 (EEO-1) promulgated jointly by the Office of Federal Contract Compliance, the Equal Employment Opportunity Commission and Plans for Progress with Joint Reporting Committee, Federal Depot, Jeffersonville, Indiana, within thirty (30) days of the date of contract award if such report has not been filed for the current year and otherwise comply with or file such other compliance reports as may be required under Executive Order 11246, as amended and Rules and Regulations adopted thereunder.

Operator further acknowledges that he may be required to develop a written affirmative action compliance program as required by the Rules and Regulations approved by the Secretary of Labor under authority of Executive Order 11246 and supply Non-Operators with a copy of such program if they so request.

CERTIFICATION OF NON-SEGREGATED FACILITIES

Operator assures Non-Operators that it does not and will not maintain or provide for its employees any segregated facilities at any of its establishments, and that it does not and will not permit its employees to perform their services at any location, under its control, where segregated facilities are maintained. For this purpose, it is understood that the phrase "segregated facilities" includes facilities which are in fact segregated on a basis of race, color, religion, or national origin, because of habit, local custom or otherwise. It is further understood and agreed that maintaining or providing segregated facilities for its employees or permitting its employees to perform their services at any location under its control where segregated facilities are maintained is a violation of the equal opportunity clause required by Executive Order 11246 of September 24, 1965.

Operator further understands and agrees that a breach of the assurance herein contained subjects it to the provisions of the Order at 41 CFR Chapter 60 of the Secretary of Labor dated May 21, 1968, and the provisions of the equal opportunity clause enumerated in contracts between the United States of America and Non-Operators.

Whoever knowingly and willfully makes any false fictitious or fraudulent representation may be liable to criminal prosecution under 18 U.S.C. Section 1001.