CASE 7025: SOUTHLAND ROYALTY COMPANY FOR DVO
COMPULSORY POOLING, EDDY COUNTY, NEW
MEXICO DE NOVO DECEMBER 11, 1980

CASE NO.

7025

APPLICATION,

TRANSCRIPTS,

SMALL EXHIBITS,

ETC.

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BLDG.
SANTA FE, NEW MEXICO
19 January 1981

COMMISSION HEARING

IN THE MATTER OF:

Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

CASE 7025

BEFORE: Commissioner Ramey
Commissioner Arnold

TRANSCRIPT OF HEARING

A P P E A R A N C E S

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MR. RAMEY: We'll call Case 7025.

MR. PADILLA: Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

MR. CARR: May it please the Commission, my name is William F. Carr, with the law firm Campbell, Byrd, and Black, Santa Fe, appearing on behalf of Southland Royalty Company.

I have two witnesses.

MR. DICKERSON: Mr. Ramey, my name is Chad Dickerson, of Artesia, New Mexico, appearing on behalf of Bassett-Birney Oil Corporation, and we will swear two witnesses and attempt to get by with one.

MR. RAMEY: Ask that the witnesses stand and be sworn at this time.

(Witnesses sworn.)

DON W. DAVIS

being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. CARR:

Q. Will you state your full name and place of residence?

A. Don W. Davis, Midland, Texas.

Q. Mr. Davis, by whom are you employed and in what capacity?

A. Southland Royalty Company as a petroleum landman.

Q. Have you previously testified before this Commission or one of its Examiners and had your credentials as a landman accepted and made a matter of record?

A. Yes, I have.

Q. Are you familiar with the application filed by Southland Royalty Company in this case and with the area which is the subject of the application?

A. Yes, I am.

MR. CARR: Are the witness' qualifications acceptable?

MR. RAMEY: Yes, they are.

Q. Mr. Davis, would you briefly state what Southland Royalty Company seeks with this application?

A. Southland Royalty Company seeks an order for forced pooling the west half of Section 35, Township 18 South, Range 29 East, Eddy County, New Mexico.

We also seek a risk factor and request

Southland Royalty Company be designated operator of the unit.

Q. Will you please refer to what has been marked for identification as Southland Royalty Company Exhibit Number One, identify this, and explain to the Commission what it shows?

A. This is a plat showing Section 35 and some of the surrounding sections. It shows the proposed location and also in the hachured lines shows the dedicated proration unit.

Q. Is this a standard proration unit?

A. Yes, it is.

Q. And are you planning to -- proposing to drill the well at a standard location?

A. Yes, we are.

Q. The red dots, I believe, show other Pennsylvanian completions in the area, is that correct?

A. That is correct.

Q. What is the status of commitment to this well in the west half of the section? Who has joined or refused to join in the drilling?

A. Bassett-Birney.

Q. Bassett-Birney has what?

A. Refused to join.

Q. Who else has joined in participation?

A. Okay, looking at the plat, I guess I'll just start from the top. The north half of the northwest quarter of Section 35, Tenneco Oil Corporation. They own 100 percent of the rights and have agreed to join in the well. And the acreage in blue, which is the south half of the northwest quarter and the northwest quarter of the southwest quarter, is acreage, according to our title, owned 50 percent by Bassett-Birney, 50 percent by Robert E. McKee Company. SRC has acquired a farm-in from the Robert E. McKee Company concerning their 50 percent interest in this acreage.

In the acreage in green, designated with the name Featherstone Farms, SRC has also acquired a farm in agreement from them concerning 100 percent of this acreage.

Q. Mr. DaVis, is there a dispute as to the ownership of any acreage involved in this application?

A. Yes, sir. 50 percent of the acreage in blue.

Q. And is that dispute presently the subject of a litigation in State District Court?

A. Yes, it is.

Q. What is the status of the subject well, the Scuthland Royalty Company Empire Federal 35 Com No. 1 Well?

A. The subject well has been drilled to

total depth; casing has been set; and we're attempting to -- at this point to try and make a completion.

Q. Could Southland Royalty Company have waited for resolution of the ownership question before spudding this well?

A. No, sir, we could not, due to the obligation dates on our farm-in agreements.

Q. Now when did your farm-out agreement expire, or which farm-out agreement was about to expire?

A. Both farm-out agreements would have expired November 5th, 1980, if we hadn't spudded a well.

Q. And when did you spud the well?

A. November 3rd.

Q. Now am I correct in stating that the only interest that Southland is attempting to pool here today is that of Bassett-Birney?

A. That is correct.

Q. According to Southland Royalty Company's title data, what percentage of the working interest does Southland Royalty represent here today?

A. We represent approximately 80 percent of the well.

Q. And that's in the west half of this section?

A. Yes, it is.

Q. And what percent of the interest in the west half is actually in dispute?

A. 19 percent, approximately.

Q. If Bassett-Birney are successful in their -- in the suit involving the title question, what percentage of the working interest would Southland Royalty Company represent?

A. 62 percent.

Q. Will you now refer to what has been marked for identification as Southland Exhibit Number Two and --

MR. RAMEY: Mr. Carr.

MR. CARR: Yes, sir.

MR. RAMEY: Again we cannot find the exhibits.

Q. Mr. DAvis, will you now refer to what has been marked for identification as Southland Royalty Company Exhibit Number Two, identify this for the Commission, and using this exhibit explain what efforts Southland has made to obtain voluntary pooling of the interests under the proposed proration unit?

A. Exhibit Two are relevant documents and letters, et cetera, concerning our attempt to try to drill

the well in the west half of Section 35. I'll go through them one at a time very, very briefly.

A letter dated February 26, 1980; SRC requested a farm-in from Bassett-Birney concerning their leasehold interest in Sections 33, 34, and 35. We offered a 1/16th override with a 50 percent back-in, which is representative of agreements in the area. We also gave them the option to join in the well.

The second is a letter dated March 24th, 1980, to Bassett-Birney Oil Corporation. We proposed the 35 No. 1 Well, requested a farm-out or joinder in the well, and also submitted an AFE. Attached is the AFE.

By letter dated March 24th, 1980, to Tenneco Oil Exploration and Production, we proposed the well to Tenneco, requested a farm-out or joinder, and also submitted an AFE. AFE attached.

A letter dated June 19th, 1980, SRC responded to Tenneco's request concerning the possibility of forming a 1-section working interest unit encompassing all of Section 35.

By letter dated June 30th, 1980, SRC advised Flag-Redfern, they own interest only in the east half, of our west half well and recommended a working interest unit.

By letter dated July 8th, 1980, SRC informed Bassett-Birney of a possible location change for the well; also attached an operating agreement for the well, plus another AFE, with the location change.

The next document is dated July 15th, 1980, to Tenneco Oil Exploration and Production. We informed them of our unsuccessful attempts to form a working interest unit and also informed them of a possible location change. AFE attached.

Next is a designation of operator from Featherstone Farms, designating SRC as operator of the subject acreage in the west half of 35, as shown on the designation of operator.

Next is a letter dated July 25th, 1980, to Bassett-Birney Oil Corporation, in reference to our early proposals to the 35 No. 1 Well, reference to our attempts to form the working interest unit, and proposed an SRC 35-A No. 1 Well, which would be drilled in the east half of Section 35; AFE attached.

By letter dated July 29th, 1980, to Flag-Redfern Oil Company we referenced our failure to form the working interest unit; AFE attached.

By letter dated September 4th, 1980, from Bassett-Birney to Southland, they relayed the message

that although they would agree to join in the well, they would not agree to execute our operating agreement and AFE.

Next is a letter from Tenneco where they furnished us the operating agreement signed, dated August 27, 1980.

Next is a letter dated September 15th, 1980, from Tenneco delivering their AFE to us, SRC.

Next is a revised operating agreement for the subject well to be located in the west half of Section 35.

Q. I believe there were two different, basically different AFE's submitted with your proposals.

A. Yes, there were.

Q. And the two -- the difference in the AFE's was the result of the fact that you moved the location of the well, is that correct?

A. That is correct, uh-huh.

Q. What are the costs reflected on the July AFE?

A. On the July AFE, July 15th, they reflect a dry hole cost of $539,200. Excuse me, excuse me, a dry hole cost of $488,000; completed well cost of $767 010.

Q. Are these costs in line with what other operators in the area are charging for similar wells?

A. Yes, at the time it was submitted, that is correct.

Q. Other than the letter from Bassett-Birney dated September 4, in which they indicated a willingness to pool interests in the west half of the subject section, have you received any -- been able to obtain the signatures on any other document which would indicate their willingness to join?

A. No, sir, not that we have furnished Bassett-Birney.

Q. Do you believe you've made,Southland Royalty Company has made a good faith effort to obtain a voluntary pooling of the interests in the west half?

A. Yes, we do.

Q. And is it the opinion of Southland Royalty Company that agreement has not yet been reached to voluntarily pool all interests under the proposed proration unit?

A. Yes.

Q. Are you prepared to make a recommendation to the Commission concerning charges for overhead and administrative costs while drilling and producing the subject well?

A. Yes, $3000 drilling rate. $300 producing rate.

Q. And this $300 is a monthly figure?

A. Yes.

Q. Do you recommend that these figures be incorporated into any order which might result from this hearing?

A. Yes, I do.

Q. And do you believe these figures to be in line with what is being charged by other operators in the area?

A. Yes.

Q. Will Southland call another witness who will testify as to geological considerations and the -- and risk factor?

A. Yes, we will.

Q. Does Southland Royalty Company request to be named -- or designated operator of the subject well?

A. Yes, sir.

Q. Mr. Davis, in your opinion will granting this application be in the best interest of conservation, the prevention of waste, and the protection of correlative rights?

A. Yes, I do.

Q. Were Exhibits One and Two prepared by you or under your direction and supervision?

A. Yes, they were prepared by me.

MR. CARR: At this time, Mr. Ramey we would offer into evidence Southland Royalty Company's Exhibits One and Two.

MR. RAMEY: Exhibits One and Two will be admitted.

MR. CARR I have nothing further of this witness on direct.

MR. RAMEY: Any questions?

MR. DICKERSON: Yes.

MR. RAMEY: Mr. Dickerson.

CROSS EXAMINATION

BY MR. DICKERSON:

Q. Mr. Davis, since your well in the west half of Section 35 is now completed, Southland now has actual well costs rather than proposed well costs, do you not?

A. Well, yes, but concerning actual completed costs, you know, there are --

Q. You think they were made?

A. Yes, but I do not have those costs with me.

Q. Mr. Davis, I'm going to hand you a copy which is marked Bassett-Birney Oil Corporation Exhibit Number One, and ask you to confirm that that is the instrument which

is part of Southland's Exhibit Number Two, a letter dated September 4th, 1980, from Bassett-Birney to Southland Royalty Corporation?

A. That is true.

Q. In order that the Commission might understand how this title litigation arose and led to the current situation, would you refer to the Southland Royalty Corporation well, located and shown on your Exhibit Number One in the east half of Section 34, and describe how this problem came about?

A. We acquired a farm-in agreement -- you mean concerning the farm-in, et cetera, all the way through?

Q. That's right.

A. We acquired a farm-in agreement from Robert E. McKee Company and Featherstone Farms covering various interest in Sections 33, 34, and 35.

Q. Now, let me ask a question. That situation in the east half of 34, as far as the dispute between Bassett-Birney and Southland, is the same title as you have indicated in blue on your Exhibit Number One?

A. That is correct.

Q. Okay, continue.

A. Okay. We acquired the farm-in agreements. Upon acquiring the farm-in agreements we approached all lease-

hold owners in Section 34 concerning the well.

You want me to go into the proposal of the well, et cetera?

Q. Just briefly indicate, in that well you approached Bassett-Birney Oil Corporation --

A. Yes, that is correct.

Upon approaching them, they executed AFE and operating agreement, showing what our title showed as their interest, and we proceeded to drill the well.

Q. And they indicated a willingness to join in participation in that well.

A. Yes, they did.

Q. And is it not true, Mr. Davis, that shortly after that well was spudded but substantially before it was to total depth, at that time Bassett-Birney became aware of the title dispute and asserted title to 100 percent of the interest under your McKee farmout?

A. Yes. At basically a little over 6000 feet.

Q. Would -- if I -- would you agree with my statement if I characterized Bassett-Birney's actions in this area in the east half of Section 34, and the subject well today as not indicating a non-willingness to participate in the drilling of these wells, but merely a non-willingness

to agree to the interest that Southland Royalty Corporation thinks that Bassett-Birney owns in these leases?

A. That question -- would you repeat that question?

Q. Bassett-Birney did indicate a willingness and desire to participate in drilling these wells, did they not?

A. Yes, yes, they did.

Q. And so the only dispute, as far as you know, involves Bassett-Birney's claim to an additional interest under both these wells that we've talked about, over and above what Southland credits Bassett-Birney with?

A. Yes.

Q. And the letter that I handed you, marked Bassett-Birney Exhibit Number One, sets forth that statement, and recites the fact that Bassett-Birney makes an additional claim of title, not recognized by Southland, as the failure and refusal of Bassett-Birney to execute your AFE and operating agreement?

A. That is true.

Q. But it did state, did it not, that Basset-Birney was willing to pool its interest to avoid the necessity of this hearing?

A. No, whether that was the reason they said

it, I can't verify that, but they did say they were willing to pool the interest, but would not execute our operating agreement or our AFE.

Q. But they have never --

A. Which is the standard procedure for accepting.

Q. But Bassett-Birney has never indicated to you in any way, shape, form, or fashion that they did not desire to participate in the drilling of either one of these wells?

A. That's kind of -- well, they said they would pool their interest, and that's really about as far as I could go.

Q. And they --

A. They said they were willing to pool their interest but were not willing to execute an operating agreement and an AFE.

Q. Setting forth the --

A. The interest as we show versus the interest as Bassett-Birney shows.

Q. Right, but they did -- Bassett-Birney did execute an AFE and operating agreement in the east half of 34 before it became aware of the title dispute?

A. The west half of 34 - is that east half?

You are correct, east half of 34. That is correct.

Q. Now, Mr. Davis, I'm going to hand you what is marked Bassett-Birney Exhibit Number Two, and ask you to describe what that is, if you've seen it before?

A. This is a communitization agreement that was mailed to us and a letter attached, concerning the 35 No. 1 Well.

Q. Stating again, basically, Bassett-Birney's willingness to participate in the well but its unwillingness to execute AFE's and operating agreements setting forth interests as asserted by Southland. Correct?

A. That is correct, except it more or less -- correct me if I'm wrong -- puts the -- whether the interest is finally determined to be owned by Southland or Bassett-Birney, puts the full liability of a dry hole concerning that disputed interest on Southland.

Q. But wasn't that the substance of Bassett-Birney Oil Corporation before, that Southland's actions prior to that time had been exactly the same effect, as far as putting the entire risk of a dry hole on Bassett-Birney?

A. Not per se in the joining of the 34 Well in the east half, no. This came after -- after the title dispute did appear, then this is their -- this is where -- this is the terms that they're willing to join on.

Q. And there were no conditions, were there, Mr. Davis, attached to Bassett-Birney's execution of the communitization agreement covering the subject proration unit?

A. Excuse me, would you repeat that, sir?

Q. There were no -- Bassett-Birney, in that letter or in any other way, did not attach any conditions to the execution of the communitization agreement, did they?

A. Well, I assume the only conditions were on the exhibit where they noted the title dispute. That is the only condition, or any different from any other communitization agreement.

Q. On Exhibit A on the affected acreage there was a star with a notation the interest, the entire interest was credited to Bassett-Birney, and a notation made that that interest as to one-half was disputed --

A. That is correct.

Q. -- between Bassett-Birney and Southland? And that communitization agreement was executed by Bassett-Birney Oil Corporation.

A. That is correct.

Q. Is your well on the subject unit perforated at the present time?

A. That would probably have to be answered by the geologist, as I prepared the land work and he has in-

formation concerning perforations, et cetera, of the well.

Q. Was any reply ever sent by Southland, Mr. Davis, to Bassett-Birney to either of the instruments marked Number One or Number Two?

A. No, sir, because also prior to the sending of these agreements, it was stated in the last hearing, as it has been stated numerous times, that we would not accept an agreement whereby no matter who was determined to own the interest, that we should bear the full dry hole cost --

Q. And that --

A. -- which was sent at that time, and that is incorporated into your proposal, so I do not feel that would probably have to bear a positive response.

Q. But Bassett-Birney's position has been exactly the same, that it would not execute instruments placing the entire burden of a dry hole on Bassett-Birney.

A. That is correct.

Q. And all these difficult questions are currently involved in litigation in the courthouse in Eddy County, New Mexico.

A. Yes.

MR. DICKERSON: No further questions.

MR. CARR: I have a couple on redirect.

MR. RAMEY: Mr. Carr.

REDIRECT EXAMINATION

BY MR. CARR:

Q Mr. Davis, I'd direct you to -- your attention to what has been marked Bassett-Birney Oil Corporation Exhibit Number Two.

MR. CARR: And initially, Chad, we'd have no objection to that being admitted into the record now.

MR. DICKERSON: Okay, I would move the admission of Number One and Number Two.

MR. RAMEY: Bassett-Birney Exhibits One and Two?

MR. DICKERSON: Yes, sir.

MR. RAMEY: They will be admitted.

Q Mr. Davis, if you will refer to the October 10, 1980, letter, does that letter again indicate Bassett-Birney's willingness to execute an operating agreement?

A. No, it does not.

Q. What does it state in regard to the operating agreement?

A. Bassett-Birney feels that --- however Bassett-Birney remains unwilling to execute the AFE and operating agreement furnished with your letter of September 29th, 1980, for the reason that the instruments still attempt

to place the risk of a dry hole upon Bassett-Birney.

Q. And the last paragraph on that page, does it propose certain changes to the operating agreement, which would make it acceptable to Bassett-Birney?

A. Yes, it does.

Q. Would those proposed changes be acceptable to Southland Royalty Company?

A. No, sir, they were not.

Q. Now, would you exactly, so there's no confusion in the record, what is the status of the subject well? Has it been completed?

A. No, it has not.

Q. Has casing been set?

A. Yes, it has.

Q. And then Mr. James will be able to give us additional data.

MR. CARR: I have nothing further of Mr. Davis.

MR. DICKERSON: Nothing further.

MR. RAMEY: He may be excused.

MR. CARR: At this time I'd call Mr. James.

ARTHUR D. JAMES

being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. CARR:

Q. Would you state your full name for the record, please?

A. My full name is Arthur Dow James.

Q. Where do you reside?

A. 1429 Lanham Street, Midland, Texas.

Q. By whom are you employed and in what capacity?

A. I'm employed with Southland Royalty Company and I am the District Geologist for the southwestern district.

Q. Have you previously testified before this Commission or one of its examiners and had your credentials accepted and made a matter of record?

A. Yes, I have, and they were accepted.

Q. Are you familiar with the application of Southland in this case and also with the area which is the subject of this case?

A. Yes, I am.

MR. CARR: Are the witness' qualifications acceptable as a geologist?

MR. RAMEY: Yes, they are.

Q. Mr. James, have you prepared certain exhibits for introduction in this case?

A. I have.

Q. I think it would be helpful if, before you go through the exhibits, if very briefly you would provide an overview of what you intend to show with your testimony.

A. What I'd like to show is Southland Royalty Company's geologic interpretation with full documentation, which will show why Southland Royalty Company drilled the SRC Empire Federal Com 35 No. 1 Well, and our pre-drill interpretation, that is, interpretation as it appeared prior to the drilling of the well, which will show that this location is risky and justifies a high risk penalty of 200 percent.

SRC is currently attempting to complete this well and at this point we are not sure if it will be a producing well. It appears to be a marginal well at this point.

I will discuss this well in detail, the results of this well, and how it has affected our pre drill interpretation, and I will also present an interpretation

that was prepared after the drilling of the well, to show you the differences, and I believe this will illustrate the geologic risk in this area quite well.

The SRC Empire 35 No. 1 was drilled to a depth of 11,791 feet to test the Morrow and Atoka sands, and is located 1980 feet from the south and west lines of Section 35, Township 18 South, Range 29 East.

You will notice on the exhibits that I will introduce that Southland Royalty is planning on offset to this well to the east, on the east half of Section 35. This well is the SRC Empire Federal Com 35-A No. 1 and is to be located in the southeastern quarter of the section.

I would like to refer now to Exhibit Number one, which was the land plat previously introduced. This map is on a scale of one inch to 2000 feet and all the map type exhibits I will introduce are on that same scale.

This area is an active area. Southland Royalty has three producing wells on this map, and I will discuss them in some detail later. Two of those wells are in Section 27, and one well is Section 34.

Southland Royalty is currently drilling a well in Section 22 in the southeastern quarter. It is the Southland Royalty Empire Federal 22 No. 1.

Tenneco, in Section 3, east of the

subject well, the 35 Com No. 1, is currently completing a well that I will discuss and it's the Tenneco No. 1 "JL".

Q. Will you now refer to what has been marked for identification as Exhibit Number Four, and explain to the Examiner what it is and what it shows?

A. Exhibit Number Four is a type log, which will illustrate the objective zones in this area. This well is the Southland Royalty Empire Federal 34 No. 1. It is located west of the 35 No. 1. It's in the east half of Section 34.

Q. Now, Mr. James, I believe Southland is -- has been looking -- focusing primarily at certain zones in the area, and you might comment on that.

A. Southland has determined that three zones are prospective in this area. If you'll turn to this type log, at a depth of approximately 10,776 feet there is an Atoka sand that occurs there. The sand is colored yellow and Southland calls this sand the Atoka E sand. This is a density-- compensated density neutron log. In the red area is the -- the red shaded area shows you the separation between these two curves on the righthand margin of the log. In this particular sand Southland Royalty was attempting to drill stem test it and while coming out of the hole the well kicked and blew out, and we were not able to get a test in this well.

It is our opinion that this is a commercial zone and it would make an attractive completion when completed.

Now if you'll turn farther down the log to a depth of approximately 11,220 feet, you will see the beginning of a series of Morrow sands, Upper Morrow sands, that Southland Royalty refers to as the A sands.

These sands are separated by a shale, called the Middle Morrow Shale, shown on your type log and shaded in green, separates a lower sand series in the Morrow that we call the E Sands. In this particular well, again, the sands are colored yellow and the separation between the density neutron log is shaded red.

In this particular well Southland has made a very attractive completion. Perforations are shown. It is completed for a CAOF of 8.073 million a day on 7-8-80. I will discuss this well a little bit later in some detail, but this type log illustrates the objective zones that we have in this area.

Q. Will you now refer to Southland Royalty Company Exhibit Number Five, identify this, and explain to the Commission what it shows?

A. Prior to introducing that exhibit, I'd like to kind of recap.

Q. That would be fine.

A. Very briefly, the history of this area and get everybody acquainted with it.

In the summer of '77 SRC drilled a well. It was the first well in our prospect that we call the Empire South prospect. This well was the Southland Royalty Empire Federal No. 1, and it is located 1980 feet from the south and west of Section 27. It was completed initially in the Upper Morrow sand sequence that I referred to earlier, which we call the A Sands. A commercial completion was not attained, and I will discuss this failure of attaining a commercial completion later.

This well was then recompleted to the Atoka E sand that I referred to, where a commercial completion was made. It was completed in June of 1980 for a CAOF of 1.8 million cubic feet of gas per day. It is an attractive commercial completion.

Southland drilled the offset to this well, the SRC Empire Federal A No. 1 at a location 660 feet from the south and 1980 feet from the west line of the same Section 27. It was completed in the same Atoka B Sand on 7-7-80 for a CAOF of 2.5 million a day and it is also an attractive commercial completion.

Southland next drilled the Empire Federal 34 No. 1, the previously referred to type log, in the east

half of Section 34, and as I mentioned, this well is completed in the Lower Morrow Sands for 8.1 million a day.

Q. Will you now go to Exhibit Number Five?

A. Exhibit Number Five is a stratigraphic cross section A-A'. This cross section was prepared in September prior to the drilling of the well. It runs from west to east through the SRC 35 No. 1, which is now a completing well, and also shows the proposed location for the SRC 35 A No. 1. The datum for this cross section is on the top of the Atoka.

It shows again the three prospective zones in the area. Note that structural dip is from -- generally from west to east. Also note the interpreted channel, the Morrow A Sands. Also note the top of the Morrow E, with a structure mapping point, which I'm going to show you a structure map later that was mapped in this point.

The red dots with the spikes are showing you completed zones. The half red -- the dots that are just half a circle are showing you shows and zones that may be productive.

Q. Will you now refer to Southland Royalty Company Exhibit Number Six, identify this, and explain what it shows?

A. Exhibit Number Six is a Morrow net poro-

sity Isopach of the Lower E Sands. This is net effective porosity, defining the net porosity as porosity that we think has adequate permeability to allow movement of either oil or gas or other fluids in the reservoir.

This is our pre-drill interpretation prepared in September, 1980. Three sand channels are shown on this exhibit. Notice that the sand channel to the north is wet and is not productive.

The sand channel in the middle is productive. The SRC Empire Federal 34 No. 1 is producing from this well, as is two other wells in Section -- north half of Section 33 and the south half of Section 28. This is an attractive zone. Structural position is important on this zone, though, as water does occur. As I mentioned, regional dip is generally from west to east and I will show a structure map next to illustrate this.

The green line that you see on there is our interpretation of the gas/water contact. This is defined by the well in Section 10, Threshold Development Conoco No. 1-10, which had 22 feet of effective porosity in this zone, and was wet.

Notice that Southland's proposed well, or the well that we have drilled now, the SRC 35 No. 1, is located down dip in an unfavorable position and was inter-

preted to be in the water leg. This was not an objective of this particular well location.

Q. Will you now refer to Southland's Exhibit Seven?

A. Exhibit Seven is a structure map on top of the Morrow E Sand. It was prepared prior to the drilling of the well in September of 1980. As I mentioned, structural dip, or dip is from west to east, and Southland's well was interpreted -- I mean the SRC 35 No. 1, was interpreted to be well down dip from the SRC Empire Federal 34 No. 1, which is producing, as I mentioned, from the lower sands.

The yellow shaded areas are interpreted -- areas of interpreted channels in the Morrow E and Morrow A Sands.

Q. Will you now refer to Southland Exhibit Eight and review this for the Commission?

A. Exhibit Eight is an exhibit that was prepared after the drilling of the SRC 35 No. 1, and you will notice that the Morrow Sands were encountered 116 feet higher than anticipated, creating a small structure closure, as shown.

Also notice that this well is structurally higher than the producing SRC 34 No. 1 which would make you think you were very fortunate indeed and had a very -- and should have a very attractive producing well from this lower

zone.

Q. Will you now refer to Exhibit Number Nine, please.

A. Exhibit Number Nine is again a net porosity Isopach of the Morrow E Sands; this time it was prepared after the drilling of the well. 35 feet of effective porosity was encountered in the SRC 35 No. 1, and it being structurally up dip from the producing SRC 34 No. 1 in the same sand, we perforated it and swabbed significant amount -- a significant amount of formation water and a small amount of gas. We have abandoned this zone and are now attempting to complete in the higher zone.

Since this well in this zone are higher than the producing well, they have to be separated, and Southland Royalty has interpreted this separation to be caused by a permeability barrier, which is shown by the projected porosity dying out to zero between the two wells.

High and thick and wet.

Q. Will you now refer to Southland Exhibit Number Ten and review this for the Commission?

A. Exhibit Number Ten was one of the two objectives of the SRC 35 No. 1. This is a net porosity Isopach from the Morrow A Sands.

Notice that we were anticipating 40+ feet

of effective porosity in this well.

The wells that are shown in solid circles are producing with the ticks in them. or spikes in them, are producing from this well -- or producing from this particular sand -- sand zone.

There have been many gas shows in this sand zone, which are shown as half red circles, and some of them may be productive, but this particular sand sequence has been a very -- has proven to be a very variable, risky zone for us in this particular area. It is productive to the south and is productive to the north, but so far Southland's efforts in this particular sand zone have been very disappointing, as to other operators.

This lack of lateral -- is composed of several sands which are integrated with shales which do not appear to be laterally continuous. This lack of lateral continuity creates variable, complex reservoirs that are difficult to predict in occurrence and in productivity. An attractive Morrow A Sand zone on wireline logs does not always indicate that there will be an attractive completion, and I will show you some data to support this. This situation was present in Southland Royalty's 27 No. 1 in the southwest quarter of 27.

Q Mr. James, will you now refer to the

Southland Royalty Company Exhibit Number Eleven and review this for the Commission?

A. Exhibit Number Eleven is a type log of the Morrow Sands in Southland Royalty's well I just mentioned the Empire Federal Com No. 1.

In this particular sand zone, again the same color scheme is used in this well as in the type log that I presented. The Morrow E Sands are shown to be clean sands but water -- water saturations and porosity determinations by log analysis are shown in the righthand border of this particular exhibit. We had relatively high water saturations and it appeared that this was not - was going to be a wet zone, and we did not production test this zone.

Instead, we tried the Morrow A Sands where you see our perforations in the Morrow A Sands. I would like to call your attention to the fact that you will notice a hot gamma ray in the A Sands. This hot gamma ray is a frequently -- frequently occurs in the Morrow A Sands and does not mean that it is an indicator of shalyness. This -- it does mean that there is mica in the sandstone and this mica has potassium in it, which causes a relatively hot reading on the gamma ray.

The density neutron curves to the right are not indicating it's shaly or indicating that it is porous,

and other logs indicate that it is permeable.

So we completed in this zone and initially obtained a very attractive, attractive completion. We had a flow rate of 2-million cubic feet of gas per day.

Log analysis, sample analysis, and this good flow rate indicate that this was an attractive, above average Morrow completion. This completion was connected to a sales line. It rapidly depleted, suggesting that it was a very, very limited reservoir. The Morrow A Sands, as I mentioned, are productive in the area, and they were one of the -- they were risky, but they were one of the primary objectives of SRC 35 No. 1.

As I mentioned, we abandoned this zone and went up to complete in the Atoka B sand, and did make an attractive completion in that sand.

Q. Will you now refer to your Exhibit Number Twelve and review this?

A. Exhibit Number Twelve is a net porosity Isopach of the Morrow A zone after our well was drilled. 22 feet of apparent pay was in this 35 No. 1, which is 20 feet less than what was expected. Porosity values vary from six to 10 percent with most of the porosity being about 8 percent.

From log analysis, although we have not

tested this zone, but log analysis indicates that this is a marginal zone.

We're currently attempting to complete in this zone, and I'll talk about that a little bit later.

Notice the well to the east of us in Section 36. That's Tenneco's State "JL" No. 36. This well was production tested -- or was tested in this zone, which is composed of many integrated sands, similar to our well, and they were not successful in those particular zones. They instead moved up to the uppermost Morrow stray sand zone, occurring right beneath the Morrow lime. This stray zone, which you could classify as in the A Sands, is 9 feet thick and is not present in our well in Section 35, and this well as of a few days ago was testing and flowing for about 800,000 cubic feet a day, and Tenneco does not think very much of the well. They think it will be a below average Morrow well. They are very sure.

In Section 11 Tenneco State 2-H Well was also completed in this zone for a CAOF of 3.5 million a day, It hasn't been on production very long but its daily average in October was 775,000 cubic feet a day, indicating a below average Morrow completion.

It is also producing 27 barrels of condensate a day and 17.5 barrels of water per day.

Q. Will you now review Exhibit Thirteen?

A. Exhibit Thirteen is the Atoka B net clean sand Isopach. This was prepared prior to the drilling of the well. It was prepared in September of 1980.

This Isopach is slightly different than the Isopachs I've presented so far. It is an Isopach of net clean sand rather than net effective porosity, but net effective porosity values are presented on the map as a control point near each one of the well locations. This net effective porosity is presented to the right of a slashed line. The value to the left of the slashed line is net clean sand and it is the contoured -- these values are contoured on the map.

Again the red circles are showing the productive wells. I've talked about the two wells in Section 27 that Southland drilled. I'll give you a little production data on these wells.

The SRC Federal 27 1 A in the northwest quarter of 27 has a cumulative of 96-million cubic feet of gas, 2000 barrels of oil as of 11-1-80. Its October daily average was 1.7 million a day and 25 barrels of oil. It was first produced in 9-80.

The Southland Royalty Federal No. 1 Well in the southwest quarter of Section 27 has a cumulative of 214-million cubic feet of gas and 3000 barrels of oil at

11-1-80.

Its October daily average was 1.4 million a day and 19 barrels of oil.

And as I mentioned, the well in Section 34, SRC 34 No. 1, was not tested but blew out and appears to be an attractive zone.

Q. Will you now proceed and review Exhibit Number Fourteen?

A. Exhibit Number Fourteen is the same map that was prepared after the drilling of the 35 No. 1. 14 feet of net clean sand was found in the well and 12 feet of effective porosity. The porosity was broken up into two zones, and Southland cored the lower part of the -- of the lower zone and recovered 10 feet of sand with 8 percent porosity. Permeability from core analysis was .01 millidarcies, extremely low; probably would not make a well in that lower zone. If it did make a well you'd have to frac it and it would be a poor well.

I'd like to present data on two more wells on this particular map exhibit, just for a completeness. I left them off the last exhibit.

In Section 1, the Tenneco "HL" Well was completed for 25 million a day and it appears to be a very attractive zone. Cumulative at 11-1-80 was 196.2 million

cubic feet of gas. Its October average producing rate was 1.6 million cubic feet of gas and 13 barrels of condensate.

A test on 1-15-80 flowed 1.1 million a day and 8 barrels of condensate.

In Section 11, the Tenneco State 1 "HL" Well has 17 feet of net clean sand and 10 feet of porosity. It was completed for 4.3 million a day. Its cumulative as of 11-1-80 was 861.4 million cubic feet of gas. Its October average was 1.9 million cubic feet and 21 barrels of condensate.

It was tested on 1-15-80 and was flowing 2.26 million a day and 25 barrels of condensate.

The Threshold Development Conoco Well in Section 10, 1-10, also appears to be an attractive well, completed for 3.8 million a day. It has a cumulative at 11-1-80 of 82.2 million cubic feet of gas. Its October average was 710,000 cubic feet a day and 7 barrels of condensate.

Q. Mr. James, will you now identify Southland Royalty Company Exhibit Fifteen and --

A. Let me talk a little more.

Q. All right.

A. Excuse me.

Notice on our well in Section 27, the

1-A in the northwest quarter had 28 feet of sand and 20 feet of effective porosity. I'm going to talk about the type of porosity in this well in just a minute.

Notice that the Southland Royalty Federal No. 1 in the southwest quarter of 27 had 12 feet of sand with 11 feet of effective porosity, and that Southland Royalty's Well 34 No. 1, in Section 34, had 9 feet of sand, net clean sand, and 9 feet of effective porosity.

The SRC Empire Federal 34 No. 1 had 9 feet of porosity in the 12 to 16 percent range, very high range.

The SRC Federal No. 1 had 11 feet of porosity in the 9 to 13 percent range, also a very high range, the high range.

The SRC Empire Federal 27-A No. 1 had 27 feet of porosity in the 10 to 14 percent range. These are very attractive looking zones.

Our well, which had 14 feet of sand and 12 feet of effective porosity, as I mentioned, is divided into two zones and I will show you the log. These zones are not nearly so attractive as the other wells.

Q. Will you now refer to Exhibit Fifteen?

A. Exhibit Fifteen is a portion of Southland Royalty's Empire Federal No. 1 Well. This -- this particular exhibit will show you the Atoka and Morrow sand

zones. And I'll talk about the Atoka zone first, the B Sand zone.

Sands are colored in yellow, as on the other exhibits, and the separation between the density and neutron log are shown in red. The scale of the porosity determination on this log is standard scale with the -- going -10 to zero to +10, +20, to +30.

The water saturations and porosity determinations calculated from log analysis are shown on the right. The porosities -- the porosity values are low and as I mentioned, we cored this lower sand and had very low permeability -- permeability values from .01 millidarcies.

If a completion is made in this zone, we think it will -- it would have to be in the upper part of the B sand and we expect it to be a below -- or certainly would be a completion not nearly as attractive as the other wells. We are not sure if it will be an attractive completion or not at this point. We have no tests in this particular zone.

I'd like to call attention to the bottom part of the well,the Morrow E Sands, beginning -- Southland's Morrow E Sands, beginning at 11,382. It's very clean looking sand body with good porosities. The water saturations were a little bit on the high -- high -- high values, except the

uppermost one and the lowermost one was kind of suspect. Because this well came in higher than the producing well to the west, we production tested it, and as I mentioned, it was wet. We have squeezed it, set a bridge plug, and we are now completed -- are completing, rather, in these Morrow A Sands. Notice the Morrow A Sands are interbedded. They look very much like the Tenneco -- a Tenneco section to the east of us, that did not make a viable completion in this zone. Instead it completed in a zone that would be correlative to about 11,190 in this particular well, and that sand is not present in this well here, and this particular section is also very similar to the section I showed you in the Empire 27 No. 1 Well where we attempted a completion that came on for 2 million a day and fizzled out to nothing when we hooked it up to the sales line.

We think this is a very marginal zone. As of this morning this well was flowing 50,000 cubic feet of gas. It was perforated and acidized. We will attempt to -- we -- our engineering department, our production department right now is evaluating this zone and at this point I don't know what we'll do next on it, but as of right now it's flowing 50,000 cubic feet of gas -- cubic feet of gas; no oil.

In our pre-drill evaluation we contended

that this well was a risky, expensive step-out well deserving a risk factor of 200 percent so that Southland Royalty and other working interest participants could receive just compensation if a successful completion is made -- was made.

Our post-drill evaluation indicates that if a completion is made it's likely to be marginal and in our opinion validates our previous claims to this well being a high risk step-out and a risky venture.

That concludes my testimony.

Q. Mr. James, have you been involved in the drilling of other Pennsylvanian wells in this area?

A. Yes, I have.

Q. What is your experience concerning the risk involved in drilling any Pennsylvanian well in the general area?

A. Well, the risk varies from prospect to prospect, but oftentimes your risk sometimes is low in certain areas and it's higher in other areas, but even if your risk is low, even after you drill the well, whether you get a successful commercial completion is an additional risk that you have to put on this well. Our risk factor, which we presented to our management along with this other documentation that I showed you in our pre-drill evaluation is a success defined as 60 percent. We gave this well a 62 per-

cent chance of success, which would, in Southland's categorations -- categorizing of a well, would put this in a high risk development category.

Q. Mr. James, at the prior hearing Southland Royalty Company recommended to the Examiner that a 200 percent risk factor be assessed for this well. Are you prepared today, based on your data, the data you've presented, and your knowledge of the well, to make a recommendation concerning the imposition of a risk factor?

A. We are requesting a 200 percent risk factor.

Q. In your opinion will granting this application be in the best interest of conservation, the prevention of waste, and the protection of correlative rights?

A. Yes, it will.

Q. Were Exhibits Four through Fifteen prepared by you or under your direction and supervision?

A. Yes, they were prepared under my supervision.

Q. And can you testify from your own knowledge as to their accuracy?

A. Yes.

MR. CARR: At this time we would offer Southland Royalty Company Exhibits Four through Fifteen.

MR. RAMEY: Exhibits Four through Fifeen will be admitted.

MR. CARR: I have nothing further of this witness on direct.

MR. RAMEY: Any questions, Mr. Dickerson?

MR. DICKERSON: Yes, sir.

CROSS EXAMINATION

BY MR. DICKERSON:

Q. Mr. James, how many rigs does Southland have running in this immediate area?

A. In this immediate area we have one rig.

Q. Is that the number of rigs you had running in recent history?

A. No, we've -- we've generally had had two rigs running in this area for the last six or ten months, something like that.

Q. Do you know what the plans are for the next six months, let's say?

A. Not that far in advance. For the next couple or three months, or the next couple or three wells I could give you some plans.

Q. Are you in charge of Southland's geolo-

gical department as concerns this area?

A. Yes, I am.

Q. Mr. James, did -- was it you that calculated this 60 percent -- 62 percent chance of success percentage you referred to?

A. No, I didn't calculate it but I agree with it 100 percent.

Q. Do you know how it was calculated?

A. Yes, I do.

Q. Would you just briefly describe the --

A. I don't have the exact numbers in front of me, but I can supply them to you later, but Southland calculates its success factor, which you referred to as a risk factor, in our drilling wells by multiplying three variables that we -- we examine and interpret geologically, and these variables are reservoir, trap, and presence of hydrocarbon. In any oil or gas producing situation you have to have all three of these particular factors present in order to have an oil or gas well. And we multiply what we think from looking at the nearby wells and the history in the area, what the success probability for each one of these factors will be, and we multiply them together to get a success -- overall success probability for the well.

An additional risk is prepared by our

engineering department that does not -- does not affect this particular success factor, but what I'm trying to say is there's additional risk in the size of the type well you might find, and the size of the well, reserve estimate is calculated by our production department, by our engineering department.

Q. Under this calculation would a well which nearly paid out be successful?

A. No. Southland defines a well as being successful -- it's a very complicated economic yardstick, but I'll present it to you, if you like.

Q. It's not necessary in any great detail. I'm just trying --

A. Okay.

Q. -- to get at a --

A. Well, Southland -- a well that pays out to Southland is not a successful well, if it just pays out. So a successful well to Southland, which we define as success probability, you have to take your investment, increase it by 25 percent. You have to take your profit discounted at 9 percent, and subtract the two, and if you get $1.00 left over, it's a successful well to Southland Royalty Company.

Q. Are these projections for the chance of a successful well made on a regional basis?

A. Regional input is always put into them.

Our -- we use our history in the area, as well as other operators' history in the area.

Q. How large an area in the vicinity of the subject proration unit does this 62 percent chance of success factor apply to?

A. Well, it's -- your question really is a difficult one to answer because when you're looking at a new prospect like this, and this is a step-out, it's not an infill location or it's not a corner shot, a step-out you have to look at how other step-outs have fared in very similar looking type of producing fields or prospects, and so I guess to answer your question, we've looked at along the Morrow trend in this particular northwest -- northeast trend, same stratigraphic as we think we -- we look at the success rate for step-outs in this situation.

And as I mentioned, we only two -- we had two objectives in this well. All three of them -- we didn't think our lower sands would be an objective.

So your question is difficult to answer and I'm not trying to be evasive.

Q. I'm just trying to understand it for myself. If I picked Southland Royalty Corporation a location, let's say, in Section 2, immediately south of the subject proration unit, is your risk factor there, or your success

factor probably still in the vicinity of 62 percent?

A. You're asking me a hypothetical question. We haven't worked up a particular well location there, but I would say that success factor would probably be in the range of 60 to 75 or 80 percent; it would be somewhere in that range.

We have a very attractive Atoka well in Section 1 and if -- let me back up a second. That's assuming we made a -- we were successful, I have to make another assumption, that we make a successful completion in Section 35, which we may not, it's likely that we won't, but if we did, I would say that the success probability for a well in Section 2, esepcially the northeast quarter, would -- would be higher than 60 percent; probably be in the range of 60 to 80 percent.

Most of our Morrow wells that we drill, and we've drilled a lot of them over the last two and a half years, or so, that you're probably aware of, our average Morrow development well is probably in the range of 75 to 80 percent. That would be our average, I would guess.

Q. But you said Morrow development wells.

A. Well, I would call this a development well. Southland defines a development well as being less than one mile away from a producing well in the zone that

you're interested in --

Q. So in your opinion this area is less attractive from the success probability standpoint, as Southland sees it, than the average Eddy County Morrow prospect?

A. I'd say that location was. I wouldn't say this area is. I think this is an attractive area, but our location, the 35 No. 1, I would say yes, was more risky than the average well we've drilled recently.

Q. Is there any other similar area in Eddy County where Southland has had two rigs running for approximately six months drilling Morrow prospects --

A. Well, you're talking about -- we weren't drilling in this one prospect. We were drilling in other -- other prospects as well, you know. When I say we had two rigs running, those rigs could have been eighteen miles apart you know, but they're in this general area.

Maybe I didn't understand your question very clearly.

Q. No, that's -- that's sufficient. When you make your maps, Mr. James, which showed the net clean sand, as you call it, what definition do you put on clean sand so that you included those in your maps and must have excluded other sands?

A. In the Atoka Sands the technique used

by the geologist who was preparing -- who was working in this area, he finds that gamma ray is a good indicator of cleanliness to the sand, unlike down in the Morrow A Sands, as I mentioned earlier. So because the gamma ray is a good indicator of cleanliness, count up the percent of the kick from the shallow base line to the maximu deflection of the gamma ray, using that on a percentage basis, and I don't know his exact technique, but it would be approximately 600 percent, or something like that.

Well, 60 percent of the way out he would net sands that were cleaner than he thought that 60 percent value would go. It's sort of a very subjective technique, but it's commonly used throughout the industry, in -- in certain sand sequences, especially the Atoka Sands.

Q. Well, did you in preparing your exhibits and including what you had classified as the net clean Morrow sand zones, did you exclude other Morrow sand zones?

He found some that were not clean enough to be classified as clean under your rationale?

A. Well, let's see, I could answer your question, perhaps, easier perhaps with an exhibit.

Well, it's not a very good example, but the Atoka B Sand is one continuous sand. This is the type log. Now make the assumption that this Atoka sand was not

nice and clean as it's shown here but kicked back and forward a little bit. Then you draw a line about 60 percent of the deflection from the shale base shale base line and wherever that sand kicked out past it, he would net as clean sand, so within a particular sand body he would discard, as a mapping technique, perhaps some of the sand, because that sand he has interpreted to contain shale, or some shale, which he was making the assumption that would affect the producing characteristics adversely.

Q. Okay, would it be fair to say that it is possible -- or let me state it another way.

Would you disagree if I said that there are sands in your -- in the subject well which have not met your definition to be included as one of your net clean sands but that you intend to perforate or recommend to Southland that the zone is perforated?

A. Maybe if you could be more specific. You're talking about our 35 No. 1 or are you talking about another --

Q. Well, I'll just talk about 35 No. 1. Are there any zones in there in the Morrow system that you would say contain a sand body that did not qualify as a net clean sand for the purposes of your map?

A. Oh, sure, there were some sands there

that were dirty that we interpreted to be dirty for one reason or another, and often -- well, first of all, we don't map the net clean sands in the Morrow, or at least I didn't present any maps, but there could be sands that are in there that wouldn't meet our criteria.

Q. But for completion purposes of the well that might meet the engineering criteria to perforate?

A. I would say no. No.

Q. In other words, you included, you think, all the sands which are possibly productive --

A. In intervals we have in our maps. We probably were optimistic, we were mapping very optimistically.

Q. What do you consider for porosity, let's say, the lower side of what you would look at as a --

A. In which particular sand body are you referring to?

A. The Morrow.

Q. Well, we -- we break the Morrow into two different zones, and both zones -- the zones, we think, have slightly different environments; they have different producing characteristics; we complete them sometimes differently; and then we map them differently.

Now if you're talking about the Middle Morrow Sands, maybe that's what you're talking about, we use

as a routine, 8 percent porosity cutoff for effective porosity. But that does not mean that you can -- you can have 14 percent porosity that is not effective porosity, or sometimes you can have 6 percent porosity that is effective porosity. So, although we initially go through, or we roughly go through with an 8 percent cutoff, that is not our final criterion for determining where we're going to include that as effective porosity or not effective porosity. We put more interpretation on that. We don't use the very straightforward, knife cutoff. We put more interpretation to it. We look at the other logs. We look at our other information that we have.

Q. There are numerous other wells within the general area, aren't there, Mr. James, not shown on your Exhibit Number One?

A. Yes. Southland, for example, in Section 21 has recently completed a well in the Morrow E Sands. I don't know the exact date on it but it's just off our area of coverage on our exhibits; about a mile away from the northwest quarter.

Q. Do you know of any lowdown on that one?

A. Not offhand, but I do know it's -- it's an attractive completion.

Q. So that was --

A. But I could get that information.

Q. That was northeast of the subject location?

A. Let's see, that's northwest.

Q. To the northwest.

A. Yeah. Our land map will show you Section 22. It's immediately west of Section 22, where we have a new producing well; just off that map.

Q. Knowing what you know now, Mr. James, had you the opportunity to drill this well over, would Southland drill this subject well?

A. Well, of course now that we know what it contains, we -- no, but if we had the same data that we had beforehand we would drill this well again, and you know, it's a high risk and in our business, as you know, we drill good wells and we drill poor wells, and this looks like it's going to be a marginal well at this point.

Q. So you don't think this is a success, as Southland defines it?

A. Can't say it's a success now, and I can say that it appears not to be a very attractive well, and it appears definitely to be going to be a below average well for this -- this area.

Q. Will you concede that production might prove that the well would be turning out to be a success even

under Southland's definition?

A. Well, sure, because as I mentioned, these Morrow A Sands are very tricky and what appears to be a good well often is a poor well and sometimes, and I can cite you examples, what appears to be a very poor well in the A Sands has turned out to be a very good well. The sands are so variable that something that may have 4 feet of pay in it may open up in 200 -- 200 feet to a point bar with 40 feet of pay in it. It's -- it's a very difficult sand sequence to work with.

Q. For the sake of discussion, Mr. James, do you know what the success percentage placed by Southland prior to drilling its well in the east half of Section 34 was?

A. In this prospect?

Q. Yes.

A. Okay, so far in this prospect, this would be -- we've drilled four successful wells and this one the verdict is out on, so this would be perhaps one out of five that was not attractive, or perhaps dry.

Q. But you've got 100 percent success ratio up to this well, then?

A. Well, sure, but if we drill two wells and were successful in our first well, we'd have 100 percent

success rate, that doesn't mean our second well would be successful.

Q. Are there several other parties active in the general area, Mr. James?

A. Yes. I mentioned Tenneco is active and I did not mention, but Yates is active in the area, as well as Conoco, and Threshold. Those come to mind immediately.

Q. I notice, or I heard you discuss, Mr. James, several producing wells but I didn't hear any mention of any dry holes. Why is that?

A. Well, perhaps I hadn't really -- well, if you'd like me to, I could mention a couple for you real quick.

Q. Okay.

A. There's a dry hole in Section 1. It's an older well. It was drilled by Ashell Leonard (sic) and I have to say in all honesty it may not have been evaluated properly, but it's technically a dry hole.

And Threshold Development has recently drilled a dry hole in the west half of Section 10.

I see what you're getting at, but I don't think you have much merit to proceed just to say that this particular map does not have a lot of dry holes in it. I could have come up with a larger area map, but Southland

did not want to present too much of its interpretation for public record, but I could tell you that there are within an area this size, this marked area, if you will go to the north and to the west and to the east -- well, not so much to the east, there aren't any wells to the east -- and south, you'll find ten or twelve dry holes, bona fide --

Q. How far is that to the north, let's say?

A. Well, I'm talking now without having a map in front of me, so you could very easily pin me down. I'm talking about the overall area.

Q. Would you say that there are very few or virtually no dry holes in the immediate vicinity of the subject well?

A. Sure, but I also know there are some poor wells that are successful in the subject area.

Q. Are there some very good wells, too?

A. Yes.

Q. And overall, would you concede that this is a very attractive area?

A. Yes, overall I would.

Q. Do you think Mr. James, that you could locate another area of the size that you have shown on Exhibit Number One with this number of Morrow wells drilled, or wells that have penetrated to the Morrow, let's say, with

as few dry holes as in this area?

A. Yes, you could. Southland's Parkway West area, which is -- begins one mile to the south of this map. We have a couple of just -- one or two dry holes -- not just Southland but perhaps six or seven or eight producing wells. But again, some of those producing wells are not all great wells, either.

Q. Did you mention any possible Wolfcamp production in this area?

A. No. We have had a couple of Wolfcamp shows but the Wolfcamp production in this area really has been disappointing.

Q. Did you --

A. And its production occurs to the west.

Q. Did you notice on the logs in the subject well any indication of possible Wolfcamp production?

A. I'm going from memory right now and I'm going to say I don't remember any. I don't believe there were any shows of any consequence, but again you'll -- I'm going from memory. I did not have --

Q. Any possible Strawn production in that area?

A. I possibly could answer your question. Let me refer to something.

There was a very minor show 4 feet thick 6 feet thick, or so. at about 9265, somthing like that, and and offhand, I don't remember if that's Wolfcamp or not, but it's up near -- it might be the Wolfcamp.

Q. And I don't want to belabor this,but you would concede that this is an area where multiple pays reduce the risk of an unsuccessful well?

A. Do you mean do multiple pays reduce the risk?

Q. Right.

A. Oh, of course, they do, and I mentioned, Southland's interpretation, this is an area with three objective -- or three possibilities. You can always find some little traps and show up the hole or something that you might test 15 or 18 years from now, but you certainly wouldn't want to drill a well for it.

Q. Do you know, Mr. James, when Southland calculates its percentage of liklihood of success on a well designed to penetrate the Morrow, does it take only into account the Morrow possibilities?

A. No. For example, in this particular well we are -- we strongly took into account the Atoka possibilities. It was our main objective. We drilled to the Morrow only to be complete and test all the zones. The

Atoka was our main objective.

Q. This large Lower Morrow sand body which you pointed out on one of your exhibits, did you make all your perforations in that sand body at one time?

A. No. We -- your question is a good one. We did not. We tested -- well, let me answer it this way. At first we tested all the perforations in the sand body at one time. Then we looked at it more closely and evaluated our results. We thought that perhaps, from log analysis, especially, we could see that there might be a gas/water contact in the well, and so we set a bridge plug to try to see if we could cut out the water.

What we did in fact was cut out the gas when we set that bridge plug and produced it, trying to produce just the upper part, we produced all water and no gas.

Q. If I noted correctly on one of your -- you showed quite variable water saturations in that zone?

A. Yeah, that's quite typical for the Morrow.

Q. Would you think that it may possibly have been a mistake, Mr. James, to have perforated that entire zone?

A. No, I think we --

Q. At once?

A. I think we fairly, conventionally evaluated this zone, and that zone is wet.

Q. You don't think it would have been possible to perforate separately the lower part of it or the upper part of it --

A. Well, surely the --

Q. -- the very upper part?

A. Southland Royalty's interpretation of that zone is that it's not productive. If we make a dry hole here we'll gladly give you the well to complete in, if you'd like to try.

Q. This is the zone that you stated is flowing 50,000 a day?

A. This is the zone that made a small amount of gas and made a significant amount of water. The zone that's flowing at 50,000 cubic feet a day is in the Morrow A Sands above that, the interbedded sand/shale sequence. We are trying to complete in that zone right now.

Q. In the upper zone?

A. Yes.

Q. You completely abandoned this lower zone?

A. Yes.

Q. You don't conceive that there's any

possibility that the failure to perforate the upper few feet of this sand might have been a better way to proceed?

A. I'm saying that Southland Royalty contends that that zone is not attractive and -- and maybe I could see what you're talking about here, just a minute.

We perforated right up to the top of the porosity. I don't see what you're getting at.

Q. Then you perforated from top to bottom all at once?

A. Yes, as I mentioned, we had a small amount of gas and a large amount of water. We thought there might be a gas/water contact and we set a portable bridge plug to try to perforate -- just to produce the upper three or four or five feet, and doing so cut off -- cut out the gas and we recovered only water, indicating that the gas was probably coming from a zone below there and it was a very small amount of gas. So we didn't want to spend any more money, or we felt we evaluated the zone thoroughly and completely, and we abandoned the zone and moved on up.

Q As far as thickness of the zone, it was -- it was not too shabby, was it?

A. It was very attractive, and by the way, our partner in this well agreed with us on it, on our procedure. It was a very attractive sand, but you sure like to

have those sands full of gas, and no water.

MR. DICKERSON: I have no further questions.

MR. CARR: I have nothing on redirect.

MR. RAMEY: Any other questions of the witness? He may be excused.

(Thereupon a recess was taken.)

MR. RAMEY: You may proceed, Mr. Dickerson.

JAMES T. MASON, JR.

being called as a witness and being duly sworn upon his oath, testified as follows, to wit:

DIRECT EXAMINATION

BY MR. DICKERSON:

Q. Will you state your name, please?

A. James T. Mason, Jr.

Q. And what is your occupation, Mr. Mason?

A. I'm a geologist/geophysicist for Yates Petroleum in Artesia.

Q And, Mr. Mason, have you previously testified as a geologist before this Commission and had your credentials made a matter of record?

A. Yes, I have.

MR. DICKERSON: We would tender Mr. Mason as a geologist, Mr. Ramey.

MR. RAMEY: So qualified.

Q. Mr. Mason, have you made a study of this area on behalf of Bassett-Birney Oil Corporation?

A. Yes, I have.

Q. Would you please refer to what is marked Bassett-Birney Exhibit Number Three and describe that -- what that instrument is?

A. Okay, Exhibit Three that we have here is a composite map. We have the structure at the base of the Southland Middle Morrow shale, which we call our Lower Morrow marker, and we there split the Morrow into an upper and lower, and this structure map is on the base of that Middle Morrow shale.

The solid contours outline the structure and it is in 50 foot contour intervals.

There is also a broken contour on top of the structure contour, which outlines the net thickness of clean Morrow sand, and we define our clean Morrow sand

a little differently, also. We use 50 API as our cutoff, and in some cases you're going to ignore radioactive sands, so it's a slightly pessimistic way of counting.

This map is essentially our pre 35 map. We did have terracing in here rather than a small anticlinal structure, and we had projected 60-some feet of clean Morrow sand. The well bore out this terracing, and in fact, pulled up a slight anticline in there, and --

Q. Now, Mr. Mason, for clarity, the numerals beside the well location symbols are the reference to the net feet of clean Morrow sand you find in all these wells?

A. Yes, sir. The negative number is subsea depth to the base of the Middle Morrow shale or Lower Morrow marker, and then the -- the two digit number in this case is the thickness of clean, total clean Morrow Sand. It includes both Upper and Lower Morrow Sands.

Q. Mr. Mason, based on your -- and you say this map was based on your study of this area prior to the drilling of the subject well?

A. This is essentially the map that I drew over a year and a half ago.

Q. For the sake of discussion, does your -- your indication of 64 feet of clean Morrow Sand in the subject well, was that substantially borne out by the actual log on

the well?

A. The log -- we had projected about 60 feet or more total clean sand. The well was drilled and proved to have 64 feet of clean Morrow Sand by our definition.

Q. Where is the subject well according to your figures, Mr. Mason, as far as the up dip or the -- the height of the structure as related to other wells in the area?

A. Okay, the subject well is up dip from several producing wells. It is structurally high to the Tenneco "JL" in 36 and the Tenneco State "HL" in Section 1.

And also that group centered around Threshold and Southland's wells down in 10, 11, 15, and 14, 15, 16.

Q. Are there any other factors that you could point to that bear on the subject of the risk involved in drilling the subject well in this area?

A. Well, I might point out that in the nine sections contiguous to and including the subject -- or the section which includes the subject well, there are six total wells. One of these, the Ashland and Hilliard, is mapped as a dry hole. The well was drilled in 1960, gas prices were low, it was logged with the old gamma neutron induction log for the resistivity, and these are somewhat

less than desireable as a log than the CNL-FDC and dualatero logs we commonly run today, and apparently Tenneco looked at these old logs and believed that there was bypass potential in the Ashland-Hilliard well.

That well was, incidentally, drilled to Devonian. The Devonian was the primary objective and not -- not Morrow.

They looked at the old logs and determined that there was enough potential to be worth a re-entry, they offset it one 40 acre spacing unit to the east, and when they drilled their State "HL" it initialed 25-million a day.

So I question, really, the Ashland-Hilliard is a dry hole. I think it's a bypassed producer.

So now, taking the six wells in these nine contiguous sections, even if we count the Ashland and Hilliard as a dry hole, you've still got 83.3 percent success ratio, that these wells are either going to produce from the Morrow, the Atoka; it is an area of multiple pays. The Strawn pay is just north of here; Cisco pay is in the couple of wells way to the northwest. The Wolfcamp looks pretty good in that well down in Section 15 in the white circle, so it is an area of multiple pays, and this significantly reduces the risk.

Q. Mr. Mason, in your opinion does this

projection of a clean Morrow sand or sand bodies in excess of 60 percent or 60 feet, rather, in the Morrow in this subject well, is that directly related to the risk involved in drilling this well?

A. Well, you have -- have several very good wells in the area that have less than 40 feet of total clean sand, and so I would say that the projection of a minimum of 60 feet of clean sand gives you a significantly reduced risk.

Q. Have you reviewed the logs, Mr. Mason, which Mr. James referred to in his testimony?

A. Yes, I have.

Q. And based on your review of those logs, do you find that he had 64 feet of clean Morrow sand in that well?

A. Yes, sir, I do.

Q. And that was substantially the same as your pre-drilling projection?

A. Yes, we had projected 60 feet as a minimum.

Q. Mr. Mason, you have on your Exhibit Number Three numerous other wells in the area. If these wells have any bearing on the risk factor in the subject well, describe how that works for us.

A. Well, we have 20 sections in this mapped

area, and these 20 sections include 20 wells, all of which penetrated the Atoka-Morrow section.

And of these, if we again treat that Ashland-Hilliard well as a dry hole, you still have a 95 percent success ratio for a 20-square mile area surrounding the subject well.

Q. In your experience is an area like this unusual for wells of this nature?

A. To be an area as large as 20 square miles without a bona fide dry hole is unusual. You could probably pick and fit and come up with one that would -- would be that large without a dry hole, but this area is, I think, almost unique.

Q. Do you think or do you have an opinion, Mr. Mason, on the degree of risk involved in drilling the subject well in view of the surrounding situation?

A. Well, I would - I would assign a minimum of 80 percent chance of success on this well, just from the surrounding production, its structural position, the availability of Morrow reservoir quality sands, and the presence of multiple pays that have been proven in pre-existing nearby wells.

Q. Mr. Mason, in your review of the logs of this subject well, have you discarded this well as much

as Mr. James has and indicated by his testimony?

A. I think that the well has more potential than -- than he's given it right now, because I think that you'll find that he's got a better well there. There is this wave of pessimism when a well doesn't come on as nicely as it should, and this may be kind of the day after the honeymoon and then the marriage picks up and everything's okay.

But I think that he's got a better well there than -- than what it appears to be now.

Q. If you have anything specifically in mind as shown by the logs, briefly refer to those facts.

A. We have -- we've had quite a bit of success in the Morrow. I think we've probably drilled 20 or 25 Morrow wells last year, and as I remember, we only plugged two of the Morrow wells.

We have a minimum porosity cutoff of about 5 percent, and consequently, I think those three or four Upper Morrow Sands that he's got here look pretty darned good.

So I'd be real happy with an Upper Morrow section like that. Also, he's got the -- what he called his Atoka B Sand, which has 7-1/2 to 8 percent porosity and 29 percent water saturation, so I think that he's got some potential there.

Q. You think those zones will give up some gas?

A. I think they will. Then around 10,430, there are a couple of little porous tongues in the Strawn that -- that thin, but they may still have quite a bit of potential. This reservoirs have fooled us before. We nearly walked away from a 4-footer on the Long Arroyo and it initialed 9-million, so you can't let these thin things just throw you out.

Then up in the Wolfcamp at 9264, about, you've got 8 or so feet, maybe 9, of porosity there. There is no gas separation, so I would kind of anticipate you'd be in an oil regime with 10-1/2 percent porosity and 7 percent water saturation, and some indicated permeability on the duolatero log.

Q. Mr. Mason, all the clues you geologists look at to foresee the future as far as the productivity is concerned, are all these clues that you've reviewed in the subject well consistent with your pre-drilling analysis of the location?

A. They are, yes.

Q. Based on your review of these instruments, Mr. Mason, would you have an opinion as to a reasonable risk factor to be imposed in the event the Commission does grant

Southland's forced pooling application?

A. I think the previously assigned penalty of 20 percent is equitable and reasonable, considering the -- that this is a high success area. It's an unusually high success area. It's almost unique for -- for even Eddy County.

MR. DICKERSON: At this time, Mr. Ramey, we'd move Exhibit -- admission of Bassett-Birney Exhibit Number Three.

MR. RAMEY: Bassett-Birney Exhibit Number Three will be admitted.

Q. Mr. Mason, do you have anything else you would like to add concerning the risk factor in this well?

A. Only that you have an extremely high success rate in the surrounding area. We define success possibly a little differently. If we get our money back and maybe make a couple of bucks, it's a success, and with four or five potential zones that you can recomplete in, you will certainly get your money back in this one.

MR. DICKERSON: I have no further questions.

MR. RAMEY: Any questions, Mr. Carr?

MR. CARR: I have a few.

CROSS EXAMINATION

BY MR. CARR:

Q. Mr. Mason, you just stated that this is a high success rate area, I believe.

A. Right.

Q. On that alone would you recommend that BAssett-Birney drill a Morrow well in the area?

A. Well, they don't have the facilities to operate a drilling well. Probably I would recommend to them that they farm out to Yates and Yates operate the well.

Q. But you would, just based on the high success ratio of the other wells in this area, recommend that they invest -- or someone invest $800,000 to drill a Morrow well in this area?

A. Well, it would depend on the local geology, as I see it at the time. I wouldn't broad brush the stuff to the east of here under -- in the potash area. I wouldn't say that that's quite as high a probability of success as this area here, but I think there's still a number of viable locations even in this 20-section map area.

Q. Have you studied the Morrow in general?

A. I've been working on the Morrow for about two years with Yates and I worked on it for about a year when I was with Continental.

Q. Would you disagree with the statement that in the Morrow that it's possible to offset a very good well and come up with a dry hole?

A. I wouldn't disagree with that.

Q. Would you think that was a fair characterization due just to the general structural configuration of the Morrow?

A. I would go more with the sand body geometries. In a lot of cases I've seen one or two places where there's an extremely good well and it's been offset all the way around with -- and I think there it's just a case of not adequately resolving the geometry of these sand bodies in a regional mode to come up with some concept of where to anticipate that sand body for the offset.

Q. Would you, based on just the way you would characterize the sand bodies conclude that you -- any place in the immediate area, say, in 35 would drill a successful Morrow well?

A. I would say that in a diagonal band trending northwesterly across Section 35, you'll have a higher success ratio. I have this Isopachous thick running northwesterly across Section 35, and I think that probably you'll have a much higher probability of success in that fairway than say you might, but I still think that the whole Section

35 looks good.

Q. Would you say there's a possibility of drilling a dry hole in the, say, northeast quarter of Section 35?

A. Well, I think you'll encounter reservoir quality Morrow rocks there, thick enough to give you a well that has a reasonable chance of being productive, but it is possible, and I've seen this several times, to have a drilling fluid problem and -- and choke your Morrow off. There are a lot of different ways to hurt the Morrow. It's essentially a producing interval and it is possible to have a geological success with good reservoir and damage it to the point that you can't produce it.

Q. Is it possible to also have -- drill a well there that would not be a geological success, no matter how well you completed it?

A. I would give 35 a very high probability of success.

Q. If you give it a high probability, isn't there also some probability that it would not be?

A. There is, there is a chance. There's always that.

Q. Now, in determining whether or not you have a successful Morrow well, when do you know you've got a

good well? Do you have to -- do you know -- you don't know that just from the logs, I assume.

A. Well, after you've looked at a number of logs and the number of cums on these wells, you begin to develop a feel for what general sand package will give you the minimum reserves that you need, and to pay out one of these Morrow wells at this depth you need approximately 400 Mcf -- or 400 million.

Q. When do you know that, only after you've perforated, is that correct?

A. You can get a pretty good estimate, say, two months after the well goes on line.

Q. So you have to produce it for a short period of time, also?

A. You have to get some production to -- to generate reserves.

Q. Now, I believe you said a few minutes ago that you saw there was a potential for some Strawn production in the subject well, is that correct?

A. Yeah.

Q. Based on your reading of the log would you recommend that the Strawn be perforated?

A. I would say that before this well is abandoned the Strawn should be perforated.

Q. Would the same also apply for the Wolfcamp?

A. I would give the Wolfcamp a shot before the well is abandoned.

Q. Is there Wolfcamp production in the immediate area?

A. There is a well down in 15 which is capable of Wolfcamp production. It has not been brought on line yet.

Q. Is that the well indicated by the white circle?

A. It is.

Q. Is that a Southland Royalty Company well?

A. Let me see. I'm not sure whose well that is. I would -- I would imagine it is because the other two wells in 15 are also SRC.

Q. Would it surprise you to learn that that well was completed in the Wolfcamp by Southland and was dry in the Wolfcamp?

A. Dry?

Q. Yes, sir.

A. Well, it sure looked like it had a good Wolfcamp shot.

Q. That just again, I guess, shows you can't really tell from a log what you've got.

A. Well, again, too, you may -- it may have been damaged in a completion attempt.

Q. Do you have any knowledge that would indicate that?

A. No, but --

Q. Now I believe you indicated in Section 27 there was a Morrow producer there, is that correct?

A. That's an error. That should have been another Atoka producer.

Q. And that well, in fact, was dry in the Morrow, was it not?

A. I think it was a little weak in the Morrow, yes.

Q. What are the -- you may have testified to this and I just didn't hear it. What are the yellow dots? What do they depict?

A. I'm sorry, the yellow dots are Atoka completions and the red are Morrow completions.

Q. Now I believe you indicated that one of the things you would look at in evaluating a well after you have the log is the number of feet of clean Morrow sand, is that correct?

A. At the point where I've got the log, then I evaluate it on the basis of porosities.

Q. Uh-huh.

A. Indicated permeabilities, water saturations, cleanliness, the history that a particular zone may have, for instance, you may have a zone that -- that has a lot of mobile clays in it and it chokes off very easily, or was choked off very easily in an offset well.

Q. Looking at the subject well, what does the number 64 opposite that well indicate?

A. That indicates 64 feet of clean Morrow sand.

Q. And that's what you got from a -- did you get that from the log?

A. Yes.

Q. If you learned that a substantial portion of that was water saturated, would that have an adverse affect on the way you evaluated the well?

A. Well, I don't know that it's water saturated.

Q. But if you did.

A. That would have some affect on how you would evaluate the well, yeah, but I'm -- I always wonder about these zones that have extremely good permeability and

they make water when they're perforated, because I just wonder how much fluid was lost as that section was drilled, how much fluid was produced if they perforated it, if they bothered to run water analysis and watched for chlorides, KCL, things like this that are added to the drill fluid that would travel with the filtrate fraction of the mud, and would come back and allow you to tag that as mud filtrate and be able to say, okay, they lost 5000 barrels of mud at this point. The KCL content of the fluid they recovered tags it as drilling filtrate, and they only recovered 500 barrels when they perforated. So they've got a lot of water that they put in the formation that wasn't there originally.

Q. So you're saying that all of those things are to be taken into consideration in determining whether or not you have a wet sand.

A. Yes. So I don't know if -- I don't know how much fluid was produced, if water samples were run.

Q. You don't have any knowledge concerning this well that would indicate to you that any of those conditions existed when that zone was tested, do you?

A. Not specifically, but it is open to speculation.

Q. But you have no data, is that right?

A. I have no data but --

Q. Do you have anything that would make you conclude that anything done in the completion of this well was done in an imprudent fashion?

A. We don't have all of the -- the information on the well, so it -- I would hate to -- to pass judgment on anybody's completion techniques, drilling techniques, or anything, when I don't have the complete records.

Q. Have you had complete records on other wells drilled and completed by Southland?

A. I'm not sure about that. I know they've made some good wells out here, particularly in this area and they have -- they have a record as a good, conscientious operator.

Q So you're not insinuating that they're not operating in a prudent fashion?

A. No. Well, there are things you can do to the Morrow that the operator might not even realize have been done, and it's then just a contractor problem or a mud engineer's error.

Q. Mr. Mason, in putting together a structure map like this, you take, I guess, certain bits of information that you obtain from the various wells drilled and completed in the area and then you interpret it and that's how you draw your contours, is that correct?

A. Right, that's -- that's really all you can do.

Q. Isn't it possible that equally competent geologists would interpret the data in a somewhat different fashion?

A. Unquestionably.

MR. CARR: I have nothing further of this witness.

MR. DICKERSON: Nothing further.

MR. RAMEY: Any other questions? He may be excused.

Anything further, Mr. Dickerson?

MR. DICKERSON: No, sir.

MR. CARR: I have a very brief statement, but I will shorten it so it's maybe five sentences.

Southland Royalty Company is here today attempting to get an order pooling the west half of Section 35. I think the testimony here today shows you that there isn't an agreement for voluntarily developing this acreage. We believe we have presented evidence on all points necessary to entitle us to a pooling order.

We also believe that the testimony shows that it's an area in which it is speculative, that there are risks involved in drilling particularly a Morrow well in the

area and that we have presented a case which would entitle Southland Royalty to a risk penalty which we think should reasonably compensate them for the risk they are assuming in drilling and completing a well while there are certain interests that are outstanding.

We also would request that the order be expedited because it is obvious the well is down and it's been kept a very tight hole -- you can tell by the fact that Mr. Dickerson has the logs on the well, but it is important that, if at all possible, the order be expedited, and we would reque' that.

MR. RAMEY: Thank you, Mr. Carr.

MR. DICKERSON: Mr. Ramey, I would just like to say that from the standpoint of Bassett-Birney Oil Corporation, this is not a matter for the New Mexico Oil Conservation Division. This is a dispute between leaseowners as to the extent of their interest. Bassett-Birney remains and has been from the very first, as is Southland, very desirous of drilling this acreage itself.

The applicable statute, Section 70-2-17, which authorizes this Division to subject interests to compulsory pooling, by its express terms, we think, provides that such pooling orders shall be made, but only when the parties have not agreed to pool their interests.

Southland -- or Bassett-Birney in this situation has not only agreed to pool its interest, it has in fact prepared and executed a communitization agreement pooling its interest. The only thing that Bassett-Birney has not agreed to do is pay for the well on the percentages deemed owned by Southland. That matter is for the courts. It's in the courts. It should be left in the courts, and should not adversely affect the interest of Southland Royalty Corporation if this application for compulsory pooling were dismissed, and for that purpose we would move that the application be dismissed.

On the other hand, on the off chance that our motion fails, we think that the testimony establishes that this is an unusually low risk area for Morrow productivity, or Morrow projection of wells to penetrate the Morrow. They have a shot at several other horizons and all these factors testified to lead to an unusually low risk area, and the penalty assessed in the original Examiner hearing of 20 percent is just and equitable and should be affirmed by this de novo proceeding.

MR. CARR: I would request the opportunity to respond to the motion.

We would simply state that a willingness to agree does not an agreement make absent the agreement and

execution of appropriate documents which establish the rights of the parties and take on the nature of a contract.

And we submit that the case is properly before the Commission and although there are issues which admittedly must be resolved by the court, that we come before you and we've met all the conditions entitling us to an order, and we submit that the order should be expeditiously provided.

MR. RAMEY: We will take the motion under advisement and rule with an order, I assume.

With that, the hearing is adjourned.

(Hearing concluded.)

C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY CERTIFY that the foregoing Transcript of Hearing before the Oil Conservation Division was reported by me; that the said transcript is a full, true, and correct record of the hearing, prepared by me to the best of my ability.

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STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BLDG.
SANTA FE, NEW MEXICO
19 January 1981

COMMISSION HEARING

IN THE MATTER OF:

Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

CASE 7025

BEFORE: Commissioner Ramey
Commissioner Arnold

TRANSCRIPT OF HEARING

A P P E A R A N C E S

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MR. RAMEY: We'll call Case 7025.

MR. PADILLA: Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

MR. CARR: May it please the Commission, my name is William F. Carr, with the law firm Campbell, Byrd, and Black, Santa Fe, appearing on behalf of Southland Royalty Company.

I have two witnesses.

MR. DICKERSON: Mr. Ramey, my name is Chad Dickerson, of Artesia, New Mexico, appearing on behalf of Bassett-Birney Oil Corporation, and we will swear two witnesses and attempt to get by with one.

MR. RAMEY: Ask that the witnesses stand and be sworn at this time.

(Witnesses sworn.)

DON W. DAVIS

being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. CARR:

Q. Will you state your full name and place of residence?

A. Don W. Davis, Midland, Texas.

Q. Mr. Davis, by whom are you employed and in what capacity?

A. Southland Royalty Company as a petroleum landman.

Q. Have you previously testified before this Commission or one of its Examiners and had your credentials as a landman accepted and made a matter of record?

A. Yes, I have.

Q. Are you familiar with the application filed by Southland Royalty Company in this case and with the area which is the subject of the application?

A. Yes, I am.

MR. CARR: Are the witness' qualifications acceptable?

MR. RAMEY: Yes, they are.

Q. Mr. Davis, would you briefly state what Southland Royalty Company seeks with this application?

A. Southland Royalty Company seeks an order for forced pooling the west half of Section 35, Township 18 South, Range 29 East, Eddy County, New Mexico.

We also seek a risk factor and request

Southland Royalty Company be designated operator of the unit.

Q. Will you please refer to what has been marked for identification as Southland Royalty Company Exhibit Number One, identify this, and explain to the Commission what it shows?

A. This is a plat showing Section 35 and some of the surrounding sections. It shows the proposed location and also in the hachured lines shows the dedicated proration unit.

Q. Is this a standard proration unit?

A. Yes, it is.

Q. And are you planning to -- proposing to drill the well at a standard location?

A. Yes, we are.

Q. The red dots, I believe, show other Pennsylvanian completions in the area, is that correct?

A. That is correct.

Q. What is the status of commitment to this well in the west half of the section? Who has joined or refused to join in the drilling?

A. Bassett-Birney.

Q. Bassett-Birney has what?

A. Refused to join.

Q. Who else has joined in participation?

A. Okay, looking at the plat, I guess I'll just start from the top. The north half of the northwest quarter of Section 35, Tenneco Oil Corporation. They own 100 percent of the rights and have agreed to join in the well. And the acreage in blue, which is the south half of the northwest quarter and the northwest quarter of the southwest quarter, is acreage, according to our title, owned 50 percent by Bassett-Birney, 50 percent by Robert E. McKee Company. SRC has acquired a farm-in from the Robert E. McKee Company concerning their 50 percent interest in this acreage.

In the acreage in green, designated with the name Featherstone Farms, SRC has also acquired a farm-in agreement from them concerning 100 percent of this acreage.

Q. Mr. DaVis, is there a dispute as to the ownership of any acreage involved in this application?

A. Yes, sir. 50 percent of the acreage in blue.

Q. And is that dispute presently the subject of a litigation in State District Court?

A. Yes, it is.

Q. What is the status of the subject well, the Southland Royalty Company Empire Federal 35 Com No. 1 Well?

A. The subject well has been drilled to

total depth; casing has been set; and we're attempting to -- at this point to try and make a completion.

Q. Could Southland Royalty Company have waited for resolution of the ownership question before spudding this well?

A. No, sir, we could not, due to the obligation dates on our farm-in agreements.

Q. Now when did your farm-out agreement expire, or which farm-out agreement was about to expire?

A. Both farm-out agreements would have expired November 5th, 1980, if we hadn't spudded a well.

Q. And when did you spud the well?

A. November 3rd.

Q. Now am I correct in stating that the only interest that Southland is attempting to pool here today is that of Bassett-Birney?

A. That is correct.

Q. According to Southland Royalty Company's title data, what percentage of the working interest does Southland Royalty represent here today?

A. We represent approximately 80 percent of the well.

Q. And that's in the west half of this section?

A. Yes, it is.

Q. And what percent of the interest in the west half is actually in dispute?

A. 19 percent, approximately.

Q. If Bassett-Birney are successful in their -- in the suit involving the title question, what percentage of the working interest would Southland Royalty Company represent?

A. 62 percent.

Q. Will you now refer to what has been marked for identification as Southland Exhibit Number Two and --

MR. RAMEY: Mr. Carr.

MR. CARR: Yes, sir.

MR. RAMEY: Again we cannot find the exhibits.

Q. Mr. DAvis, will you now refer to what has been marked for identification as Southland Royalty Company Exhibit Number Two, identify this for the Commission, and using this exhibit explain what efforts Southland has made to obtain voluntary pooling of the interests under the proposed proration unit?

A. Exhibit Two are relevant documents and letters, et cetera, concerning our attempt to try to drill

the well in the west half of Section 35. I'll go through them one at a time very, very briefly.

A letter dated February 26, 1980; SRC requested a farm-in from Bassett-Birney concerning their leasehold interest in Sections 33, 34, and 35. We offered a 1/16th override with a 50 percent back-in, which is representative of agreements in the area. We also gave them the option to join in the well.

The second is a letter dated March 24th, 1980, to Bassett-Birney Oil Corporation. We proposed the 35 No. 1 Well, requested a farm-out or joinder in the well, and also submitted an AFE. Attached is the AFE.

By letter dated March 24th, 1980, to Tenneco Oil Exploration and Production, we proposed the well to Tenneco, requested a farm-out or joinder, and also submitted an AFE. AFE attached.

A letter dated June 19th, 1980, SRC responded to Tenneco's request concerning the possibility of forming a 1-section working interest unit encompassing all of Section 35.

By letter dated June 30th, 1980, SRC advised Flag-Redfern, they own interest only in the east half, of our west half well and recommended a working interest unit.

By letter dated July 8th, 1980, SRC informed Bassett-Birney of a possible location change for the well; also attached an operating agreement for the well, plus another AFE, with the location change.

The next document is dated July 15th, 1980, to Tenneco Oil Exploration and Production. We informed them of our unsuccessful attempts to form a working interest unit and also informed them of a possible location change. AFE attached.

Next is a designation of operator from Featherstone Farms, designating SRC as operator of the subject acreage in the west half of 35, as shown on the designation of operator.

Next is a letter dated July 25th, 1980, to Bassett-Birney Oil Corporation, in reference to our early proposals to the 35 No. 1 Well, reference to our attempts to form the working interest unit, and proposed an SRC 35-A No. 1 Well, which would be drilled in the east half of Section 35, AFE attached.

By letter dated July 29th, 1980, to Flag-Redfern Oil Company we referenced our failure to form the working interest unit; AFE attached.

By letter dated September 4th, 1980, from Bassett-Birney to Southland, they relayed the message

that although they would agree to join in the well, they would not agree to execute our operating agreement and AFE.

Next is a letter from Tenneco where they furnished us the operating agreement signed, dated August 27, 1980.

Next is a letter dated September 15th, 1980, from Tenneco delivering their AFE to us, SRC.

Next is a revised operating agreement for the subject well to be located in the west half of Section 35.

Q. I believe there were two different, basically different AFE's submitted with your proposals.

A. Yes, there were.

Q. And the two -- the difference in the AFE's was the result of the fact that you moved the location of the well, is that correct?

A. That is correct, uh-huh.

Q. What are the costs reflected on the July AFE?

A. On the July AFE, July 15th, they reflect a dry hole cost of $538,200. Excuse me, excuse me, a dry hole cost of $488,000; completed well cost of $767,010.

Q. Are these costs in line with what other operators in the area are charging for similar wells?

A. Yes, at the time it was submitted, that is correct.

Q. Other than the letter from Bassett-Birney dated September 4, in which they indicated a willingness to pool interests in the west half of the subject section, have you received any -- been able to obtain the signatures on any other document which would indicate their willingness to join?

A. No, sir, not that we have furnished Bassett-Birney.

Q. Do you believe you've made,Southland Royalty Company has made a good faith effort to obtain a voluntary pooling of the interests in the west half?

A. Yes, we do.

Q. And is it the opinion of Southland Royalty Company that agreement has not yet been reached to voluntarily pool all interests under the proposed proration unit?

A. Yes.

Q. Are you prepared to make a recommendation to the Commission concerning charges for overhead and administrative costs while drilling and producing the subject well?

A. Yes, $3000 drilling rate: $300 producing rate.

Q. And this $300 is a monthly figure?

A. Yes.

Q. Do you recommend that these figures be incorporated into any order which might result from this hearing?

A. Yes, I do.

Q. And do you believe these figures to be in line with what is being charged by other operators in the area?

A. Yes.

Q. Will Southland call another witness who will testify as to geological considerations and the -- and risk factor?

A. Yes, we will.

Q. Does Southland Royalty Company request to be named -- or designated operator of the subject well?

A. Yes, sir.

Q. Mr. Davis, in your opinion will granting this application be in the best interest of conservation, the prevention of waste, and the protection of correlative rights?

A. Yes, I do.

Q. Were Exhibits One and Two prepared by you or under your direction and supervision?

A. Yes, they were prepared by me.

MR. CARR: At this time, Mr. Ramey, we would offer into evidence Southland Royalty Company's Exhibits One and Two.

MR. RAMEY: Exhibits One and Two will be admitted.

MR. CARR: I have nothing further of this witness on direct.

MR. RAMEY: Any questions?

MR. DICKERSON: Yes.

MR. RAMEY: Mr. Dickerson.

CROSS EXAMINATION

BY MR. DICKERSON:

Q. Mr. Davis, since your well in the west half of Section 35 is now completed, Southland now has actual well costs rather than proposed well costs, do you not?

A. Well, yes, but concerning actual completed costs, you know, there are --

Q. You think they were made?

A. Yes, but I do not have those costs with me.

Q. Mr. Davis, I'm going to hand you a copy which is marked Bassett-Birney Oil Corporation Exhibit Number One, and ask you to confirm that that is the instrument which

is part of Southland's Exhibit Number Two, a letter dated September 4th, 1980, from Bassett-Birney to Southland Royalty Corporation?

A. That is true.

Q. In order that the Commission might understand how this title litigation arose and led to the current situation, would you refer to the Southland Royalty Corporation well, located and shown on your Exhibit Number One in the east half of Section 34, and describe how this problem came about?

A. We acquired a farm-in agreement -- you mean concerning the farm-in, et cetera, all the way through?

Q. That's right.

A. We acquired a farm-in agreement from Robert E. McKee Company and Featherstone Farms, covering various interest in Sections 33, 34, and 35.

Q. Now, let me ask a question. That situation in the east half of 34, as far as the dispute between Bassett-Birney and Southland, is the same title as you have indicated in blue on your Exhibit Number One?

A. That is correct.

Q. Okay, continue.

A. Okay. We acquired the farm-in agreements. Upon acquiring the farm-in agreements we approached all lease-

hold owners in Section 34 concerning the well.

You want me to go into the proposal of the well, et cetera?

Q. Just briefly indicate, in that well you approached Bassett-Birney Oil Corporation --

A. Yes, that is correct.

Upon approaching them, they executed AFE and operating agreement, showing what our title showed as their interest, and we proceeded to drill the well.

Q. And they indicated a willingness to join in participation in that well.

A. Yes, they did.

Q. And is it not true, Mr. Davis, that shortly after that well was spudded but substantially before it was to total depth, at that time Bassett-Birney became aware of the title dispute and asserted title to 100 percent of the interest under your McKee farmout?

A. Yes. At basically a little over 6000 feet.

Q. Would -- if I -- would you agree with my statement if I characterized Bassett-Birney's actions in this area in the east half of Section 34, and the subject well today as not indicating a non-willingness to participate in the drilling of these wells, but merely a non-willingness

to agree to the interest that Southland Royalty Corporation thinks that Bassett-Birney owns in these leases?

A. That question -- would you repeat that question?

Q. Bassett-Birney did indicate a willingness and desire to participate in drilling these wells, did they not?

A. Yes, yes, they did.

Q. And so the only dispute, as far as you know, involves Bassett-Birney's claim to an additional interest under both these wells that we've talked about, over and above what Southland credits Bassett-Birney with?

A. Yes.

Q. And the letter that I handed you, marked Bassett-Birney Exhibit Number One, sets forth that statement, and recites the fact that Bassett-Birney makes an additional claim of title, not recognized by Southland, as the failure and refusal of Bassett-Birney to execute your AFE and operating agreement?

A. That is true.

Q. But it did state, did it not, that Basset-Birney was willing to pool its interest to avoid the necessity of this hearing?

A. No, whether that was the reason they said

it, I can't verify that, but they did say they were willing to pool the interest, but would not execute our operating agreement or our AFE.

Q. But they have never --

A. Which is the standard procedure for accepting.

Q. But Bassett-Birney has never indicated to you in any way, shape, form, or fashion that they did not desire to participate in the drilling of either one of these wells?

A. That's kind of -- well, they said they would pool their interest, and that's really about as far as I could go.

Q. And they --

A. They said they were willing to pool their interest but were not willing to execute an operating agreement and an AFE.

Q. Setting forth the --

A. The interest as we show versus the interest as Bassett-Birney shows.

Q. Right, but they did -- Bassett-Birney did execute an AFE and operating agreement in the east half of 34 before it became aware of the title dispute?

A. The west half of 34 - is that east half?

You are correct, east half of 34. That is correct.

Q. Now, Mr. Davis, I'm going to hand you what is marked Bassett-Birney Exhibit Number Two, and ask you to describe what that is, if you've seen it before?

A. This is a communitization agreement that was mailed to us and a letter attached, concerning the 35 No. 1 Well.

Q. Stating again, basically, Bassett-Birney's willingness to participate in the well but its unwillingness to execute AFE's and operating agreements setting forth interests as asserted by Southland. Correct?

A. That is correct, except it more or less -- correct me if I'm wrong -- puts the -- whether the interest is finally determined to be owned by Southland or Bassett-Birney, puts the full liability of a dry hole concerning that disputed interest on Southland.

Q. But wasn't that the substance of Bassett-Birney Oil Corporation before, that Southland's actions prior to that time had been exactly the same effect, as far as putting the entire risk of a dry hole on Bassett-Birney?

A. Not per se in the joining of the 34 Well in the east half, no. This came after -- after the title dispute did appear, then this is their -- this is where -- this is the terms that they're willing to join on.

Q. And there were no conditions, were there, Mr. Davis, attached to Bassett-Birney's execution of the communitization agreement covering the subject proration unit?

A. Excuse me, would you repeat that, sir?

Q. There were no -- Bassett-Birney, in that letter or in any other way, did not attach any conditions to the execution of the communitization agreement, did they?

A. Well, I assume the only conditions were on the exhibit where they noted the title dispute. That is the only condition, or any different from any other communitization agreement.

Q. On Exhibit A on the affected acreage there was a star with a notation the interest, the entire interest was credited to Bassett-Birney, and a notation made that that interest as to one-half was disputed --

A. That is correct.

Q. -- between Bassett-Birney and Southland? And that communitization agreement was executed by Bassett-Birney Oil Corporation.

A. That is correct.

Q. Is your well on the subject unit perforated at the present time?

A. That would probably have to be answered by the geologist, as I prepared the land work and he has in-

formation concerning perforations, et cetera, of the well.

Q. Was any reply ever sent by Southland, Mr. Davis, to Bassett-Birney to either of the instruments marked Number One or Number Two?

A. No, sir, because also prior to the sending of these agreements, it was stated in the last hearing, as it has been stated numerous times, that we would not accept an agreement whereby no matter who was determined to own the interest, that we should bear the full dry hole cost --

Q. And that --

A. -- which was sent at that time, and that is incorporated into your proposal, so I do not feel that would probably have to bear a positive response.

Q. But Bassett-Birney's position has been exactly the same, that it would not execute instruments placing the entire burden of a dry hole on Bassett-Birney.

A. That is correct.

Q. And all these difficult questions are currently involved in litigation in the courthouse in Eddy County, New Mexico.

A. Yes.

MR. DICKERSON: No further questions.

MR. CARR: I have a couple on redirect.

MR. RAMEY: Mr. Carr.

REDIRECT EXAMINATION

BY MR. CARR:

Q. Mr. Davis, I'd direct you to -- your attention to what has been marked Bassett-Birney Oil Corporation Exhibit Number Two.

MR. CARR: And initially, Chad, we'd have no objection to that being admitted into the record now.

MR. DICKERSON: Okay, I would move the admission of Number One and Number Two.

MR. RAMEY: Bassett-Birney Exhibits One and Two?

MR. DICKERSON: Yes, sir.

MR. RAMEY: They will be admitted.

Q. Mr. Davis, if you will refer to the October 10, 1980, letter, does that letter again indicate Bassett-Birney's willingness to execute an operating agreement?

A. No, it does not.

Q. What does it state in regard to the operating agreement?

A. Bassett-Birney feels that --- however Bassett-Birney remains unwilling to execute the AFE and operating agreement furnished with your letter of September 29th, 1980, for the reason that the instruments still attempt

to place the risk of a dry hole upon Bassett-Birney.

Q. And the last paragraph on that page, does it propose certain changes to the operating agreement, which would make it acceptable to Bassett-Birney?

A. Yes, it does.

Q. Would those proposed changes be acceptable to Southland Royalty Company?

A. No, sir, they were not.

Q. Now, would you exactly, so there's no confusion in the record, what is the status of the subject well? Has it been completed?

A. No, it has not.

Q. Has casing been set?

A. Yes, it has.

Q. And then Mr. James will be able to give us additional data.

MR. CARR: I have nothing further of Mr. Davis.

MR. DICKERSON: Nothing further.

MR. RAMEY: He may be excused.

MR. CARR: At this time I'd call Mr. James.

ARTHUR D. JAMES

being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. CARR:

Q. Would you state your full name for the record, please?

A. My full name is Arthur Dow James.

Q. Where do you reside?

A. 1429 Lanham Street, Midland, Texas.

Q. By whom are you employed and in what capacity?

A. I'm employed with Southland Royalty Company and I am the District Geologist for the southwestern district.

Q. Have you previously testified before this Commission or one of its examiners and had your credentials accepted and made a matter of record?

A. Yes, I have, and they were accepted.

Q. Are you familiar with the application of Southland in this case and also with the area which is the subject of this case?

A. Yes, I am.

MR. CARR: Are the witness' qualifications acceptable as a geologist?

MR. RAMEY: Yes, they are.

Q. Mr. James, have you prepared certain exhibits for introduction in this case?

A. I have.

Q. I think it would be helpful if, before you go through the exhibits, if very briefly you would provide an overview of what you intend to show with your testimony.

A. What I'd like to show is Southland Royalty Company's geologic interpretation with full documentation, which will show why Southland Royalty Company drilled the SRC Empire Federal Com 35 No. 1 Well, and our pre-drill interpretation, that is, interpretation as it appeared prior to the drilling of the well, which will show that this location is risky and justifies a high risk penalty of 200 percent.

SRC is currently attempting to complete this well and at this point we are not sure if it will be a producing well. It appears to be a marginal well at this point.

I will discuss this well in detail, the results of this well, and how it has affected our pre-drill interpretation, and I will also present an interpretation

that was prepared after the drilling of the well, to show you the differences, and I believe this will illustrate the geologic risk in this area quite well.

The SRC Empire 35 No. 1 was drilled to a depth of 11,791 feet to test the Morrow and Atoka sands, and is located 1980 feet from the south and west lines of Section 35, Township 18 South, Range 29 East.

You will notice on the exhibits that I will introduce that Southland Royalty is planning on offset to this well to the east, on the east half of Section 35. This well is the SRC Empire Federal Com 35-A No. 1 and is to be located in the southeastern quarter of the section.

I would like to refer now to Exhibit Number one, which was the land plat previously introduced. This map is on a scale of one inch to 2000 feet and all the map type exhibits I will introduce are on that same scale.

This area is an active area. Southland Royalty has three producing wells on this map, and I will discuss them in some detail later. Two of those wells are in Section 27, and one well is Section 34.

Southland Royalty is currently drilling a well in Section 22 in the southeastern quarter. It is the Southland Royalty Empire Federal 22 No. 1.

Tenneco, in Section 36, east of the

subject well, the 35 Com No. 1, is currently completing a well that I will discuss and it's the Tenneco No. 1 "JL".

Q. Will you now refer to what has been marked for identification as Exhibit Number Four, and explain to the Examiner what it is and what it shows?

A. Exhibit Number Four is a type log, which will illustrate the objective zones in this area. This well is the Southland Royalty Empire Federal 34 No. 1. It is located west of the 35 No. 1. It's in the east half of Section 34.

Q. Now, Mr. James, I believe Southland is -- has been looking -- focusing primarily at certain zones in the area, and you might comment on that.

A. Southland has determined that three zones are prospective in this area. If you'll turn to this type log, at a depth of approximately 10,776 feet there is an Atoka sand that occurs there. The sand is colored yellow and Southland calls this sand the Atoka E sand. This is a density-- compensated density neutron log. In the red area is the -- the red shaded area shows you the separation between these two curves on the righthand margin of the log. In this particular sand Southland Royalty was attempting to drill stem test it and while coming out of the hole the well kicked and blew out, and we were not able to get a test in this well.

It is our opinion that this is a commercial zone and it would make an attractive completion when completed.

Now if you'll turn farther down the log to a depth of approximately 11,220 feet, you will see the beginning of a series of Morrow sands, Upper Morrow sands, that Southland Royalty refers to as the A sands.

These sands are separated by a shale, called the Middle Morrow Shale, shown on your type log and shaded in green, separates a lower sand series in the Morrow that we call the E Sands. In this particular well, again, the sands are colored yellow and the separation between the density neutron log is shaded red.

In this particular well Southland has made a very attractive completion. Perforations are shown. It is completed for a CAOF of 8.073 million a day on 7-8-80. I will discuss this well a little bit later in some detail, but this type log illustrates the objective zones that we have in this area.

Q. Will you now refer to Southland Royalty Company Exhibit Number Five, identify this, and explain to the Commission what it shows?

A. Prior to introducing that exhibit, I'd like to kind of recap.

Q. That would be fine.

A. Very briefly, the history of this area and get everybody acquainted with it.

In the summer of '77 SRC drilled a well. It was the first well in our prospect that we call the Empire South prospect. This well was the Southland Royalty Empire Federal No. 1, and it is located 1980 feet from the south and west of Section 27. It was completed initially in the Upper Morrow sand sequence that I referred to earlier, which we call the A Sands. A commercial completion was not attained, and I will discuss this failure of attaining a commercial completion later.

This well was then recompleted to the Atoka E sand that I referred to, where a commercial completion was made. It was completed in June of 1980 for a CAOF of 1.8 million cubic feet of gas per day. It is an attractive commercial completion.

Southland drilled the offset to this well, the SRC Empire Federal A No. 1 at a location 660 feet from the south and 1980 feet from the west line of the same Section 27. It was completed in the same Atoka B Sand on 7-7-80 for a CAOF of 2.5 million a day and it is also an attractive commercial completion.

Southland next drilled the Empire Federal 34 No. 1, the previously referred to type log, in the east

half of Section 34, and as I mentioned, this well is completed in the Lower Morrow Sands for 8.1 million a day.

Q. Will you now go to Exhibit Number Five?

A. Exhibit Number Five is a stratigraphic cross section A-A'. This cross section was prepared in September prior to the drilling of the well. It runs from west to east through the SRC 35 No. 1, which is now a completing well, and also shows the proposed location for the SRC 35 A No. 1. The datum for this cross section is on the top of the Atoka.

It shows again the three prospective zones in the area. Note that structural dip is from -- generally from west to east. Also note the interpreted channel, the Morrow A Sands. Also note the top of the Morrow E, with a structure mapping point, which I'm going to show you a structure map later that was mapped in this point.

The red dots with the spikes are showing you completed zones. The half red -- the dots that are just half a circle are showing you shows and zones that may be productive.

Q. Will you now refer to Southland Royalty Company Exhibit Number Six, identify this, and explain what it shows?

A. Exhibit Number Six is a Morrow net poro-

sity Isopach of the Lower E Sands. This is net effective porosity, defining the net porosity as porosity that we think has adequate permeability to allow movement of either oil or gas or other fluids in the reservoir.

This is our pre-drill interpretation prepared in September, 1980. Three sand channels are shown on this exhibit. Notice that the sand channel to the north is wet and is not productive.

The sand channel in the middle is productive. The SRC Empire Federal 34 No. 1 is producing from this well, as is two other wells in Section -- north half of Section 33 and the south half of Section 28. This is an attractive zone. Structural position is important on this zone, though, as water does occur. As I mentioned, regional dip is generally from west to east and I will show a structure map next to illustrate this.

The green line that you see on there is our interpretation of the gas/water contact. This is defined by the well in Section 10, Threshold Development Conoco No. 1-10, which had 22 feet of effective porosity in this zone, and was wet.

Notice that Southland's proposed well, or the well that we have drilled now, the SRC 35 No. 1, is located down dip in an unfavorable position and was inter-

preted to be in the water leg. This was not an objective of this particular well location.

Q. Will you now refer to Southland's Exhibit Seven?

A. Exhibit Seven is a structure map on top of the Morrow E Sand. It was prepared prior to the drilling of the well in September of 1980. As I mentioned, structural dip, or dip is from west to east, and Southland's well was interpreted -- I mean the SRC 35 No. 1, was interpreted to be well down dip from the SRC Empire Federal 34 No. 1, which is producing, as I mentioned, from the lower sands.

The yellow shaded areas are interpreted -- areas of interpreted channels in the Morrow E and Morrow A Sands.

Q. Will you now refer to Southland Exhibit Eight and review this for the Commission?

A. Exhibit Eight is an exhibit that was prepared after the drilling of the SRC 35 No. 1, and you will notice that the Morrow Sands were encountered 116 feet higher than anticipated, creating a small structure closure, as shown.

Also notice that this well is structurally higher than the producing SRC 34 No. 1, which would make you think you were very fortunate indeed and had a very -- and should have a very attractive producing well from this lower

zone.

Q. Will you now refer to Exhibit Number Nine, please.

A. Exhibit Number Nine is again a net porosity Isopach of the Morrow E Sands; this time it was prepared after the drilling of the well. 35 feet of effective porosity was encountered in the SRC 35 No. 1, and it being structurally up dip from the producing SRC 34 No. 1 in the same sand, we perforated it and swabbed significant amount -- a significant amount of formation water and a small amount of gas. We have abandoned this zone and are now attempting to complete in the higher zone.

Since this well in this zone are higher than the producing well, they have to be separated, and Southland Royalty has interpreted this separation to be caused by a permeability barrier, which is shown by the projected porosity dying out to zero between the two wells.

High and thick and wet.

Q. Will you now refer to Southland Exhibit Number Ten and review this for the Commission?

A. Exhibit Number Ten was one of the two objectives of the SRC 35 No. 1. This is a net porosity Isopach from the Morrow A Sands.

Notice that we were anticipating 40+ feet

of effective porosity in this well.

The wells that are shown in solid circles are producing,with the ticks in them, or spikes in them, are producing from this well -- or producing from this particular sand -- sand zone.

There have been many gas shows in this sand zone, which are shown as half red circles, and some of them may be productive, but this particular sand sequence has been a very -- has proven to be a very variable, risky zone for us in this particular area. It is productive to the south and is productive to the north, but so far Southland's efforts in this particular sand zone have been very disappointing, as to other operators.

This lack of lateral -- is composed of several sands which are integrated with shales which do not appear to be laterally continuous. This lack of lateral continuity creates variable, complex reservoirs that are difficult to predict in occurrence and in productivity. An attractive Morrow A Sand zone on wireline logs does not always indicate that there will be an attractive completion, and I will show you some data to support this. This situation was present in Southland Royalty's 27 No. 1 in the southwest quarter of 27.

Q. Mr. James, will you now refer to the

Southland Royalty Company Exhibit Number Eleven and review this for the Commission?

A. Exhibit Number Eleven is a type log of the Morrow Sands in Southland Royalty's well I just mentioned, the Empire Federal Com No. 1.

In this particular sand zone, again the same color scheme is used in this well as in the type log that I presented. The Morrow E Sands are shown to be clean sands but water -- water saturations and porosity determinations by log analysis are shown in the righthand border of this particular exhibit. We had relatively high water saturations and it appeared that this was not -- was going to be a wet zone, and we did not production test this zone.

Instead, we tried the Morrow A Sands where you see our perforations in the Morrow A Sands. I would like to call your attention to the fact that you will notice a hot gamma ray in the A Sands. This hot gamma ray is a frequently -- frequently occurs in the Morrow A Sands and does not mean that it is an indicator of shalyness. This -- it does mean that there is mica in the sandstone and this mica has potassium in it, which causes a relatively hot reading on the gamma ray.

The density neutron curves to the right are not indicating it's shaly or indicating that it is porous,

and other logs indicate that it is permeable.

So we completed in this zone and initially obtained a very attractive, attractive completion. We had a flow rate of 2-million cubic feet of gas per day.

Log analysis, sample analysis, and this good flow rate indicate that this was an attractive, above average Morrow completion. This completion was connected to a sales line. It rapidly depleted, suggesting that it was a very, very limited reservoir. The Morrow A Sands, as I mentioned, are productive in the area, and they were one of the -- they were risky, but they were one of the primary objectives of SRC 35 No. 1.

As I mentioned, we abandoned this zone and went up to complete in the Atoka B sand, and did make an attractive completion in that sand.

Q. Will you now refer to your Exhibit Number Twelve and review this?

A. Exhibit Number Twelve is a net porosity Isopach of the Morrow A zone after our well was drilled. 22 feet of apparent pay was in this 35 No. 1, which is 20 feet less than what was expected. Porosity values vary from six to 10 percent with most of the porosity being about 8 percent.

From log analysis, although we have not

tested this zone, but log analysis indicates that this is a marginal zone.

We're currently attempting to complete in this zone, and I'll talk about that a little bit later.

Notice the well to the east of us in Section 36. That's Tenneco's State "JL" No. 36. This well was production tested -- or was tested in this zone, which is composed of many integrated sands, similar to our well, and they were not successful in those particular zones. They instead moved up to the uppermost Morrow stray sand zone, occurring right beneath the Morrow lime. This stray zone, which you could classify as in the A Sands, is 9 feet thick and is not present in our well in Section 35, and this well as of a few days ago was testing and flowing for about 800,000 cubic feet a day, and Tenneco does not think very much of the well. They think it will be a below average Morrow well. They are very sure.

In Section 11 Tenneco State 2-H Well was also completed in this zone for a CAOF of 3.5 million a day, It hasn't been on production very long but its daily average in October was 775,000 cubic feet a day, indicating a below average Morrow completion.

It is also producing 27 barrels of condensate a day and 17.5 barrels of water per day.

Q. Will you now review Exhibit Thirteen?

A. Exhibit Thirteen is the Atoka B net clean sand Isopach. This was prepared prior to the drilling of the well. It was prepared in September of 1980.

This Isopach is slightly different than the Isopachs I've presented so far. It is an Isopach of net clean sand rather than net effective porosity, but net effective porosity values are presented on the map as a control point near each one of the well locations. This net effective porosity is presented to the right of a slashed line. The value to the left of the slashed line is net clean sand and it is the contoured -- these values are contoured on the map.

Again the red circles are showing the productive wells. I've talked about the two wells in Section 27 that Southland drilled. I'll give you a little production data on these wells.

The SRC Federal 27 1-A in the northwest quarter of 27 has a cumulative of 96-million cubic feet of gas, 2000 barrels of oil as of 11-1-80. Its October daily average was 1.7 million a day and 25 barrels of oil. It was first produced in 9-80.

The Southland Royalty Federal No. 1 Well in the southwest quarter of Section 27 has a cumulative of 214-million cubic feet of gas and 3000 barrels of oil at

11-1-80.

Its October daily average was 1.4 million a day and 19 barrels of oil.

And as I mentioned, the well in Section 34, SRC 34 No. 1, was not tested but blew out and appears to be an attractive zone.

Q. Will you now proceed and review Exhibit Number Fourteen?

A. Exhibit Number Fourteen is the same map that was prepared after the drilling of the 35 No. 1. 14 feet of net clean sand was found in the well and 12 feet of effective porosity. The porosity was broken up into two zones, and Southland cored the lower part of the -- of the lower zone and recovered 10 feet of sand with 8 percent porosity. Permeability from core analysis was .01 millidarcies, extremely low; probably would not make a well in that lower zone. If it did make a well you'd have to frac it and it would be a poor well.

I'd like to present data on two more wells on this particular map exhibit, just for a completeness. I left them off the last exhibit.

In Section 1, the Tenneco "HL" Well was completed for 25 million a day and it appears to be a very attractive zone. Cumulative at 11-1-80 was 196.2 million

cubic feet of gas. Its October average producing rate was 1.6 million cubic feet of gas and 13 barrels of condensate.

A test on 1-15-80 flowed 1.1 million a day and 8 barrels of condensate.

In Section 11, the Tenneco State 1 "HL" Well has 17 feet of net clean sand and 10 feet of porosity. It was completed for 4.3 million a day. Its cumulative as of 11-1-80 was 861.4 million cubic feet of gas. Its October average was 1.9 million cubic feet and 21 barrels of condensate.

It was tested on 1-15-80 and was flowing 2.26 million a day and 25 barrels of condensate.

The Threshold Development Conoco Well in Section 10, 1-10, also appears to be an attractive well, completed for 3.8 million a day. It has a cumulative at 11-1-80 of 82.2 million cubic feet of gas. Its October average was 710,000 cubic feet a day and 7 barrels of condensate.

Q. Mr. James, will you now identify Southland Royalty Company Exhibit Fifteen and --

A. Let me talk a little more.

Q. All right.

A. Excuse me.

Notice on our well in Section 27, the

1-A in the northwest quarter had 28 feet of sand and 20 feet of effective porosity. I'm going to talk about the type of porosity in this well in just a minute.

Notice that the Southland Royalty Federal No. 1 in the southwest quarter of 27 had 12 feet of sand with 11 feet of effective porosity, and that Southland Royalty's Well 34 No. 1, in Section 34, had 9 feet of sand, net clean sand, and 9 feet of effective porosity.

The SRC Empire Federal 34 No. 1 had 9 feet of porosity in the 12 to 16 percent range, very high range.

The SRC Federal No. 1 had 11 feet of porosity in the 9 to 13 percent range, also a very high range, the high range.

The SRC Empire Federal 27-A No. 1 had 27 feet of porosity in the 10 to 14 percent range. These are very attractive looking zones.

Our well, which had 14 feet of sand and 12 feet of effective porosity, as I mentioned, is divided into two zones and I will show you the log. These zones are not nearly so attractive as the other wells.

Q. Will you now refer to Exhibit Fifteen?

A. Exhibit Fifteen is a portion of Southland Royalty's Empire Federal No. 1 Well. This -- this particular exhibit will show you the Atoka and Morrow sand

zones. And I'll talk about the Atoka zone first, the B Sand zone.

Sands are colored in yellow, as on the other exhibits, and the separation between the density and neutron log are shown in red. The scale of the porosity determination on this log is standard scale with the -- going -10 to zero to +10, +20, to +30.

The water saturations and porosity determinations calculated from log analysis are shown on the right. The porosities -- the porosity values are low and as I mentioned, we cored this lower sand and had very low permeability -- permeability values from .01 millidarcies.

If a completion is made in this zone, we think it will -- it would have to be in the upper part of the B sand and we expect it to be a below -- or certainly would be a completion not nearly as attractive as the other wells. We are not sure if it will be an attractive completion or not at this point. We have no tests in this particular zone.

I'd like to call attention to the bottom part of the well,the Morrow E Sands, beginning -- Southland's Morrow E Sands, beginning at 11,382. It's very clean looking sand body with good porosities. The water saturations were a little bit on the high -- high -- high values, except the

uppermost one and the lowermost one was kind of suspect. Because this well came in higher than the producing well to the west, we production tested it, and as I mentioned, it was wet. We have squeezed it, set a bridge plug, and we are now completed -- are completing, rather, in these Morrow A Sands. Notice the Morrow A Sands are interbedded. They look very much like the Tenneco -- a Tenneco section to the east of us, that did not make a viable completion in this zone. Instead it completed in a zone that would be correlative to about 11,190 in this particular well, and that sand is not present in this well here, and this particular section is also very similar to the section I showed you in the Empire 27 No. 1 Well where we attempted a completion that came on for 2 million a day and fizzled out to nothing when we hooked it up to the sales line.

We think this is a very marginal zone. As of this morning this well was flowing 50,000 cubic feet of gas. It was perforated and acidized. We will attempt to -- we -- our engineering department, our production department right now is evaluating this zone and at this point I don't know what we'll do next on it, but as of right now it's flowing 50,000 cubic feet of gas -- cubic feet of gas; no oil.

In our pre-drill evaluation we contended

that this well was a risky, expensive step-out well deserving a risk factor of 200 percent so that Southland Royalty and other working interest participants could receive just compensation if a successful completion is made -- was made.

Our post-drill evaluation indicates that if a completion is made it's likely to be marginal and in our opinion validates our previous claims to this well being a high risk step-out and a risky venture.

That concludes my testimony.

Q. Mr. James, have you been involved in the drilling of other Pennsylvanian wells in this area?

A. Yes, I have.

Q. What is your experience concerning the risk involved in drilling any Pennsylvanian well in the general area?

A. Well, the risk varies from prospect to prospect, but oftentimes your risk sometimes is low in certain areas and it's higher in other areas, but even if your risk is low, even after you drill the well, whether you get a successful commercial completion is an additional risk that you have to put on this well. Our risk factor, which we presented to our management along with this other documentation that I showed you in our pre-drill evaluation, is a success defined as 60 percent. We gave this well a 62 per-

cent chance of success, which would, in Southland's categorations -- categorizing of a well, would put this in a high risk development category.

Q. Mr. James, at the prior hearing Southland Royalty Company recommended to the Examiner that a 200 percent risk factor be assessed for this well. Are you prepared today, based on your data, the data you've presented, and your knowledge of the well, to make a recommendation concerning the imposition of a risk factor?

A. We are requesting a 200 percent risk factor.

Q. In your opinion will granting this application be in the best interest of conservation, the prevention of waste, and the protection of correlative rights?

A. Yes, it will.

Q. Were Exhibits Four through Fifteen prepared by you or under your direction and supervision?

A. Yes, they were prepared under my supervision.

Q. And can you testify from your own knowledge as to their accuracy?

A. Yes.

MP. CARR: At this time we would offer Southland Royalty Company Exhibits Four through Fifteen.

MR. RAMEY: Exhibits Four through Fifeen will be admitted.

MR. CARR: I have nothing further of this witness on direct.

MR. RAMEY: Any questions, Mr. Dickerson?

MR. DICKERSON: Yes, sir.

CROSS EXAMINATION

BY MR. DICKERSON:

Q. Mr. James, how many rigs does Southland have running in this immediate area?

A. In this immediate area we have one rig.

Q. Is that the number of rigs you had running in recent history?

A. No, we've -- we've generally had had two rigs running in this area for the last six or ten months, something like that.

Q. Do you know what the plans are for the next six months, let's say?

A. Not that far in advance. For the next couple or three months, or the next couple or three wells I could give you some plans.

Q. Are you in charge of Southland's geolo-

gical department as concerns this area?

A. Yes, I am.

Q. Mr. James, did -- was it you that calculated this 60 percent -- 62 percent chance of success percentage you referred to?

A. No, I didn't calculate it but I agree with it 100 percent.

Q. Do you know how it was calculated?

A. Yes, I do.

Q. Would you just briefly describe the --

A. I don't have the exact numbers in front of me, but I can supply them to you later, but Southland calculates its success factor, which you referred to as a risk factor, in our drilling wells by multiplying three variables that we -- we examine and interpret geologically, and these variables are reservoir, trap, and presence of hydrocarbon. In any oil or gas producing situation you have to have all three of these particular factors present in order to have an oil or gas well. And we multiply what we think from looking at the nearby wells and the history in the area, what the success probability for each one of these factors will be, and we multiply them together to get a success -- overall success probability for the well.

An additional risk is prepared by our

engineering department that does not -- does not affect this particular success factor, but what I'm trying to say is there's additional risk in the size of the type well you might find, and the size of the well, reserve estimate is calculated by our production department, by our engineering department.

Q. Under this calculation would a well which nearly paid out be successful?

A. No. Southland defines a well as being successful -- it's a very complicated economic yardstick, but I'll present it to you, if you like.

Q. It's not necessary in any great detail. I'm just trying --

A. Okay.

Q. -- to get at a --

A. Well, Southland -- a well that pays out to Southland is not a successful well, if it just pays out. So a successful well to Southland, which we define as success probability, you have to take your investment, increase it by 25 percent. You have to take your profit discounted at 9 percent, and subtract the two, and if you get $1.00 left over, it's a successful well to Southland Royalty Company.

Q. Are these projections for the chance of a successful well made on a regional basis?

A. Regional input is always put into them.

Our -- we use our history in the area, as well as other operators' history in the area.

Q. How large an area in the vicinity of the subject proration unit does this 62 percent chance of success factor apply to?

A. Well, it's -- your question really is a difficult one to answer because when you're looking at a new prospect like this, and this is a step-out, it's not an infill location or it's not a corner shot, a step-out you have to look at how other step-outs have fared in very similar looking type of producing fields or prospects, and so I guess to answer your question, we've looked at along the Morrow trend in this particular northwest -- northeast trend, same stratigraphic as we think we -- we look at the success rate for step-outs in this situation.

And as I mentioned, we only two -- we had two objectives in this well. All three of them -- we didn't think our lower sands would be an objective.

So your question is difficult to answer and I'm not trying to be evasive.

Q. I'm just trying to understand it for myself. If I picked Southland Royalty Corporation a location, let's say, in Section 2, immediately south of the subject proration unit, is your risk factor there, or your success

factor probably still in the vicinity of 62 percent?

A. You're asking me a hypothetical question. We haven't worked up a particular well location there, but I would say that success factor would probably be in the range of 60 to 75 or 80 percent; it would be somewhere in that range.

We have a very attractive Atoka well in Section 1 and if -- let me back up a second. That's assuming we made a -- we were successful, I have to make another assumption, that we make a successful completion in Section 35, which we may not, it's likely that we won't, but if we did, I would say that the success probability for a well in Section 2, esepcially the northeast quarter, would -- would be higher than 60 percent; probably be in the range of 60 to 80 percent.

Most of our Morrow wells that we drill, and we've drilled a lot of them over the last two and a half years, or so, that you're probably aware of, our average Morrow development well is probably in the range of 75 to 80 percent. That would be our average, I would guess.

Q. But you said Morrow development wells.

A. Well, I would call this a development well. Southland defines a development well as being less than one mile away from a producing well in the zone that

you're interested in --

Q. So in your opinion this area is less attractive from the success probability standpoint, as Southland sees it, than the average Eddy County Morrow prospect?

A. I'd say that location was. I wouldn't say this area is. I think this is an attractive area, but our location, the 35 No. 1, I would say yes, was more risky than the average well we've drilled recently.

Q. Is there any other similar area in Eddy County where Southland has had two rigs running for approximately six months drilling Morrow prospects --

A. Well, you're talking about -- we weren't drilling in this one prospect. We were drilling in other -- other prospects as well, you know. When I say we had two rigs running, those rigs could have been eighteen miles apart, you know, but they're in this general area.

Maybe I didn't understand your question very clearly.

Q. No, that's -- that's sufficient. When you make your maps, Mr. James, which showed the net clean sand, as you call it, what definition do you put on clean sand so that you included those in your maps and must have excluded other sands?

A. In the Atoka Sands the technique used

by the geologist who was preparing -- who was working in this area, he finds that gamma ray is a good indicator of cleanliness to the sand, unlike down in the Morrow A Sands, as I mentioned earlier. So because the gamma ray is a good indicator of cleanliness, count up the percent of the kick from the shallow base line to the maximu deflection of the gamma ray, using that on a percentage basis, and I don't know his exact technique, but it would be approximately 600 percent, or something like that.

Well, 60 percent of the way out he would net sands that were cleaner than he thought that 60 percent value would go. It's sort of a very subjective technique, but it's commonly used throughout the industry, in -- in certain sand sequences, especially the Atoka Sands.

Q. Well, did you in preparing your exhibits and including what you had classified as the net clean Morrow sand zones, did you exclude other Morrow sand zones?

He found some that were not clean enough to be classified as clean under your rationale?

A. Well, let's see, I could answer your question, perhaps, easier perhaps with an exhibit.

Well, it's not a very good example, but the Atoka B Sand is one continuous sand. This is the type log. Now make the assumption that this Atoka sand was not

nice and clean as it's shown here but kicked back and forward a little bit. Then you draw a line about 60 percent of the deflection from the shale base shale base line and wherever that sand kicked out past it, he would net as clean sand, so within a particular sand body he would discard, as a mapping technique, perhaps some of the sand, because that sand he has interpreted to contain shale, or some shale, which he was making the assumption that would affect the producing characteristics adversely.

Q. Okay, would it be fair to say that it is possible -- or let me state it another way.

Would you disagree if I said that there are sands in your -- in the subject well which have not met your definition to be included as one of your net clean sands but that you intend to perforate or recommend to Southland that the zone is perforated?

A. Maybe if you could be more specific. You're talking about our 35 No. 1 or are you talking about another --

Q. Well, I'll just talk about 35 No. 1. Are there any zones in there in the Morrow system that you would say contain a sand body that did not qualify as a net clean sand for the purposes of your map?

A. Oh, sure, there were some sands there

that were dirty that we interpreted to be dirty for one reason or another, and often -- well, first of all, we don't map the net clean sands in the Morrow, or at least I didn't present any maps, but there could be sands that are in there that wouldn't meet our criteria.

Q. But for completion purposes of the well that might meet the engineering criteria to perforate?

A. I would say no. No.

Q. In other words, you included, you think, all the sands which are possibly productive --

A. In intervals we have in our maps. We probably were optimistic, we were mapping very optimistically.

Q. What do you consider for porosity, let's say, the lower side of what you would look at as a --

A. In which particular sand body are you referring to?

A. The Morrow.

Q. Well, we -- we break the Morrow into two different zones, and both zones -- the zones, we think, have slightly different environments; they have different producing characteristics; we complete them sometimes differently; and then we map them differently.

Now if you're talking about the Middle Morrow Sands, maybe that's what you're talking about, we use

as a routine, 8 percent porosity cutoff for effective porosity. But that does not mean that you can -- you can have 14 percent porosity that is not effective porosity, or sometimes you can have 6 percent porosity that is effective porosity. So, although we initially go through, or we roughly go through with an 8 percent cutoff, that is not our final criterion for determining where we're going to include that as effective porosity or not effective porosity. We put more interpretation on that. We don't use the very straightforward, knife cutoff. We put more interpretation to it. We look at the other logs. We look at our other information that we have.

Q. There are numerous other wells within the general area, aren't there, Mr. James, not shown on your Exhibit Number One?

A. Yes. Southland, for example, in Section 21 has recently completed a well in the Morrow E Sands. I don't know the exact date on it but it's just off our area of coverage on our exhibits; about a mile away from the northwest quarter.

Q. Do you know of any lowdown on that one?

A. Not offhand, but I do know it's -- it's an attractive completion.

Q. So that was --

A. But I could get that information.

Q. That was northeast of the subject location?

A. Let's see, that's northwest.

Q. To the northwest.

A. Yeah. Our land map will show you Section 22. It's immediately west of Section 22, where we have a new producing well; just off that map.

Q. Knowing what you know now, Mr. James, had you the opportunity to drill this well over, would Southland drill this subject well?

A. Well, of course now that we know what it contains, we -- no, but if we had the same data that we had beforehand we would drill this well again, and you know, it's a high risk and in our business, as you know, we drill good wells and we drill poor wells, and this looks like it's going to be a marginal well at this point.

Q. So you don't think this is a success, as Southland defines it?

A. Can't say it's a success now, and I can say that it appears not to be a very attractive well, and it appears definitely to be going to be a below average well for this -- this area.

Q. Will you concede that production might prove that the well would be turning out to be a success even

under Southland's definition?

A. Well, sure, because as I mentioned, these Morrow A Sands are very tricky and what appears to be a good well often is a poor well and sometimes, and I can cite you examples, what appears to be a very poor well in the A Sands has turned out to be a very good well. The sands are so variable that something that may have 4 feet of pay in it may open up in 200 -- 200 feet to a point bar with 40 feet of pay in it. It's -- it's a very difficult sand sequence to work with.

Q. For the sake of discussion, Mr. James, do you know what the success percentage placed by Southland prior to drilling its well in the east half of Section 34 was?

A. In this prospect?

Q. Yes.

A. Okay, so far in this prospect, this would be -- we've drilled four successful wells and this one the verdict is out on, so this would be perhaps one out of five that was not attractive, or perhaps dry.

Q. But you've got 100 percent success ratio up to this well, then?

A. Well, sure, but if we drill two wells and were successful in our first well, we'd have 100 percent

success rate, that doesn't mean our second well would be successful.

Q. Are there several other parties active in the general area, Mr. James?

A. Yes. I mentioned Tenneco is active and I did not mention, but Yates is active in the area, as well as Conoco, and Threshold. Those come to mind immediately.

Q. I notice, or I heard you discuss, Mr. James, several producing wells but I didn't hear any mention of any dry holes. Why is that?

A. Well, perhaps I hadn't really -- well, if you'd like me to, I could mention a couple for you real quick.

Q. Okay.

A. There's a dry hole in Section 1. It's an older well. It was drilled by Ashell Leonard (sic) and I have to say in all honesty it may not have been evaluated properly, but it's technically a dry hole.

And Threshold Development has recently drilled a dry hole in the west half of Section 10.

I see what you're getting at, but I don't think you have much merit to proceed just to say that this particular map does not have a lot of dry holes in it. I could have come up with a larger area map, but Southland

did not want to present too much of its interpretation for public record, but I could tell you that there are within an area this size, this marked area, if you will go to the north and to the west and to the east -- well, not so much to the east, there aren't any wells to the east -- and south, you'll find ten or twelve dry holes, bona fide --

Q. How far is that to the north, let's say?

A. Well, I'm talking now without having a map in front of me, so you could very easily pin me down. I'm talking about the overall area.

Q. Would you say that there are very few or virtually no dry holes in the immediate vicinity of the subject well?

A. Sure, but I also know there are some poor wells that are successful in the subject area.

Q. Are there some very good wells, too?

A. Yes.

Q. And overall, would you concede that this is a very attractive area?

A. Yes, overall I would.

Q. Do you think Mr. James, that you could locate another area of the size that you have shown on Exhibit Number One with this number of Morrow wells drilled, or wells that have penetrated to the Morrow, let's say, with

as few dry holes as in this area?

A. Yes, you could. Southland's Parkway West area, which is -- begins one mile to the south of this map. We have a couple of just -- one or two dry holes -- not just Southland but perhaps six or seven or eight producing wells. But again, some of those producing wells are not all great wells, either.

Q. Did you mention any possible Wolfcamp production in this area?

A. No. We have had a couple of Wolfcamp shows but the Wolfcamp production in this area really has been disappointing.

Q. Did you --

A. And its production occurs to the west.

Q. Did you notice on the logs in the subject well any indication of possible Wolfcamp production?

A. I'm going from memory right now and I'm going to say I don't remember any. I don't believe there were any shows of any consequence, but again you'll -- I'm going from memory. I did not have --

Q. Any possible Strawn production in that area?

A. I possibly could answer your question. Let me refer to something.

There was a very minor show 4 feet thick, 6 feet thick, or so. at about 9265, somthing like that, and and offhand, I don't remember if that's Wolfcamp or not, but it's up near -- it might be the Wolfcamp.

Q. And I don't want to belabor this,but you would concede that this is an area where multiple pays reduce the risk of an unsuccessful well?

A. Do you mean do multiple pays reduce the risk?

Q. Right.

A. Oh, of course, they do, and I mentioned, Southland's interpretation, this is an area with three objective -- or three possibilities. You can always find some little traps and show up the hole or something that you might test 15 or 18 years from now, but you certainly wouldn't want to drill a well for it.

Q. Do you know, Mr. James, when Southland calculates its percentage of liklihood of success on a well designed to penetrate the Morrow, does it take only into account the Morrow possibilities?

A. No. For example, in this particular well we are -- we strongly took into account the Atoka possibilities. It was our main objective. We drilled to the Morrow only to be complete and test all the zones. The

Atoka was our main objective.

Q. This large Lower Morrow sand body which you pointed out on one of your exhibits, did you make all your perforations in that sand body at one time?

A. No. We -- your question is a good one. We did not. We tested -- well, let me answer it this way. At first we tested all the perforations in the sand body at one time. Then we looked at it more closely and evaluated our results. We thought that perhaps, from log analysis, especially, we could see that there might be a gas/water contact in the well, and so we set a bridge plug to try to see if we could cut out the water.

What we did in fact was cut out the gas when we set that bridge plug and produced it, trying to produce just the upper part, we produced all water and no gas.

Q. If I noted correctly on one of your -- you showed quite variable water saturations in that zone?

A. Yeah, that's quite typical for the Morrow.

Q. Would you think that it may possibly have been a mistake, Mr. James, to have perforated that entire zone?

A. No, I think we --

Q. At once?

A. I think we fairly, conventionally evaluated this zone, and that zone is wet.

Q. You don't think it would have been possible to perforate separately the lower part of it or the upper part of it --

A. Well, surely the --

Q. -- the very upper part?

A. Southland Royalty's interpretation of that zone is that it's not productive. If we make a dry hole here we'll gladly give you the well to complete in, if you'd like to try.

Q. This is the zone that you stated is flowing 50,000 a day?

A. This is the zone that made a small amount of gas and made a significant amount of water. The zone that's flowing at 50,000 cubic feet a day is in the Morrow A Sands above that, the interbedded sand/shale sequence. We are trying to complete in that zone right now.

Q. In the upper zone?

A. Yes.

Q. You completely abandoned this lower zone?

A. Yes.

Q. You don't conceive that there's any

possibility that the failure to perforate the upper few feet of this sand might have been a better way to proceed?

A. I'm saying that Southland Royalty contends that that zone is not attractive and -- and maybe I could see what you're talking about here, just a minute.

We perforated right up to the top of the porosity. I don't see what you're getting at.

Q. Then you perforated from top to bottom all at once?

A. Yes, as I mentioned, we had a small amount of gas and a large amount of water. We thought there might be a gas/water contact and we set a portable bridge plug to try to perforate -- just to produce the upper three or four or five feet, and doing so cut off -- cut out the gas and we recovered only water, indicating that the gas was probably coming from a zone below there and it was a very small amount of gas. So we didn't want to spend any more money, or we felt we evaluated the zone thoroughly and completely, and we abandoned the zone and moved on up.

Q. As far as thickness of the zone, it was -- it was not too shabby, was it?

A. It was very attractive, and by the way, our partner in this well agreed with us on it, on our procedure. It was a very attractive sand, but you sure like to

have those sands full of gas, and no water.

MR. DICKERSON: I have no further questions.

MR. CARR: I have nothing on redirect.

MR. RAMEY: Any other questions of the witness? He may be excused.

(Thereupon a recess was taken.)

MR. RAMEY: You may proceed, Mr. Dickerson.

JAMES T. MASON, JR.

being called as a witness and being duly sworn upon his oath, testified as follows, to wit:

DIRECT EXAMINATION

BY MR. DICKERSON:

Q. Will you state your name, please?

A. James T. Mason, Jr.

Q. And what is your occupation, Mr. Mason?

A. I'm a geologist/geophysicist for Yates Petroleum in Artesia.

Q And, Mr. Mason, have you previously testified as a geologist before this Commission and had your credentials made a matter of record?

A. Yes, I have.

MR. DICKERSON: We would tender Mr. Mason as a geologist, Mr. Ramey.

MR. RAMEY: So qualified.

Q. Mr. Mason, have you made a study of this area on behalf of Bassett-Birney Oil Corporation?

A. Yes, I have.

Q. Would you please refer to what is marked Bassett-Birney Exhibit Number Three and describe that -- what that instrument is?

A. Okay, Exhibit Three that we have here is a composite map. We have the structure at the base of the Southland Middle Morrow shale, which we call our Lower Morrow marker, and we there split the Morrow into an upper and lower, and this structure map is on the base of that Middle Morrow shale.

The solid contours outline the structure and it is in 50 foot contour intervals.

There is also a broken contour on top of the structure contour, which outlines the net thickness of clean Morrow sand, and we define our clean Morrow sand

a little differently, also. We use 50 API as our cutoff, and in some cases you're going to ignore radioactive sands, so it's a slightly pessimistic way of counting.

This map is essentially our pre 35 map. We did have terracing in here rather than a small anticlinal structure, and we had projected 60-some feet of clean Morrow sand. The well bore out this terracing, and in fact, pulled up a slight anticline in there, and --

Q. Now, Mr. Mason, for clarity, the numerals beside the well location symbols are the reference to the net feet of clean Morrow sand you find in all these wells?

A. Yes, sir. The negative number is subsea depth to the base of the Middle Morrow shale or Lower Morrow marker, and then the -- the two digit number in this case is the thickness of clean, total clean Morrow Sand. It includes both Upper and Lower Morrow Sands.

Q. Mr. Mason, based on your -- and you say this map was based on your study of this area prior to the drilling of the subject well?

A. This is essentially the map that I drew over a year and a half ago.

Q. For the sake of discussion, does your -- your indication of 64 feet of clean Morrow Sand in the subject well, was that substantially borne out by the actual log on

the well?

A. The log -- we had projected about 60 feet or more total clean sand. The well was drilled and proved to have 64 feet of clean Morrow Sand by our definition.

Q. Where is the subject well according to your figures, Mr. Mason, as far as the up dip or the -- the height of the structure as related to other wells in the area?

A. Okay, the subject well is up dip from several producing wells. It is structurally high to the Tenneco "JL" in 36 and the Tenneco State "HL" in Section 1.

And also that group centered around Threshold and Southland's wells down in 10, 11, 15, and 14, 15, 16.

Q. Are there any other factors that you could point to that bear on the subject of the risk involved in drilling the subject well in this area?

A. Well, I might point out that in the nine sections contiguous to and including the subject -- or the section which includes the subject well, there are six total wells. One of these, the Ashland and Hilliard, is mapped as a dry hole. The well was drilled in 1960, gas prices were low, it was logged with the old gamma neutron induction log for the resistivity, and these are somewhat

less than desireable as a log than the CNL-FDC and dualatero logs we commonly run today, and apparently Tenneco looked at these old logs and believed that there was bypass potential in the Ashland-Hilliard well.

That well was, incidentally, drilled to Devonian. The Devonian was the primary objective and not -- not Morrow.

They looked at the old logs and determined that there was enough potential to be worth a re-entry, they offset it one 40 acre spacing unit to the east, and when they drilled their State "HL" it initialed 25-million a day.

So I question, really, the Ashland-Hilliard is a dry hole. I think it's a bypassed producer.

So now, taking the six wells in these nine contiguous sections, even if we count the Ashland and Hilliard as a dry hole, you've still got 83.3 percent success ratio, that these wells are either going to produce from the Morrow, the Atoka; it is an area of multiple pays. The Strawn pay is just north of here; Cisco pay is in the couple of wells way to the northwest. The Wolfcamp looks pretty good in that well down in Section 15 in the white circle, so it is an area of multiple pays, and this significantly reduces the risk.

Q. Mr. Mason, in your opinion does this

projection of a clean Morrow sand or sand bodies in excess of 60 percent or 60 feet, rather, in the Morrow in this subject well, is that directly related to the risk involved in drilling this well?

A. Well, you have -- have several very good wells in the area that have less than 40 feet of total clean sand, and so I would say that the projection of a minimum of 60 feet of clean sand gives you a significantly reduced risk.

Q. Have you reviewed the logs, Mr. Mason, which Mr. James referred to in his testimony?

A. Yes, I have.

Q. And based on your review of those logs, do you find that he had 64 feet of clean Morrow sand in that well?

A. Yes, sir, I do.

Q. And that was substantially the same as your pre-drilling projection?

A. Yes, we had projected 60 feet as a minimum.

Q. Mr. Mason, you have on your Exhibit Number Three numerous other wells in the area. If these wells have any bearing on the risk factor in the subject well, describe how that works for us.

A. Well, we have 20 sections in this mapped

area, and these 20 sections include 20 wells, all of which penetrated the Atoka-Morrow section.

And of these, if we again treat that Ashland-Hilliard well as a dry hole, you still have a 95 percent success ratio for a 20-square mile area surrounding the subject well.

Q. In your experience is an area like this unusual for wells of this nature?

A. To be an area as large as 20 square miles without a bona fide dry hole is unusual. You could probably pick and fit and come up with one that would -- would be that large without a dry hole, but this area is, I think, almost unique.

Q. Do you think or do you have an opinion, Mr. Mason, on the degree of risk involved in drilling the subject well in view of the surrounding situation?

A. Well, I would -- I would assign a minimum of 80 percent chance of success on this well, just from the surrounding production, its structural position, the availability of Morrow reservoir quality sands, and the presence of multiple pays that have been proven in pre-existing nearby wells.

Q. Mr. Mason, in your review of the logs of this subject well, have you discarded this well as much

as Mr. James has and indicated by his testimony?

A. I think that the well has more potential than -- than he's given it right now, because I think that you'll find that he's got a better well there. There is this wave of pessimism when a well doesn't come on as nicely as it should, and this may be kind of the day after the honeymoon and then the marriage picks up and everything's okay.

But I think that he's got a better well there than -- than what it appears to be now.

Q. If you have anything specifically in mind as shown by the logs, briefly refer to those facts.

A. We have -- we've had quite a bit of success in the Morrow. I think we've probably drilled 20 or 25 Morrow wells last year, and as I remember, we only plugged two of the Morrow wells.

We have a minimum porosity cutoff of about 5 percent, and consequently, I think those three or four Upper Morrow Sands that he's got here look pretty darned good.

So I'd be real happy with an Upper Morrow section like that. Also, he's got the -- what he called his Atoka B Sand, which has 7-1/2 to 8 percent porosity and 29 percent water saturation, so I think that he's got some potential there.

Q. You think those zones will give up some gas?

A. I think they will. Then around 10,430, there are a couple of little porous tongues in the Strawn that -- that thin, but they may still have quite a bit of potential. This reservoirs have fooled us before. We nearly walked away from a 4-footer on the Long Arroyo and it initialed 9-million, so you can't let these thin things just throw you out.

Then up in the Wolfcamp at 9264, about, you've got 8 or so feet, maybe 9, of porosity there. There is no gas separation, so I would kind of anticipate you'd be in an oil regime with 10-1/2 percent porosity and 7 percent water saturation, and some indicated permeability on the duolatero log.

Q. Mr. Mason, all the clues you geologists look at to foresee the future as far as the productivity is concerned, are all these clues that you've reviewed in the subject well consistent with your pre-drilling analysis of the location?

A. They are, yes.

Q. Based on your review of these instruments, Mr. Mason, would you have an opinion as to a reasonable risk factor to be imposed in the event the Commission does grant

Southland's forced pooling application?

A. I think the previously assigned penalty of 20 percent is equitable and reasonable, considering the -- that this is a high success area. It's an unusually high success area. It's almost unique for -- for even Eddy County.

MR. DICKERSON: At this time, Mr. Ramey, we'd move Exhibit -- admission of Bassett-Birney Exhibit Number Three.

MR. RAMEY: Bassett-Birney Exhibit Number Three will be admitted.

Q. Mr. Mason, do you have anything else you would like to add concerning the risk factor in this well?

A. Only that you have an extremely high success rate in the surrounding area. We define success possibly a little differently. If we get our money back and maybe make a couple of bucks, it's a success, and with four or five potential zones that you can recomplete in, you will certainly get your money back in this one.

MR. DICKERSON: I have no further questions.

MR. RAMEY: Any questions, Mr. Carr?

MR. CARR: I have a few.

CROSS EXAMINATION

BY MR. CARR:

Q. Mr. Mason, you just stated that this is a high success rate area, I believe.

A. Right.

Q. On that alone would you recommend that BAssett-Birney drill a Morrow well in the area?

A. Well, they don't have the facilities to operate a drilling well. Probably I would recommend to them that they farm out to Yates and Yates operate the well.

Q. But you would, just based on the high success ratio of the other wells in this area, recommend that they invest -- or someone invest $800,000 to drill a Morrow well in this area?

A. Well, it would depend on the local geology, as I see it at the time. I wouldn't broad brush the stuff to the east of here under -- in the potash area. I wouldn't say that that's quite as high a probability of success as this area here, but I think there's still a number of viable locations even in this 20-section map area.

Q. Have you studied the Morrow in general?

A. I've been working on the Morrow for about two years with Yates and I worked on it for about a year when I was with Continental.

Q. Would you disagree with the statement that in the Morrow that it's possible to offset a very good well and come up with a dry hole?

A. I wouldn't disagree with that.

Q. Would you think that was a fair characterization due just to the general structural configuration of the Morrow?

A. I would go more with the sand body geometries. In a lot of cases I've seen one or two places where there's an extremely good well and it's been offset all the way around with -- and I think there it's just a case of not adequately resolving the geometry of these sand bodies in a regional mode to come up with some concept of where to anticipate that sand body for the offset.

Q. Would you, based on just the way you would characterize the sand bodies conclude that you -- any place in the immediate area, say, in 35 would drill a successful Morrow well?

A. I would say that in a diagonal band trending northwesterly across Section 35, you'll have a higher success ratio. I have this Isopachous thick running northwesterly across Section 35, and I think that probably you'll have a much higher probability of success in that fairway than say you might, but I still think that the whole Section

35 looks good.

Q. Would you say there's a possibility of drilling a dry hole in the, say, northeast quarter of Section 35?

A. Well, I think you'll encounter reservoir quality Morrow rocks there, thick enough to give you a well that has a reasonable chance of being productive, but it is possible, and I've seen this several times, to have a drilling fluid problem and -- and choke your Morrow off. There are a lot of different ways to hurt the Morrow. It's essentially a producing interval and it is possible to have a geological success with good reservoir and damage it to the point that you can't produce it.

Q. Is it possible to also have -- drill a well there that would not be a geological success, no matter how well you completed it?

A. I would give 35 a very high probability of success.

Q. If you give it a high probability, isn't there also some probability that it would not be?

A. There is, there is a chance. There's always that.

Q. Now, in determining whether or not you have a successful Morrow well, when do you know you've got a

good well? Do you have to -- do you know -- you don't know that just from the logs, I assume.

A. Well, after you've looked at a number of logs and the number of cums on these wells, you begin to develop a feel for what general sand package will give you the minimum reserves that you need, and to pay out one of these Morrow wells at this depth you need approximately 400 Mcf -- or 400 million.

Q. When do you know that, only after you've perforated, is that correct?

A. You can get a pretty good estimate, say, two months after the well goes on line.

Q. So you have to produce it for a short period of time, also?

A. You have to get some production to -- to generate reserves.

Q. Now, I believe you said a few minutes ago that you saw there was a potential for some Strawn production in the subject well, is that correct?

A. Yeah.

Q. Based on your reading of the log would you recommend that the Strawn be perforated?

A. I would say that before this well is abandoned the Strawn should be perforated.

Q. Would the same also apply for the Wolfcamp?

A. I would give the Wolfcamp a shot before the well is abandoned.

Q. Is there Wolfcamp production in the immediate area?

A. There is a well down in 15 which is capable of Wolfcamp production. It has not been brought on line yet.

Q. Is that the well indicated by the white circle?

A. It is.

Q. Is that a Southland Royalty Company well?

A. Let me see. I'm not sure whose well that is. I would -- I would imagine it is because the other two wells in 15 are also SRC.

Q. Would it surprise you to learn that that well was completed in the Wolfcamp by Southland and was dry in the Wolfcamp?

A. Dry?

Q. Yes, sir.

A. Well, it sure looked like it had a good Wolfcamp shot.

Q. That just again, I guess, shows you can't really tell from a log what you've got.

A. Well, again, too, you may -- it may have been damaged in a completion attempt.

Q. Do you have any knowledge that would indicate that?

A. No, but --

Q. Now I believe you indicated in Section 27 there was a Morrow producer there, is that correct?

A. That's an error. That should have been another Atoka producer.

Q. And that well, in fact, was dry in the Morrow, was it not?

A. I think it was a little weak in the Morrow, yes.

Q. What are the -- you may have testified to this and I just didn't hear it. What are the yellow dots? What do they depict?

A. I'm sorry, the yellow dots are Atoka completions and the red are Morrow completions.

Q. Now I believe you indicated that one of the things you would look at in evaluating a well after you have the log is the number of feet of clean Morrow sand, is that correct?

A. At the point where I've got the log, then I evaluate it on the basis of porosities.

Q. Uh-huh.

A. Indicated permeabilities, water saturations, cleanliness, the history that a particular zone may have, for instance, you may have a zone that -- that has a lot of mobile clays in it and it chokes off very easily, or was choked off very easily in an offset well.

Q. Looking at the subject well, what does the number 64 opposite that well indicate?

A. That indicates 64 feet of clean Morrow sand.

Q. And that's what you got from a -- did you get that from the log?

A. Yes.

Q. If you learned that a substantial portion of that was water saturated, would that have an adverse affect on the way you evaluated the well?

A. Well, I don't know that it's water saturated.

Q. But if you did.

A. That would have some affect on how you would evaluate the well, yeah, but I'm -- I always wonder about these zones that have extremely good permeability and

they make water when they're perforated, because I just wonder how much fluid was lost as that section was drilled, how much fluid was produced if they perforated it, if they bothered to run water analysis and watched for chlorides, KCL, things like this that are added to the drill fluid that would travel with the filtrate fraction of the mud, and would come back and allow you to tag that as mud filtrate and be able to say, okay, they lost 5000 barrels of mud at this point. The KCL content of the fluid they recovered tags it as drilling filtrate, and they only recovered 500 barrels when they perforated. So they've got a lot of water that they put in the formation that wasn't there originally.

Q. So you're saying that all of those things are to be taken into consideration in determining whether or not you have a wet sand.

A. Yes. So I don't know if -- I don't know how much fluid was produced, if water samples were run.

Q. You don't have any knowledge concerning this well that would indicate to you that any of those conditions existed when that zone was tested, do you?

A. Not specifically, but it is open to speculation.

Q. But you have no data, is that right?

A. I have no data but --

Q. Do you have anything that would make you conclude that anything done in the completion of this well was done in an imprudent fashion?

A. We don't have all of the -- the information on the well, so it -- I would hate to -- to pass judgment on anybody's completion techniques, drilling techniques, or anything, when I don't have the complete records.

Q. Have you had complete records on other wells drilled and completed by Southland?

A. I'm not sure about that. I know they've made some good wells out here, particularly in this area and they have -- they have a record as a good, conscientious operator.

Q. So you're not insinuating that they're not operating in a prudent fashion?

A. No. Well, there are things you can do to the Morrow that the operator might not even realize have been done, and it's then just a contractor problem or a mud engineer's error.

Q. Mr. Mason, in putting together a structure map like this, you take, I guess, certain bits of information that you obtain from the various wells drilled and completed in the area and then you interpret it and that's how you draw your contours, is that correct?

A. Right, that's -- that's really all you can do.

Q. Isn't it possible that equally competent geologists would interpret the data in a somewhat different fashion?

A. Unquestionably.

MR. CARR: I have nothing further of this witness.

MR. DICKERSON: Nothing further.

MR. RAMEY: Any other questions? He may be excused.

Anything further, Mr. Dickerson?

MR. DICKERSON: No, sir.

MR. CARR: I have a very brief statement, but I will shorten it so it's maybe five sentences.

Southland Royalty Company is here today attempting to get an order pooling the west half of Section 35. I think the testimony here today shows you that there isn't an agreement for voluntarily developing this acreage. We believe we have presented evidence on all points necessary to entitle us to a pooling order.

We also believe that the testimony shows that it's an area in which it is speculative, that there are risks involved in drilling particularly a Morrow well in the

area and that we have presented a case which would entitle Southland Royalty to a risk penalty which we think should reasonably compensate them for the risk they are assuming in drilling and completing a well while there are certain interests that are outstanding.

We also would request that the order be expedited because it is obvious the well is down and it's been kept a very tight hole -- you can tell by the fact that Mr. Dickerson has the logs on the well, but it is important that, if at all possible, the order be expedited, and we would request that.

MR. RAMEY: Thank you, Mr. Carr.

MR. DICKERSON: Mr. Ramey, I would just like to say that from the standpoint of Bassett-Birney Oil Corporation, this is not a matter for the New Mexico Oil Conservation Division. This is a dispute between leaseowners as to the extent of their interest. Bassett-Birney remains and has been from the very first, as is Southland, very desirous of drilling this acreage itself.

The applicable statute, Section 70-2-17, which authorizes this Division to subject interests to compulsory pooling, by its express terms, we think, provides that such pooling orders shall be made, but only when the parties have not agreed to pool their interests.

Southland -- or Bassett-Birney in this situation has not only agreed to pool its interest, it has in fact prepared and executed a communitization agreement pooling its interest. The only thing that Bassett-Birney has not agreed to do is pay for the well on the percentages deemed owned by Southland. That matter is for the courts. It's in the courts. It should be left in the courts, and should not adversely affect the interest of Southland Royalty Corporation if this application for compulsory pooling were dismissed, and for that purpose we would move that the application be dismissed.

On the other hand, on the off chance that our motion fails, we think that the testimony establishes that this is an unusually low risk area for Morrow productivity, or Morrow projection of wells to penetrate the Morrow. They have a shot at several other horizons and all these factors testified to lead to an unusually low risk area, and the penalty assessed in the original Examiner hearing of 20 percent is just and equitable and should be affirmed by this de novo proceeding.

MR. CARR: I would request the opportunity to respond to the motion.

We would simply state that a willingness to agree does not an agreement make absent the agreement and

execution of appropriate documents which establish the rights of the parties and take on the nature of a contract.

And we submit that the case is properly before the Commission and although there are issues which admittedly must be resolved by the court, that we come before you and we've met all the conditions entitling us to an order, and we submit that the order should be expeditiously provided.

MR. RAMEY: We will take the motion under advisement and rule with an order, I assume.

With that, the hearing is adjourned.

(Hearing concluded.)

C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY CERTIFY that the foregoing Transcript of Hearing before the Oil Conservation Division was reported by me; that the said transcript is a full, true, and correct record of the hearing, prepared by me to the best of my ability.

Sally W. Boyd C.S.R.

SALLY W. BOYD, C.S.R.
Rt. 1 Box 193-B
Santa Fe, New Mexico 87501
Phone (505) 455-7409

NEW MEXICO OIL CONSERVATION COMMISSION

COMMISSION HEARING

SANTA FE, NEW MEXICO

Hearing Date JANUARY 19, 1981 Time: 9:00 A.M.

NAME	REPRESENTING	LOCATION
W. F. Kellahin	Kellahin & Kellahin	Santa Fe
James S. Schaub	James S. Schaub	Wichita Falls, Tex
A R Kendrick	John E. Roberts	Cayter, N.M.
Joe Carson	Logue Carson & Dickerson	Artesia NM
Mark D. Stephens	Coronado Explor. Corp.	Albuq., N.M.
Gary Stephens	USGS	Albuquerque
Chad Dickerson	Logue Carson & Dickerson	Artesia
Jack McCan	Barrett & Burrus Oil Corp	"
James T. Mason	"	"
William F. Carr	Campbell, Byrd & Black	Santa Fe
S.G. Buell	Jasper & Buell	Santa Fe
Steven D. King	Tenneco Oil Co	San Antonio
Michael Mickey	Tenneco Oil E&P	San Antonio
JERRY L. LEE	SUPRON ENERGY CORP	DALLAS
G BURKE	—	—
Harry Yates	Coronado Explor Corp	Albuquerque

NEW MEXICO OIL CONSERVATION COMMISSION

COMMISSION HEARING

SANTA FE, NEW MEXICO

Hearing Date JANUARY 19, 1981 Time: 9:00 A.M.

NAME	REPRESENTING	LOCATION
Don Davis	SRC	Midland
A. P. Thomas	SRC	Midland

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

BRUCE KING
GOVERNOR

LARRY KEHOE
SECRETARY

POST OFFICE BOX 2088
STATE LAND OFFICE BUILDING
SANTA FE, NEW MEXICO 87501
(505) 827-2434

February 10, 1981

Re: CASE NO. 7025
ORDER NO. R-6498-A

Mr. William F. Carr
Campbell and Black
Attorneys at Law
Post Office Box 2208
Santa Fe, New Mexico

Applicant:

Southland Royalty Company

Dear Sir:

Enclosed herewith are two copies of the above-referenced Commission order recently entered in the subject case.

Yours very truly,

JOE D. RAMEY
Director

JDR/fd

Copy of order also sent to:

Hobbs OCC x
Artesia OCC x
Aztec OCC

Other Chad Dickerson

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING
CALLED BY THE OIL CONSERVATION
COMMISSION OF NEW MEXICO FOR
THE PURPOSE OF CONSIDERING:

CASE NO. 7025 DE NOVO
Order No. R-6498-A

APPLICATION OF SOUTHLAND ROYALTY
COMPANY FOR COMPULSORY POOLING,
EDDY COUNTY, NEW MEXICO.

ORDER OF THE COMMISSION

BY THE COMMISSION:

This cause came on for hearing at 9 a.m. on January 19, 1981, at Santa Fe, New Mexico, before the Oil Conservation Commission of New Mexico, hereinafter referred to as the "Commission."

NOW, on this 9th day of February, 1981, the Commission, a quorum being present, having considered the testimony presented and the exhibits received at said hearing, and being fully advised in the premises,

FINDS:

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

(2) That the applicant, Southland Royalty Company, seeks an order pooling all mineral interests in the Pennsylvanian formation underlying the W/2 of Section 35, Township 18 South, Range 29 East, NMPM, Eddy County, New Mexico.

(3) That the matter came on for hearing at 9 a.m. on September 17, 1980, at Santa Fe, New Mexico, before Examiner Richard L. Stamets and, pursuant to this hearing, Order No. R-6498 was issued on October 21, 1980, which granted Southland's application and compulsorily pooled all mineral interests in the Pennsylvanian formation underlying the W/2 of Section 35, Township 18 South, Range 29 East, NMPM, Eddy County, New Mexico.

(4) That on November 6, 1980, application for Hearing De Novo was made by Southland Royalty Company and the matter was set for hearing before the Commission.

(5) That the matter came on for hearing de novo on January 19, 1981.

(6) That a well has been drilled to the Pennsylvanian formation upon said pooled unit and is presently being tested for completion.

(7) That the log of said well indicates that in all probability the well will be a commercial well.

(8) That the evidence adduced at said hearing indicates that Division Order No. R-6498 entered October 21, 1980, should be affirmed.

IT IS THEREFORE ORDERED:

(1) That Division Order No. R-6498, entered October 21, 1980, is hereby affirmed.

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

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

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

ALEX J. ARMIJO, Member

EMERY C. ARNOLD, Member

JOE D. RAMEY, Member & Secretary

S E A L

fd/

BEFORE THE OIL CONSERVATION DIVISION

OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE APPLICATION OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO	CASE NOS. 7024 and 7025

MEMORANDUM IN OPPOSITION TO APPLICATIONS OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING

Section 70-2-17, N.M.S.A. 1978, provides in part as follows . . .

> C. When two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, the owner or owners thereof may validly pool their interests and develop their lands as a unit. Where, however, such owner or owners have not agreed to pool their interests, and where one such separate owner, or owners, who has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply, the division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interests or both in the spacing or proration unit as a unit.

As a matter of simple construction of the above statute, the division has authority to subject interests to compulsory pooling only when "such owner or owners have not agreed to pool their interests."

As expressly stated in the authorizing statute for this division, and as recognized by the Supreme Court of New Mexico in Sims v. Mechem, 72 N.M. 186, 382 P.2d 183, the authority of the division to pool arises only when such pooling has not been voluntarily agreed to by the parties. In this case, Bassett-Birney has agreed to pool its interests with the other leasehold owners in the spacing units.

The controversy between Southland and Bassett-Birney involves disputed title to interests in a Federal Oil and Gas Lease upon the lands affected by Southland's application herein, to which both Southland and Bassett-Birney claim title. As stated by Bassett-Birney in its Exhibit No. 1, "Bassett-Birney is willing to pool its interests" in the wells proposed to be drilled by Southland. Also, as made clear in such Exhibit, Bassett-Birney's objection to the operating agreements and AFE's furnished by Southland arises from the erroneous interests credited to Bassett-Birney by Southland in those instruments, and not with regard to any lack of agreement of Bassett-Birney to voluntarily pool its interests under the proposed wells. Bassett-Birney should not be required to assume the cost of a dry hole attributable to the disputed interests, in the face of Southland's denial of its title.

By its applications in these proceedings Southland attempts to accomplish by compulsory pooling what it can only accomplish by litigation. As reflected by Bassett-Birney Exhibit No. 2, the underlying title dispute between Southland and Bassett-Birney is presently the subject of litigation in the United States District Court for the District of New Mexico. In this suit, or in such other court to which this litigation may ultimately be transferred, the underlying title dispute between Southland and Bassett-Birney will ultimately be resolved.

As recognized in Williams and Meyers, Oil and Gas Law, §941.3, compulsory pooling statutes do not have any effect upon the underlying titles of the interest owners. In Monsanto Chemical Company v. Southern Natural Gas Company, 234 La. 939, 102 So.2d 223, 9 O&GR 1110, the court held that it was beyond the authority of the regulatory commission to determine who was entitled to production under the terms of voluntary agreements affecting the title to the premises, and further found that the only authority of the agency was to allocate to each tract a

pro rata share of the unit production. To the same effect is Arkansas-Louisana Gas Company v. Southwest Natural Production Company, 221 La. 608, 60 So.2d 9, 1 O&GR 1186, in which it was held that it was beyond the constitutional and legislative authority of the Commissioner of Conservation of the State of Louisiana to determine the title to the mineral ownership itself. In Texas it has also been held that orders of the Railroad Commission do not effect a transfer of title. Nale v. Carroll, 155 Tex. 555, 289 S.W.2d 743, 5 O&GR 1379, in which it was stated: "Rules and regulations of the Railroad Commission cannot effect a change or transfer of property rights. A Rule 37 Permit cannot be made the basis for a claim of title."

As stated above, only the courts have the power to determine the title to this disputed interest in real estate. The courts also will determine the rights of Southland and Bassett-Birney once the title dispute has been resolved, with regard to such questions as drainage caused during the pendency of the dispute, for any decrease in the speculative value of the land by reason of the drilling of a dry hole and other such measures. Williams and Meyers, supra, §231.4.

As shown by its Exhibits, Bassett-Birney is willing to pool its interests and to participate in the wells proposed by Southland, but is not willing to execute AFE's and operating agreements not recognizing the leasehold interests claimed by Bassett-Birney. For these reasons, the policies behind enactment of compulsory pooling statutes in virtually all of the oil producing states, that being the prevention of waste and the furtherance of spacing rules regulating the size of the drilling units, have no application to the dispute between Southland and Bassett-Birney. Further, the fact that the prevailing party in the litigation will be made whole for any damages suffered by it as a result of the title dispute assures that no waste can be prevented by the applications of Southland in these proceedings. Southland is free to drill its proposed wells, and

Bassett-Birney has elected to participate therein to the full extent of its interests. The title to any production resulting will also be determined in the litigation.

For the reasons stated above, the division has no authority to subject the interests of Bassett-Birney to compulsory pooling under these circumstances, and the applications of Southland should therefore be denied.

BASSETT-BIRNEY OIL CORPORATION

By: Chad Dickerson
Chad Dickerson

LOSEE, CARSON & DICKERSON, P.A.
P. O. Drawer 239
Artesia, New Mexico 88210

Attorneys for Bassett-Birney Oil Corporation

September 4, 1980

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis, Landman

Re: Proposed Southland Royalty Company Empire
Federal "35" Com. No. 1 and "35-A" Com. No. 1
Wells, W/2 and E/2 Sec. 35, T-18-S, R-29-E,
Eddy County, New Mexico

Gentlemen:

This acknowledges receipt of your letters of July 8 and July 25, 1980, together with joint operating agreements and AFEs covering the proposed drilling of the subject wells.

The joint operating agreement dated July 8 covering W/2 Section 35 and the AFE for your No. "35" Com. No. 1, credits our company with a 19.026479% (60/315.35) interest, when in fact we own a 38.052957% (120/315.35) interest. The joint operating agreement dated July 17, 1980 covering E/2 Section 35 and the AFE for your No. "35-A" Com. No. 1, credits our company with a 6.3199% (20/316.46) interest, when in fact we own a 12.6398% (40/316.46) interest. Southland Royalty has instituted a suit against, among other parties, Bassett-Birney Oil Corporation, in the United States District Court for the District of New Mexico, Case No. CIV-80-0614 HB, contesting a portion of our title to the working interest underlying the proposed wells. In view of the incorrect statements in your operating agreements and AFEs as to our ownership in the proposed wells and the pending lawsuit, we are unable to approve either the AFEs or joint operating agreements.

Bassett-Birney is willing to pool its interests in the W/2 of Section 35 and in the E/2 of Section 35 for the drilling of the "35" Com. No. 1 Well and the "35-A" Com. No. 1 Well.

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 1

September 4, 1980

If you have any questions, please do not hesitate to call me.

Very truly yours,

BASSETT-BIRNEY OIL CORPORATION

By Jack W. McCaw

Jack W. McCaw,
Vice President

October 10, 1980

Mr. William F. Carr
Campbell and Black, P.A.
P. O. Box 2208
Santa Fe, New Mexico 87501

Dear Bill:

Enclosed, plase find the following Communitization Agreements, duly executed by Bassett-Birney Oil Corporation:

1. Covering E/2 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico.

2. Covering W/2 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico.

As you will note, these instruments pool the entire interest of Bassett-Birney in the proposed wells. Since Southland, though Operator, has not furnished Bassett-Birney with Communitization Agreements, we prepared these ourselves for Southland's convenience. However, Bassett-Birney remains unwilling to execute the AFE and Operating Agreement furnished with your letter of September 29, 1980, for the reason that the instruments still attempt to place the risk of a dry hole upon Bassett-Birney. Bassett-Birney feels that since Southland is the one proposing the immediate drilling of these wells prior to settlement or judgment upon the disputed title, that Southland should be willing to risk the dry hole, regardless of the outcome of the dispute. We find nothing in our statutes authorizing the Oil Conservation Division to force Bassett-Birney to execute such an Operating Agreement.

Bassett-Birney is willing to execute the Operating Agreement furnished, if the following changes are made in Article XV(B):

(a) In (2), change "credited to it" in line 2 to "credited to it and Robert E. McKee, Inc."

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 2

(b) In (5), delete the words "either" and "or a dry hole" in line 1.

Please let us know Southland's position on these questions.

Sincerely yours,

LOSEE, CARSON & DICKERSON, P.A.

Chad Dickerson

CD:pvm
Enclosures

cc: Mr. Jack W. McCaw

COMMUNITIZATION AGREEMENT

THIS AGREEMENT, entered into as of the 1st day of October, 1980, by and between the parties subscribing, ratifying or consenting hereto, such parties being hereinafter referred to as "parties hereto,"

W I T N E S S E T H:

WHEREAS, the Act of February 25, 1920, 41 Stat. 437, as amended, authorizes communitization or drilling agreements communitizing or pooling a Federal oil and gas lease or any portions thereof with other lands, whether or not owned by the United States, when separate tracts under such Federal lease cannot be independently developed and operated in conformity with an established well-spacing program for the field or area and such communitization or pooling is determined to be in the public interest; and

WHEREAS, the parties hereto own working, royalty, or other leasehold interests, or operating rights under the oil and gas leases and lands subject to this agreement which cannot be independently developed and operated in conformity with the well-spacing program established for the field or area in which said lands are located; and

WHEREAS, the parties hereto desire to communitize and pool their respective mineral interests in lands subject to this agreement for the purpose of developing and producing communitized substances in accordance with the terms and conditions of this agreement:

NOW, THEREFORE, in consideration of the premises and the mutual advantages to the parties hereto, it is mutually convenanted and agreed by and between the parties hereto as follows:

1. The lands covered by this agreement (hereinafter referred to as "communitized area") are described as follows:

Township 18 South, Range 29 East, N.M.P.M.

Section 35: W/2

containing 315.35 acres, more or less,

and this agreement shall extend to and include the Morrow formation underlying said lands and the dry gas and associated liquid hydrocarbons herein referred to as "communitized substances," producible from such formation.

2. Attached hereto, and made a part of this agreement for all purposes, is Exhibit "A" designating the operator of the communitized area and showing the oil and gas interests in all lands within the communitized area, and the authorization, if any, for communitizing or pooling any patented or fee lands within the communitized area.

3. All matters of operation shall be governed by the Operator under and pursuant to the terms and provisions of this agreement. A successor operator may be designated by the owners of the working

interest in the communitized area and four (4) executed copies of a designation of successor operator shall be filed with the Regional Oil and Gas Supervisor.

4. Operator shall furnish the Secretary of the Interior or his authorized representative, a log and history of any well drilled on the communitized area, monthly reports of operations, statements of communitized substances sales and royalties, and such other reports as are deemed necessary to compute monthly the royalty due the United States, as specified in the applicable oil and gas operating regulations.

5. Nondiscrimination: In connection with the performance of work under this agreement, the operator agrees to comply with all of the provisions of Section 202(1) to (7) inclusive of Executive Order 11246 (30 F.R. 12319), as amended, which are hereby incorporated by reference in this agreement.

6. The communitized area shall be developed and operated as an entirety with the understanding and agreement between the parties hereto that all communitized substances produced therefrom shall be allocated among the leaseholds comprising said area in the proportion that the acreage interest of each leasehold bears to the entire acreage interest committed to this agreement.

7. The royalties payable on communitized substances allocated to the individual leases comprising the communitized area and the rentals provided for in said leases shall be determined and paid on the basis prescribed in each of the individual leases. For any federal lease bearing a sliding- or step-scale rate of royalty, such rate shall be determined separately as to the production from each communitization agreement to which such lease may be committed, and separately as to any non-communitized lease production; provided, however, as to leases where the rate of royalty for gas is based on total lease production per day shall be determined by the sum of all communitized production allocated to such a lease and any non-communitized lease production. Payment of rentals under the terms of leases subject to this agreement shall not be affected by this agreement except as provided for under the terms and provisions of said leases or as may herein be otherwise provided. Except as herein modified and changed, the oil and gas leases subject to this agreement shall remain in full force and effect as originally made and issued.

8. There shall be no obligation on the lessees to offset any well or wells completed in the formation covered by this agreement on separate component tracts into which the communitized area is now or may hereafter be divided, nor shall any lessee be required to measure separately communitized substances by reason of the diverse ownership thereof, but the lessees shall not be released from their obligation to protect the communitized area from drainage of communitized substances by a well or wells drilled offsetting said area.

9. The commencement, completion, continued operation or production of a well or wells for communitized substances on the communitized area shall be construed and considered as the commencement, completion, continued operation or production on each and all of the lands within and comprising said communitized area, and operations or production pursuant to this agreement shall be deemed to be operations or production as to each lease committed hereto.

10. Production of communitized substances and disposal thereof shall be in conformity with allocation, allotments and quotas made or fixed by any duly authorized person or regulatory body under applicable Federal or State statutes. The agreement shall be subject to all applicable Federal and State laws or executive orders, rules and regulations, and no party hereto shall suffer a forfeiture or be liable in damages for failure to comply with any of the provisions of this agreement if such compliance is prevented by, or if such failure results from, compliance with any such laws, orders, rules or regulations.

11. This agreement shall be effective as of the date hereof upon execution by the necessary parties, notwithstanding the date of execution, and upon approval by the Secretary of the Interior, or his duly authorized representative, and shall remain in force and effect for a period of two (2) years and so long thereafter as communitized substances are or can be produced from the communitized area in paying quantities from the communitized area and upon fulfillment of all requirements of the Secretary of the Interior, or his duly authorized representative, with respect to any dry hole or abandoned well, this agreement may be terminated at any time by mutual agreement of the parties hereto. This agreement shall not terminate upon cessation of production if, within sixty (60) days thereafter, reworking or drilling operations on the communitized area are commenced and are thereafter conducted with reasonable diligence during the period of nonproduction.

12. It is agreed by the parties hereto that the Secretary of the Interior, or his duly authorized representative, shall have the right of supervision over all operations within the communitized area to the same extent and degree as provided in the oil and gas leases under which the United States of America is lessor and in the applicable oil and gas operation regulations of the Department of the Interior.

13. The covenants herein shall be construed to be covenants running with the land with respect to the communitized interests of the parties hereto and their successors in interest until this agreement terminates; and any grant, transfer or conveyance of any such land or interest subject hereto, whether voluntary or not, shall be and hereby is conditioned upon the assumption of all obligations hereunder by the grantee, transferee, or other successor in interest, and as to Federal land shall be subject to approval by the Secretary of the Interior.

14. This agreement shall be binding upon the parties hereto and shall extend to and be binding upon their respective heirs, personal representatives, administrators, successors and assigns.

15. This communitization agreement shall also serve as a written designation of pooled unit, under and pursuant to the provisions of the oil and gas leases included within the communitized area and covering oil, gas and other minerals owned by private individuals.

16. This agreement may be executed in any number of counterparts, no one of which needs to be executed by all parties, or may be ratified or consented to by separate instrument, in writing, specifically referring hereto, and shall be binding upon all parties who have executed such a counterpart, ratification or consent hereto with the same force and effect as if all parties had signed the same document.

IN WITNESS WHEREOF the parties hereto have executed this agreement as of the day and year first above written and have set opposite their respective names the date of execution.

ATTEST: BASSETT-BIRNEY OIL CORPORATION

OCT 10 1980
Date

Secretary

By: Jack W. McCaw
VICE President

SOUTHLAND ROYALTY COMPANY

Date

By: _____
Attorney-in-Fact

ATTEST: TENNECO OIL COMPANY

Date

Secretary

By: _____
President

ATTEST: ROBERT S. McKEE, INC.

Date

Secretary

By: _____
President

FEATHERSTONE FARMS, LTD.

Date

By: _____
Partner

STATE OF NEW MEXICO)
: ss.
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this 10th day of October, 1980, by Jack W. McCaw VICE President of BASSETT-BIRNEY OIL CORPORATION, a New Mexico corporation, on behalf of said corporation.

My commission expires:
August 1, 1984

Kim B. Bilberry
Notary Public

OFFICIAL SEAL
Signature:
KIM BILBERRY
NOTARY PUBLIC - NEW MEXICO
NOTARY BOND FILED WITH SECRETARY OF STATE
My Commission Expires 8-1-84

STATE OF TEXAS)
: ss.
COUNTY OF MIDLAND)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, Attorney-in-Fact for SOUTHLAND ROYALTY COMPANY, a Texas corporation, on behalf of said corporation.

My commission expires:
_____

_____
Notary Public

STATE OF TEXAS)
: ss.
COUNTY OF BEXAR)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, President of TENNECO OIL COMPANY, a Delaware corporation, on behalf of said corporation.

My commission expires:
_____

_____
Notary Public

STATE OF TEXAS)
: ss.
COUNTY OF EL PASO)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, President of ROBERT E. McKEE, INC., a Texas corporation, on behalf of said corporation.

My commission expires:
_____

_____
Notary Public

STATE OF NEW MEXICO)
: ss.
COUNTY OF CHAVES)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, Partner, on behalf of FEATHERSTONE FARMS, LTD., a New Mexico limited partnership.

My commission expires:
_____

_____
Notary Public

EXHIBIT "A" TO COMMUNITIZATION AGREEMENT DATED OCTOBER 1, 1980, EMBRACING THE N/2 SECTION 35, TOWNSHIP 18 SOUTH, RANGE 29 EAST, N.M.P.M.

Operator of Communitized Area: Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Tract No. 1

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: NE/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

Tenneco Oil Company	100%

O.R.R.I. and Percentage:

Heirs and devisees of C. Melvin Neal, deceased	2.500000%

P.P.I. and Percentage:

*Robert E. McKee General Contractor, Inc.	4.21875%
†Robert J. Leonard	3.12500%
†Patrick J. Leonard	3.12500%
†Timothy T. Leonard	3.12500%

*Pursuant to Production Payment Agreement dated March 9, 1960, recorded Book 106, Page 399, from Leonard Oil Company to Robert E. McKee General Contractor, Inc., until $88,612.50 shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

†Pursuant to Assignment dated October 1, 1965, recorded Book 160, Page 67, from Leonard Oil Company to Tenneco Oil Company, until $3 million shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

Tract No. 2

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: NW/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

Tenneco Oil Company	100%

O.R.R.I. and Percentage:

Jimmie Marie Terry, Trustee of the Sandra Leigh Runyan Trust dated November 16, 1972	.666674%
Jimmie Marie Terry, Trustee of the Susan Lynn Perry Trust dated November 16, 1972	.666674%
Billie L. Kruse, Trustee of the Barbara Kruse Frankenfield Trust dated October 2, 1966	.666664%

P.P.I. and Percentage:

*Robert E. McKee General Contractor, Inc.	4.46875%
†Robert J. Leonard	3.125000%
†Patrick J. Leonard	3.125000%
†Timothy T. Leonard	3.125000%

*Pursuant to Production Payment Agreement dated March 9, 1960, recorded Book 166, Page 399, from Leonard Oil Company to Robert E. McKee General Contractor, Inc., until $88,612.50 shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

†Pursuant to Assignment dated October 1, 1965, recorded Book 160, Page 67, from Leonard Oil Company to Tenneco Oil Company, until $3 million shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

Tract No. 3

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: SE/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

*Bassett-Birney Oil Corporation 100%

*Title to 1/2 disputed between Bassett-Birney Oil Corporation and Southland Royalty Company.

O.R.R.I. and Percentage:

Heirs and devisees of C. Melvin Neal, deceased 2.50000%

Tract No. 4

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: SW/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

*Bassett-Birney Oil Corporation 100%

*Title to 1/2 disputed between Bassett-Birney Oil Corporation and Southland Royalty Company.

O.R.R.I. and Percentage:

Jimmie Marie Terry, Trustee of the Sandra Leigh Runyan Trust dated November 16, 1972	.66667%
Jimmie Marie Terry, Trustee of the Susan Lynn Perry Trust dated November 16, 1972	.66667%
Billie L. Kruse, Trustee of the Barbara Kruse Frankenfield Trust dated October 2, 1966	.66666%

Tract No. 5

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: NW/4 SW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

*Bassett-Birney Oil Corporation 100%

*Title to 1/2 disputed by Bassett-Birney Oil Corporation and Southland Royalty Company.

O.P.R.I. and Percentage:

Neil B. Watson 5%

Tract No. 6

Lessor: United States

Lessee of Record: Featherstone Farms, Ltd.

Serial No. of Lease: NM 010907-A

Date of Lease: April 1, 1953

Description of Lands Committed: Lots 3 and 4 (S/2 SW/4), NE/4 SW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 115.35

Working Interest and Percentage:

Before Payout:

Southland Royalty Company 100%

After Payout:

Southland Royalty Company 50%
Featherstone Farms, Ltd. 50%

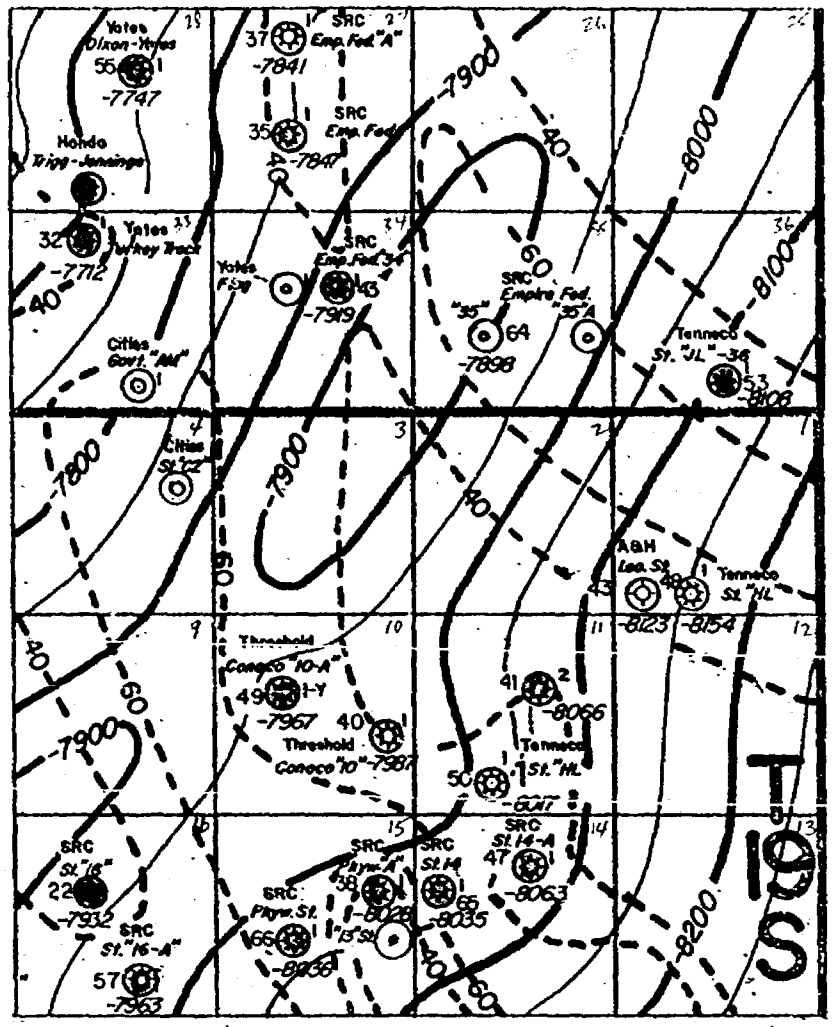
O.R.R.I. and Percentage:

Before Payout:

Featherstone Farms, Ltd. 6.25%

RECAPITULATION

Tract Number	No. of Acres Committed	Percentage of Interest in Communitized Area
1	40.00	12.68432%
2	40.00	12.68432%
3	40.00	12.68432%
4	40.00	12.68432%
5	40.00	12.68432%
6	115.35	36.57840%
TOTAL	315.35	100.00000%



Morrow Penetration

64 ---Feet of Clean (50 API) Morrow Sand in Well

-7898 -----Subsea Depth of Lower Morrow

----- Morrow Gas Well

-7800 Structural Contours of Lower Morrow 50 ft. C.I.

60 Isoliths of Total Clean (50 API) Morrow Sand

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 3

Book Work
FORM 925260 REV.

Dresser Atlas

DRESSER

Combination Logging Systems

Compensated **Densilog**
Compensated **Neutron**

FILE NO.

COMPANY SOUTHLAND ROYALTY CO.
WELL EMPIRE FEDERAL "35" NO.1
FIELD WILDCAT
COUNTY EDDY STATE NEW MEXIC

LOCATION: 1980FSL & 1980 FWL
SEC 35 TWP 18-S RGE 29-E

Other Service
DLL/MLL/G
CAL

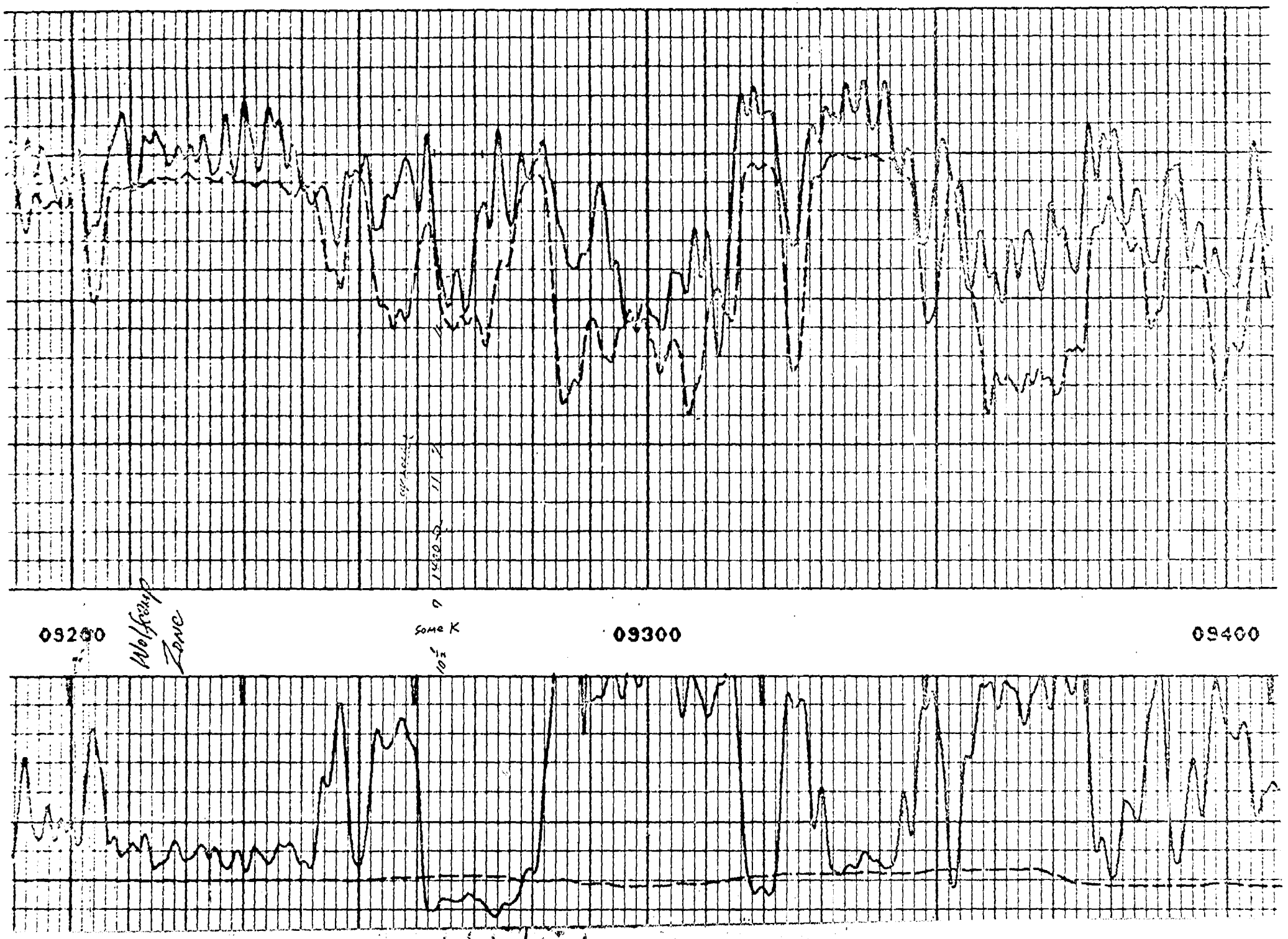
Permanent Datum GL Elev. 3433.5'
Log Measured from KB Ft. Above Permanent Datum
Drilling Measured from KB

Elevations
KB 3447'
DF
GL 3433.5'

Date	12-19-80			
Run No.	TWO			
Service Order	50952			
Depth—Driller	11,791'			
Depth—Logger	11,796'			
Bottom Logged Interval	11,799'			
Top Logged Interval	3162'			
Casing—Driller	8 5/8 @ 3200'	@	@	@
Casing—Logger	3162'			
Bit Size	7 7/8"			
Type Fluid in Hole	BGEL/DRISPAC/LOID/KCl			
Density and Viscosity	10.9 45			
pH and Fluid Loss	9.5 5.2 cc	cc	cc	
Source of Sample				
Rm @ Meas. Temp.	.061 @ 60 °F	@ °F	@ °F	@
Rmf @ Meas. Temp.	.054 @ 60 °F	@ °F	@ °F	@
Rmc @ Meas. Temp.	.14 @ 61A °F	@ °F	@ °F	@
Source of Rmf and Rmc	M —			
Rm @ BHT	.025 @ 160 °F	@ °F	@ °F	@
Time Since Circ.	8 HRS.			
Max. Rec. Temp. Deg. F.	160 °F	°F	°F	
Equip. No. and Location	11935 HOBBS			
Recorded By	MCELROY/CLEMENTS			
Witnessed By	PIERSON			

FIELD PRINT

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 4


09200
Wolfcamp Zone
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09300
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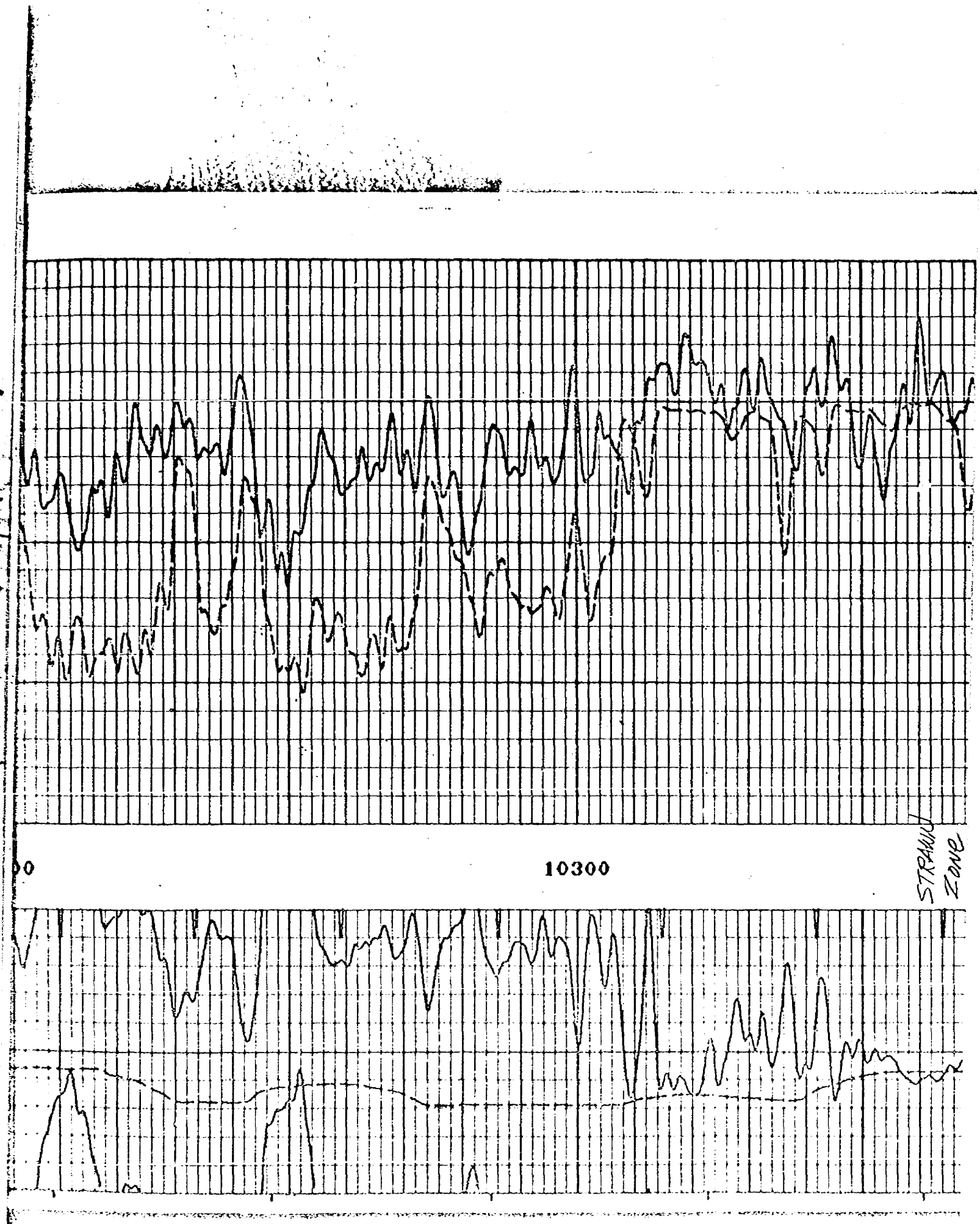
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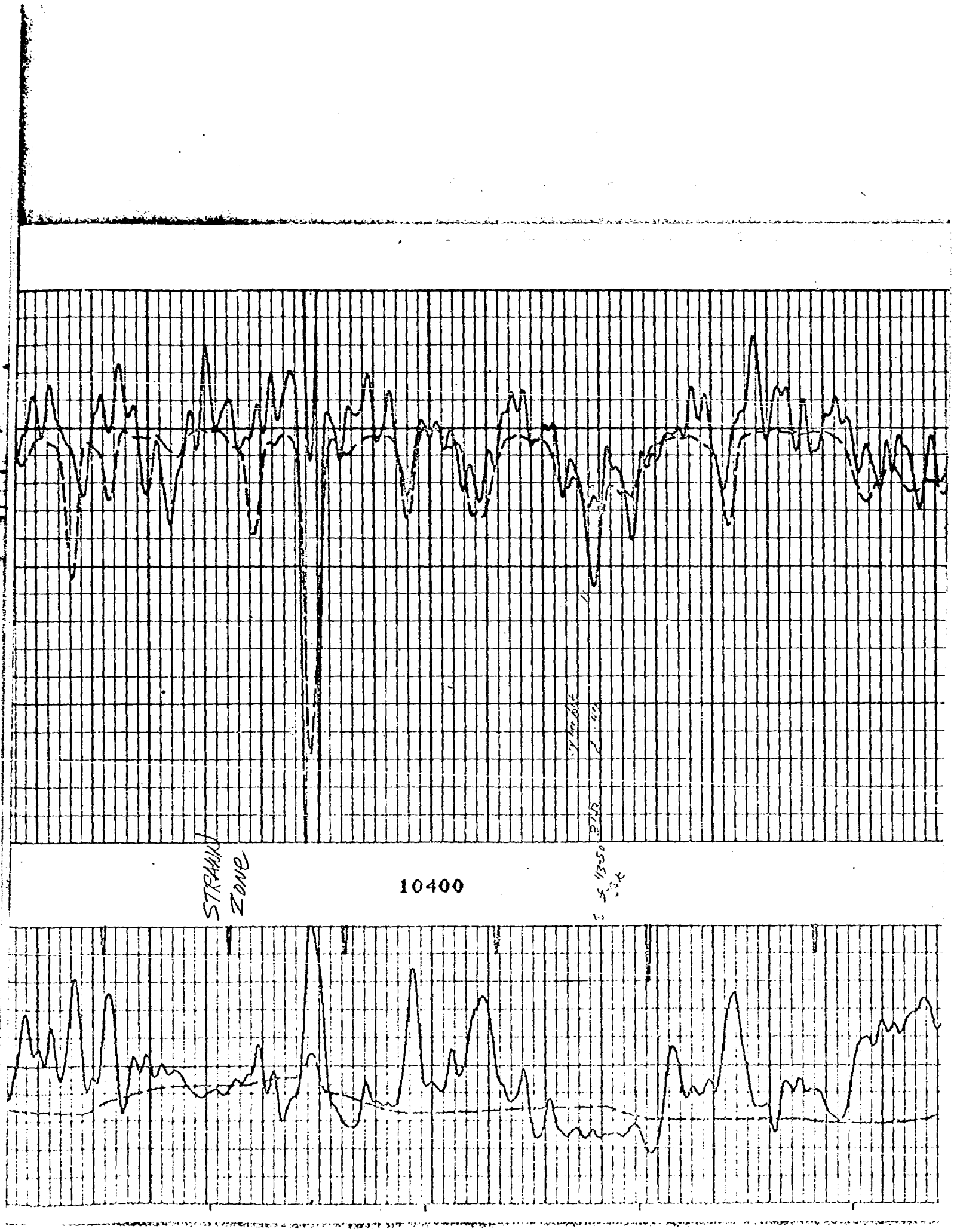
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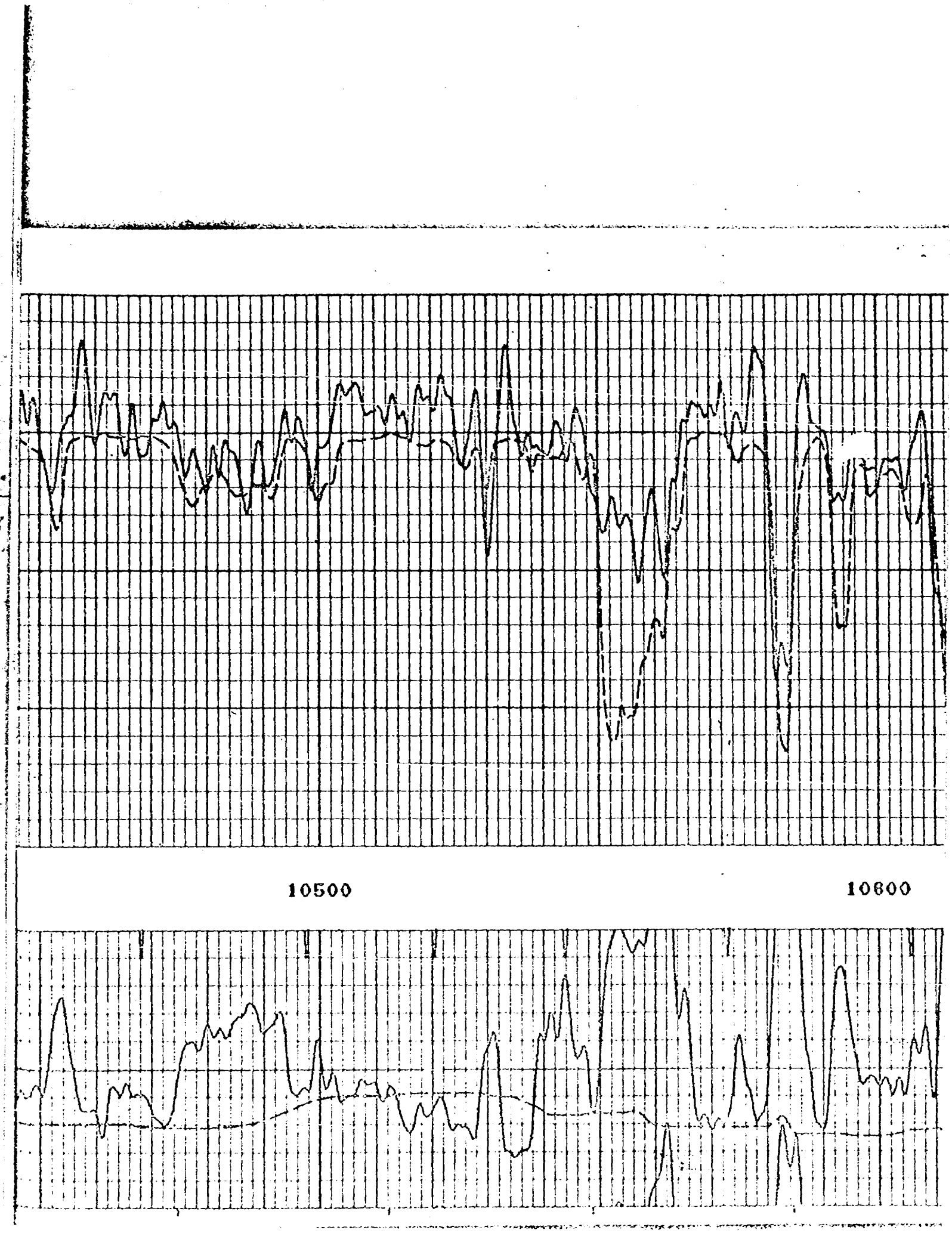
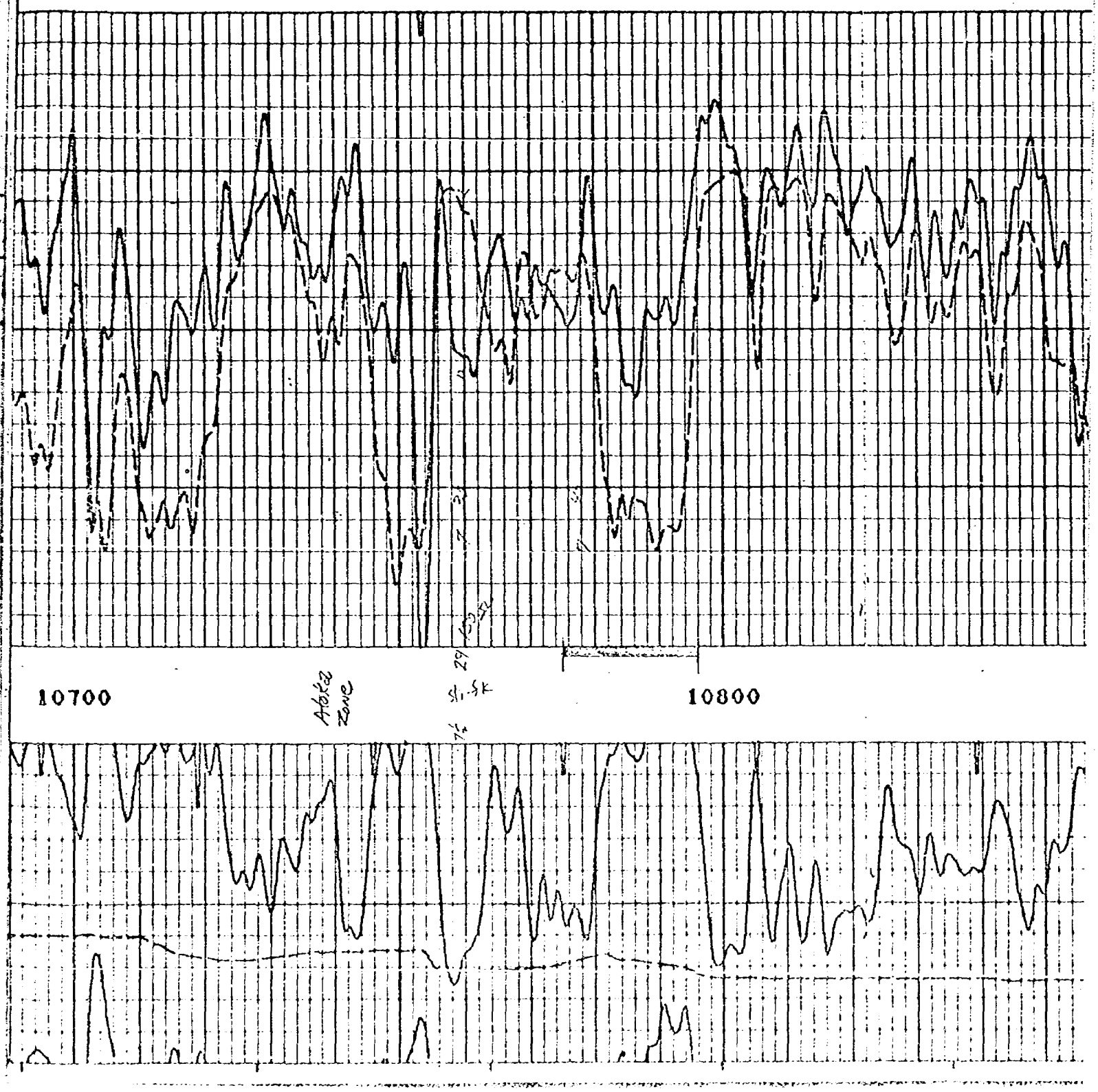
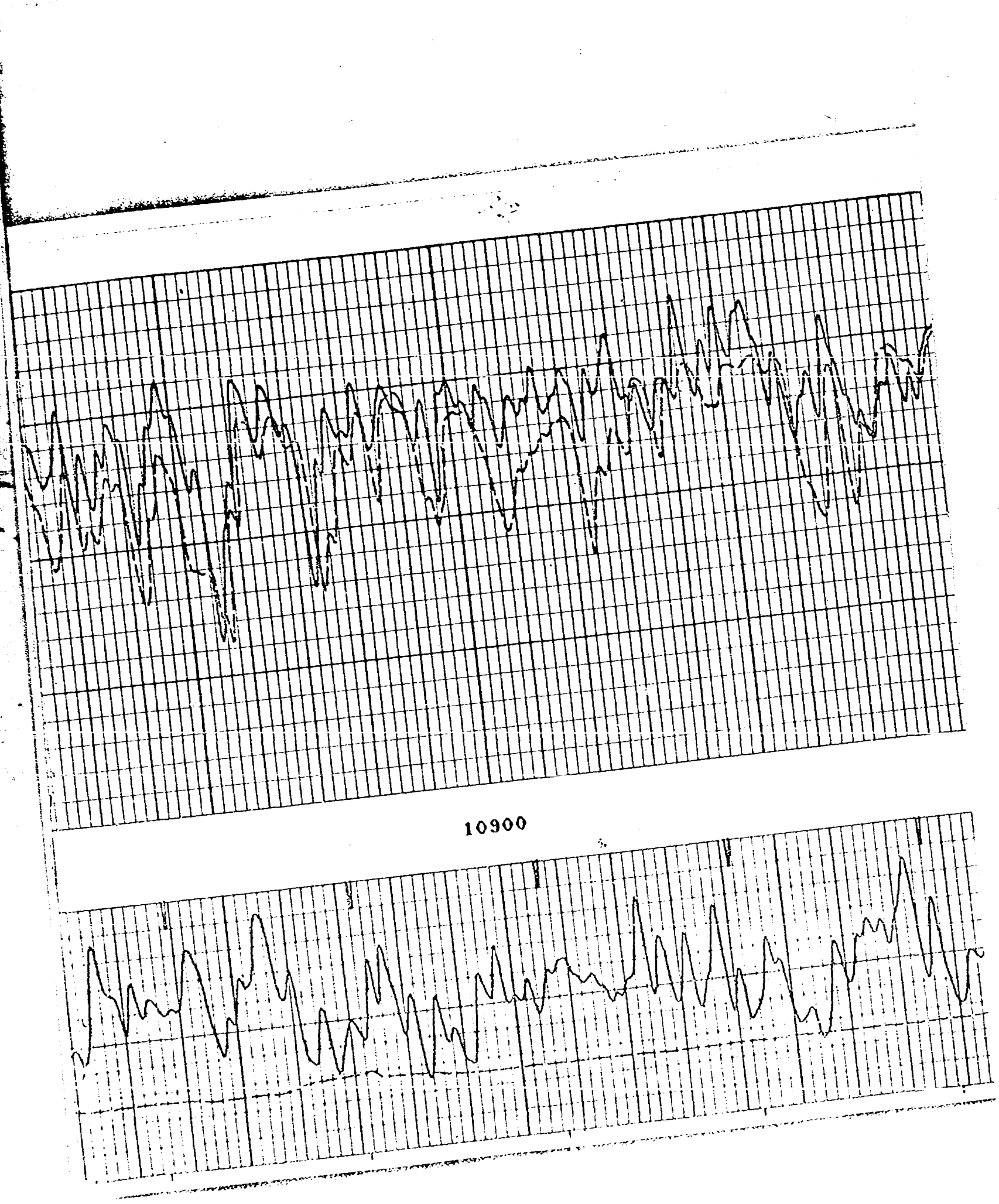
ZONE
10400


10500
10600

¢#1 Rec 21' sd & sh





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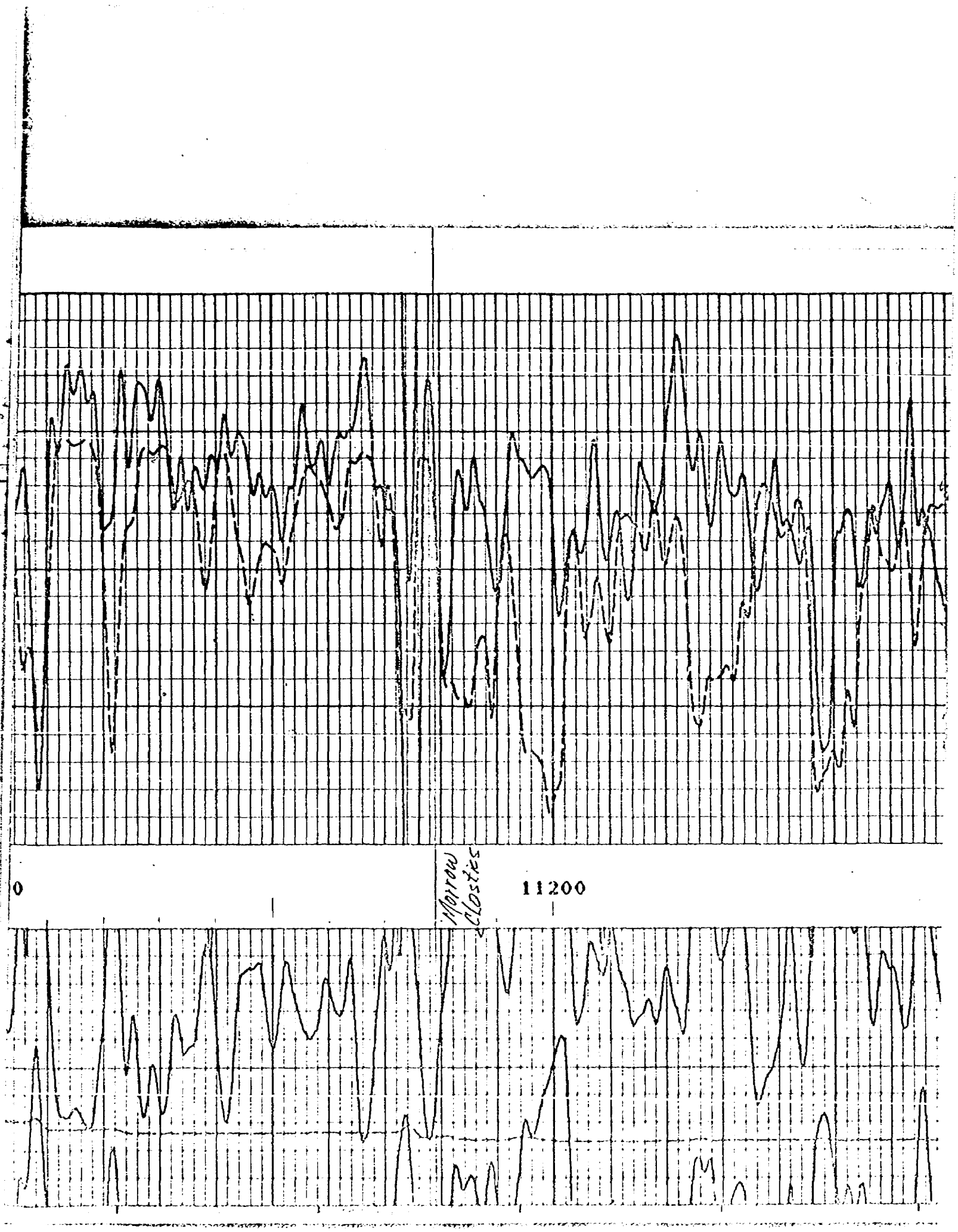
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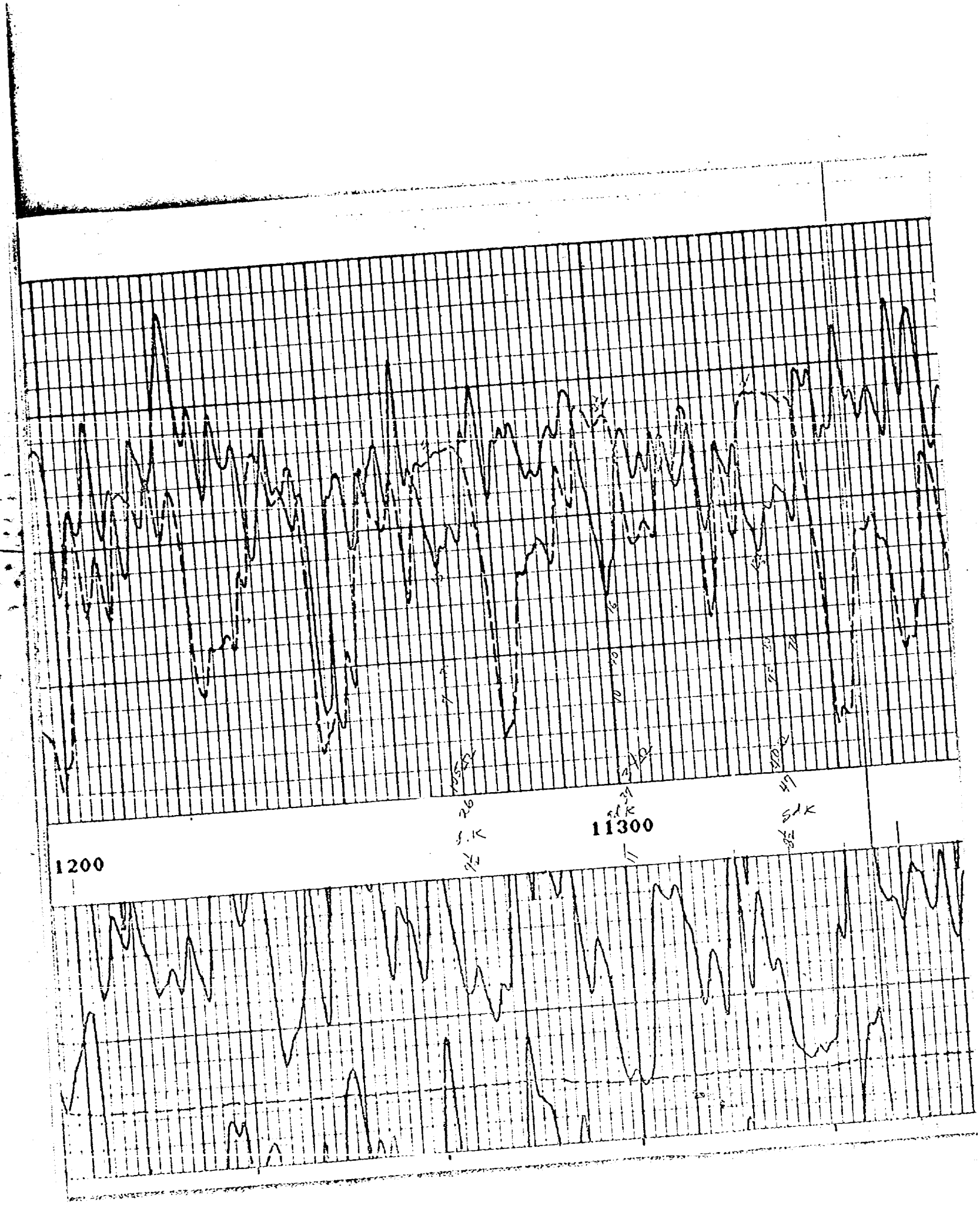
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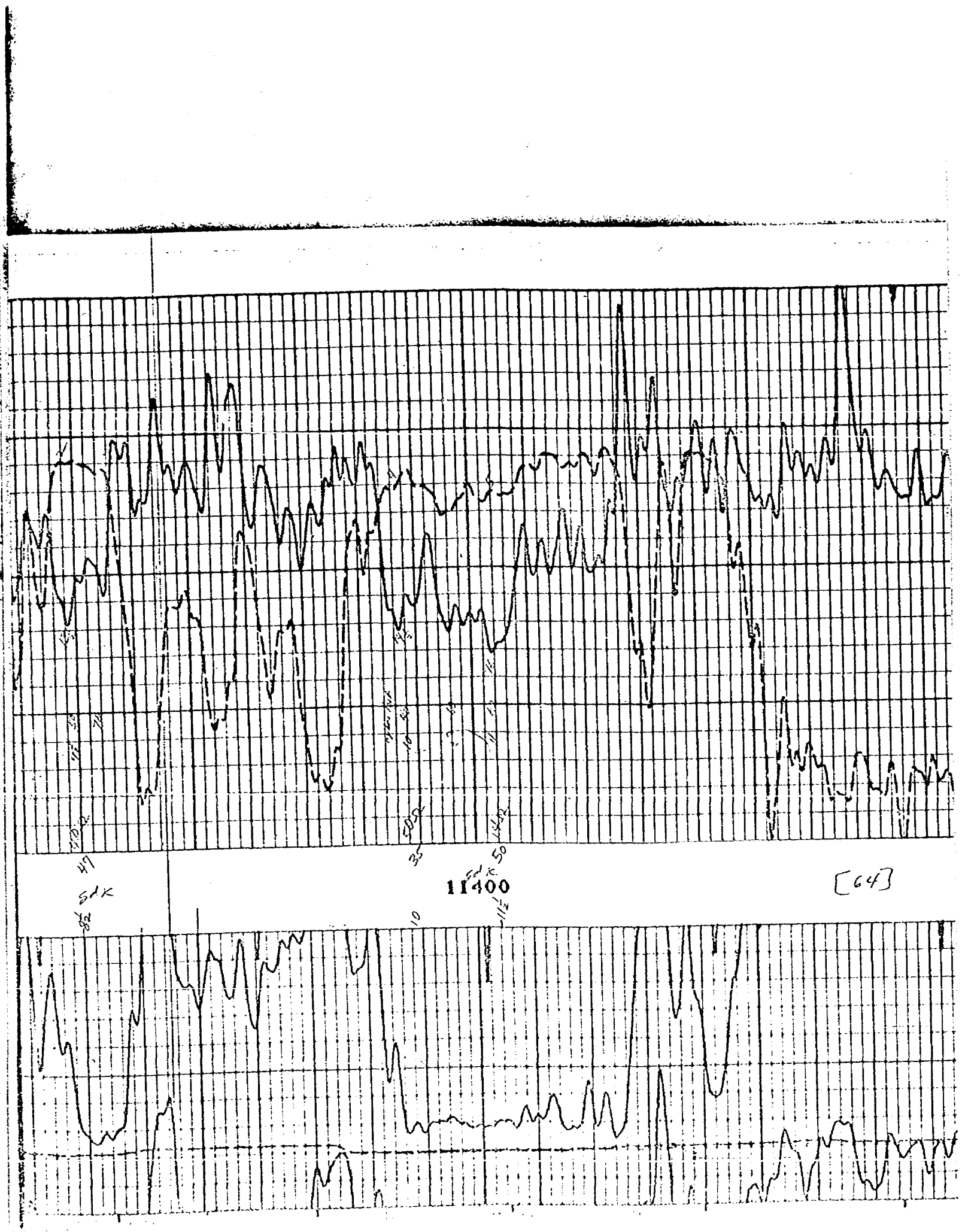
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[64]

FORM 925196 REV. 7-78

Dresser Atlas

DRESSER

Combination Logging Systems

Dual Laterolog
Micro Laterolog

R

FILE NO.

1-22-2

COMPANY SOUTHLAND ROYALTY

WELL EMPIRE FEDERAL "35" NO. 1

FIELD WILDCAT

COUNTY EDDY STATE NEW MEXICO

LOCATION: 1980' FSL & 1980' FWL

SEC 35 TWP 18-S RGE 29-E

Other Services: CDL/CN/GR, CAL

Permanent Datum GL Elev. 3433.5'

Log Measured from KB 13.5 Ft. Above Permanent Datum

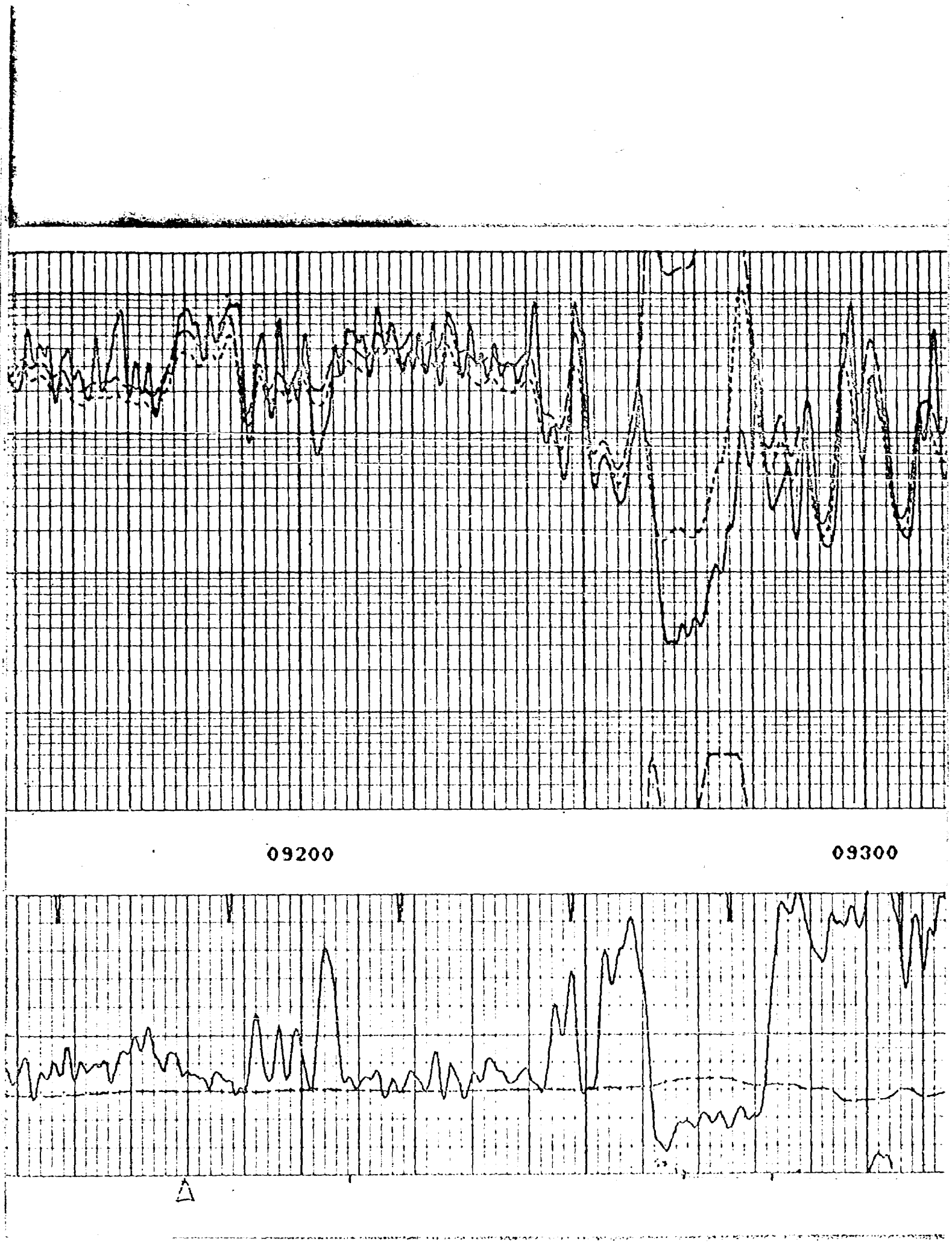
Drilling Measured from KB

Elevations: KB 3447, DF , GL 3433.5'

Date	12-19-20			
Run No.	TWO			
Service Order	50952			
Depth—Driller	11,791'			
Depth—Logger	11,796'			
Bottom Logged Interval	11,794'			
Top Logged Interval	3162'			
Casing—Driller	8 5/8 @ 3200	@	@	@
Casing—Logger	3162'			
Bit Size	7 7/8"			
Type Fluid in Hole	BGEL/DRISPAC/LOIB/KCl			
Density and Viscosity	10.9 | 45			
pH and Fluid Loss	9.5 | 5.2 cc	cc	cc	cc
Source of Sample				
Rm @ Meas. Temp.	.061 @ 60 °F	@ °F	@ °F	@ °F
Rmf @ Meas. Temp	.054 @ 60 °F	@ °F	@ °F	@ °F
Rmc @ Meas. Temp.	NA @ NA °F	@ °F	@ °F	@ °F
Source of Rmf and Rmc	M | —			
Rm @ BHT	.025 @ 160 °F	@ °F	@ °F	@ °F
Time Since Circ.	15 HRS			
Max. Rec. Temp. Deg. F	160 °F	°F	°F	°F
Equip. No. and Location	4937 5 HOBBS			
Recorded By	MCLEROY/CLEMENTS			
Witnessed By	PARSON			

FIELD PRINT

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 5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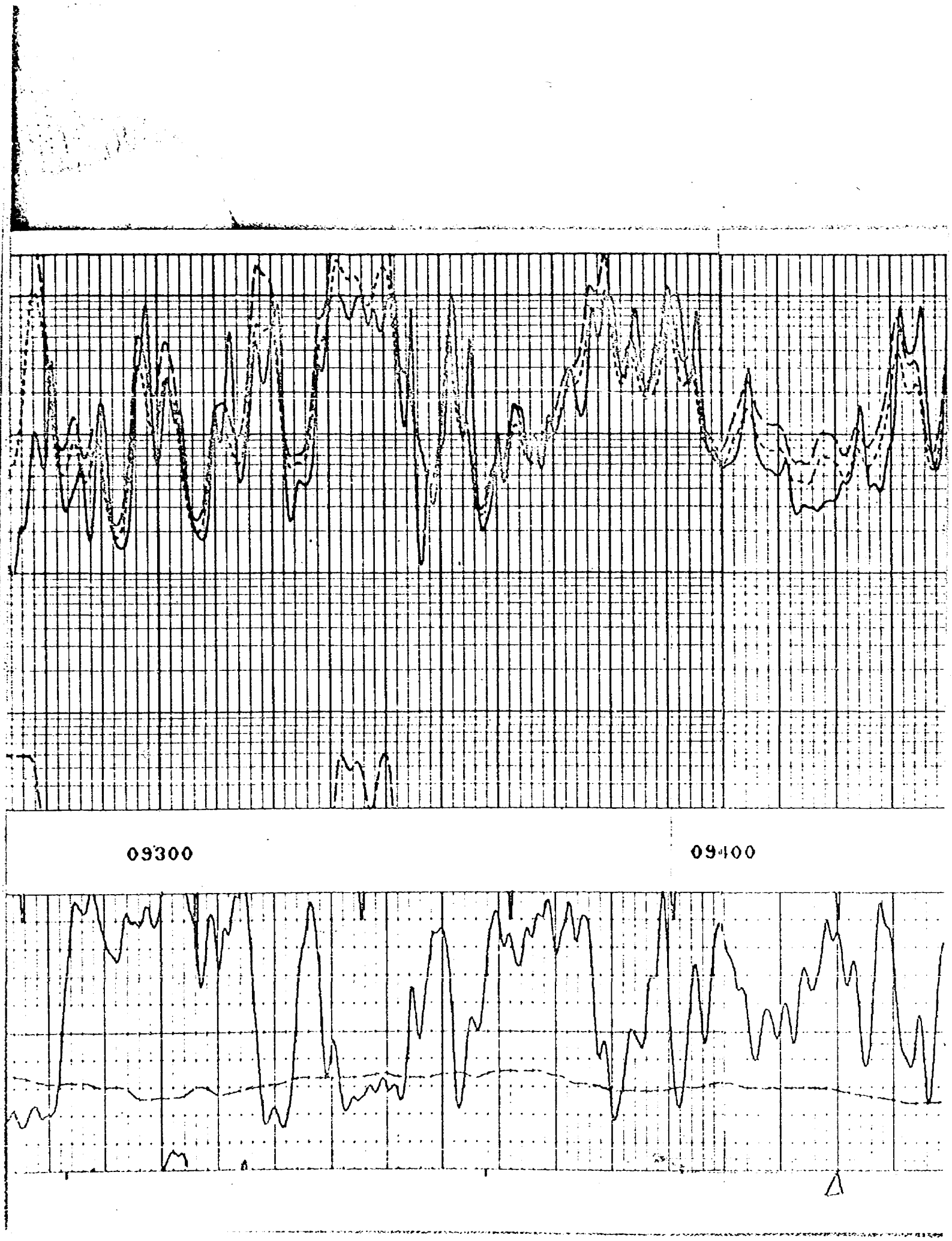
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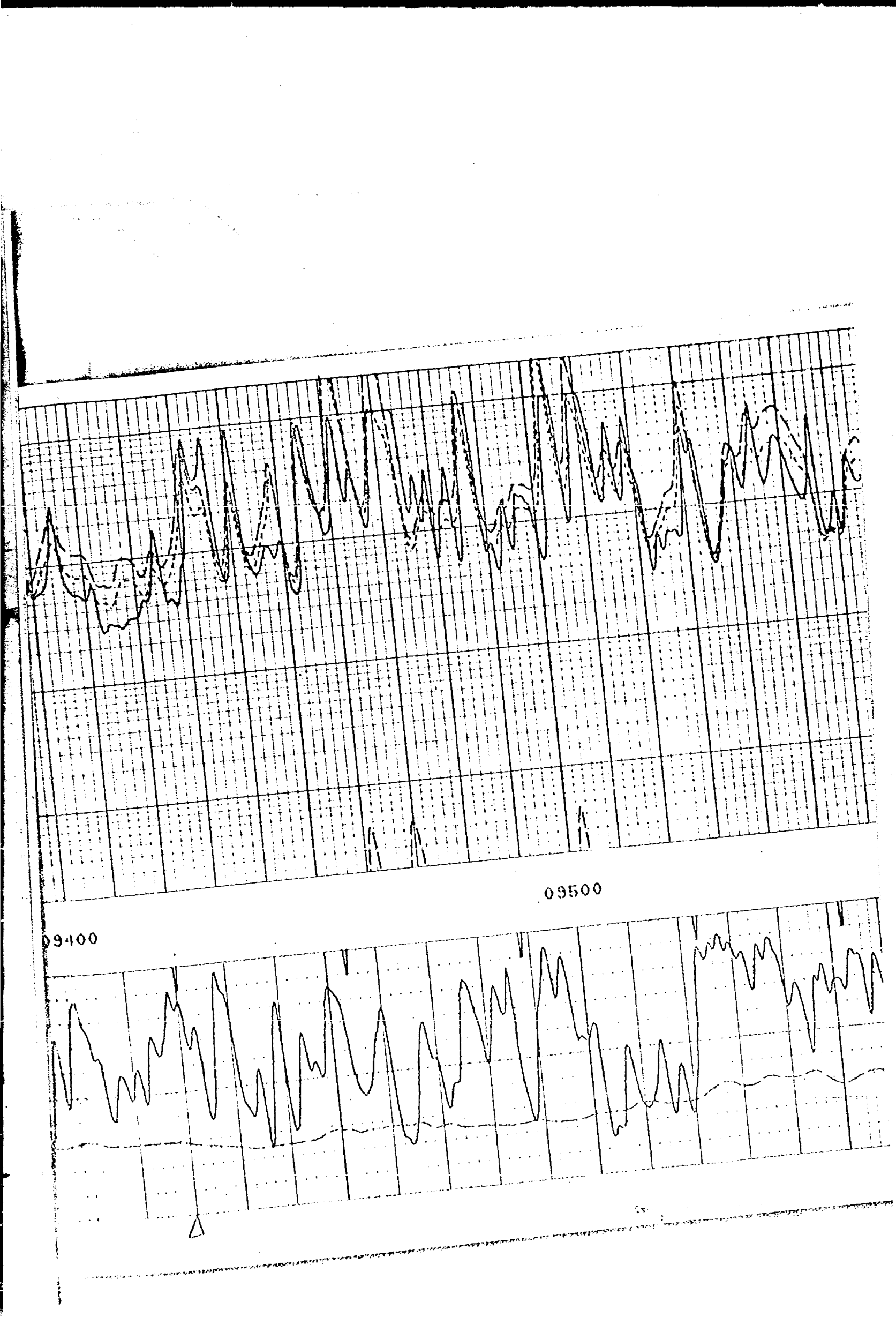
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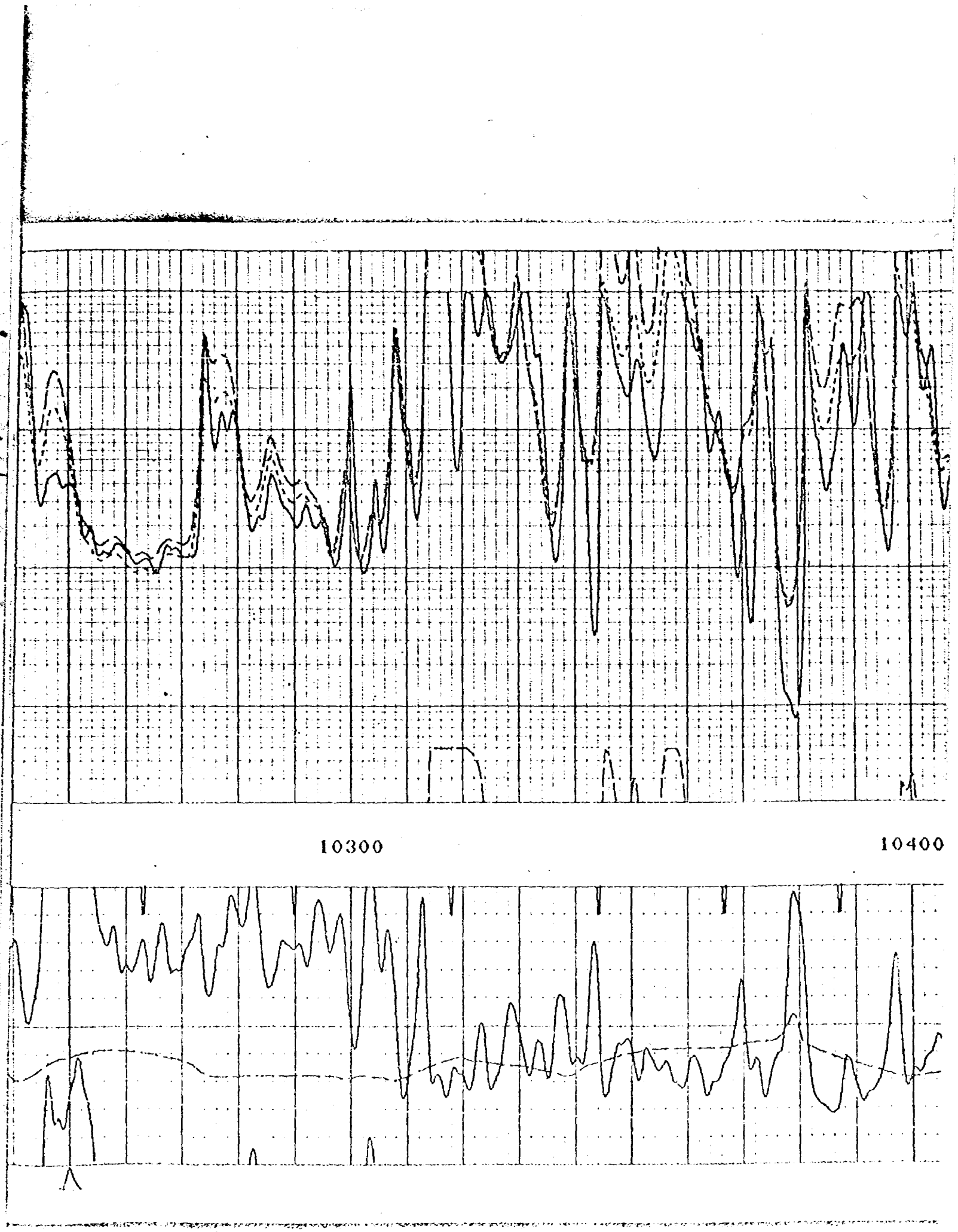
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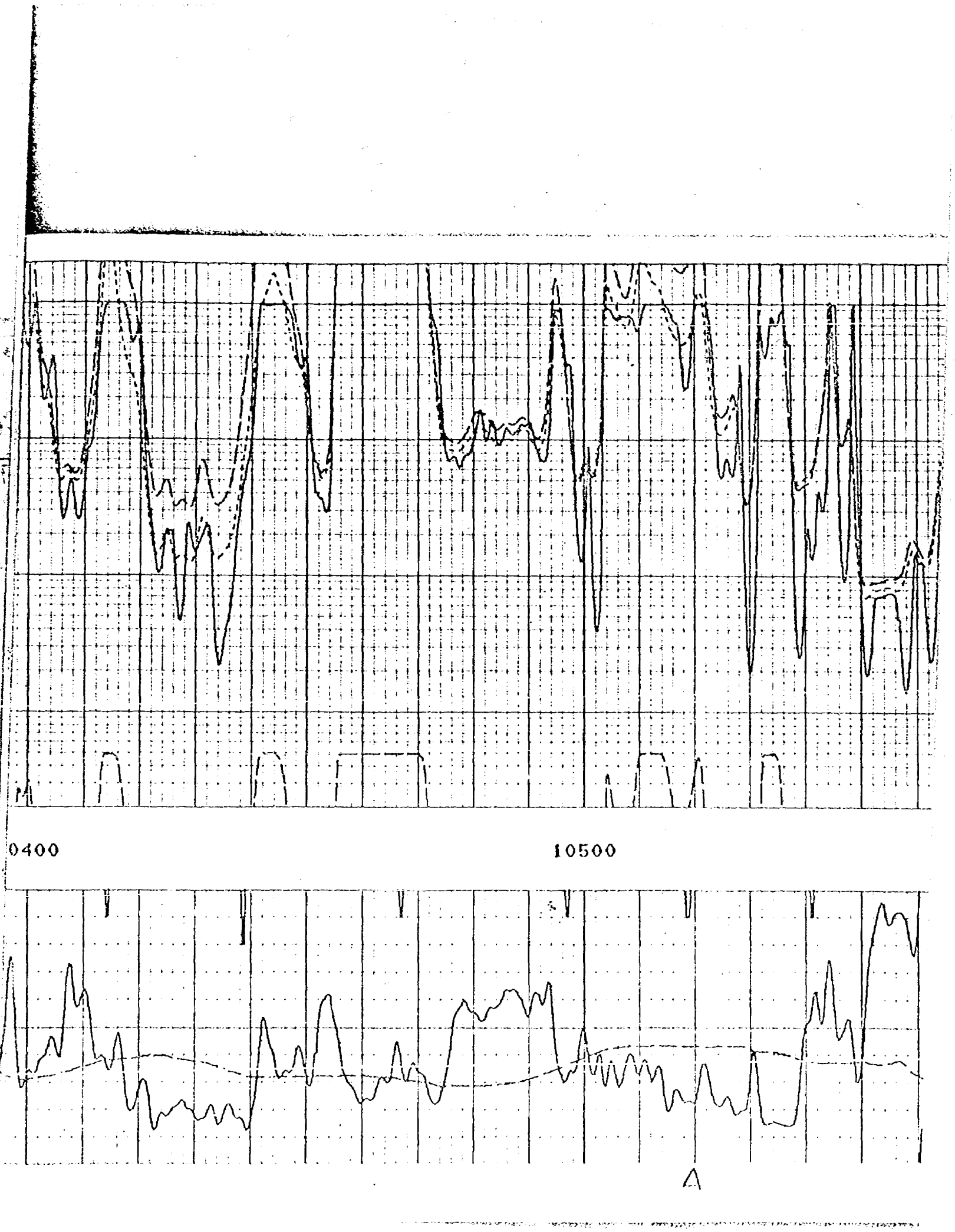
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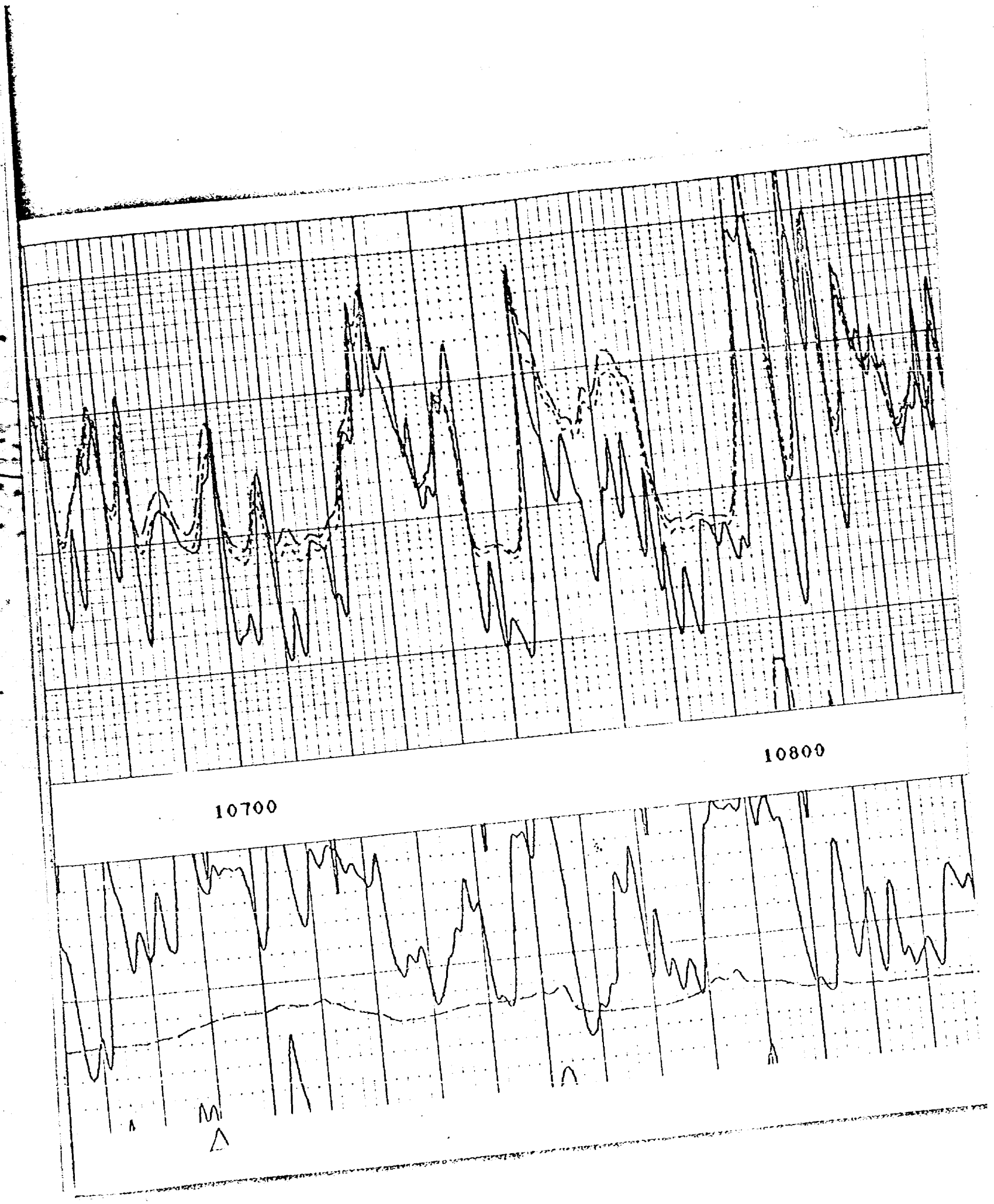
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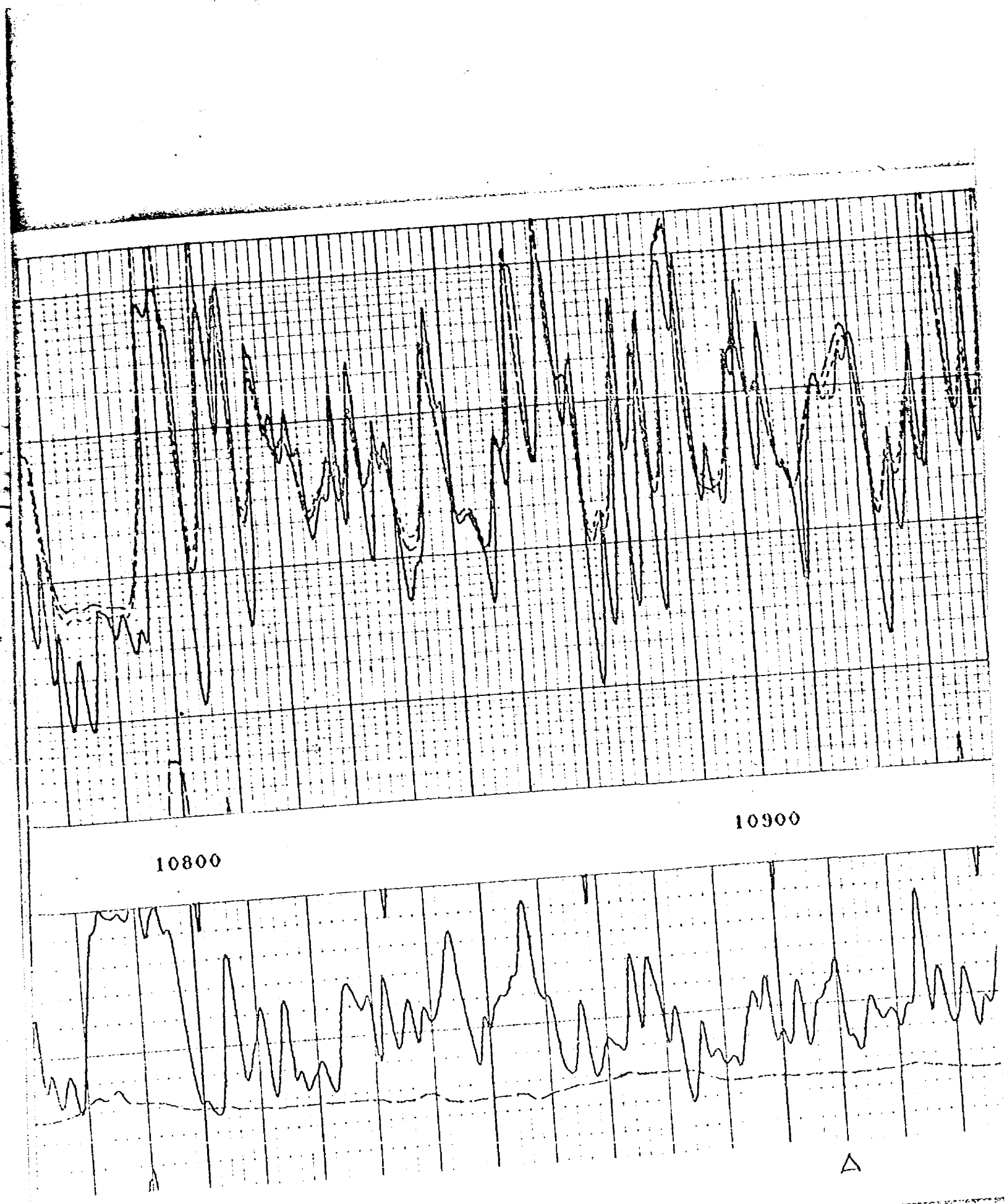
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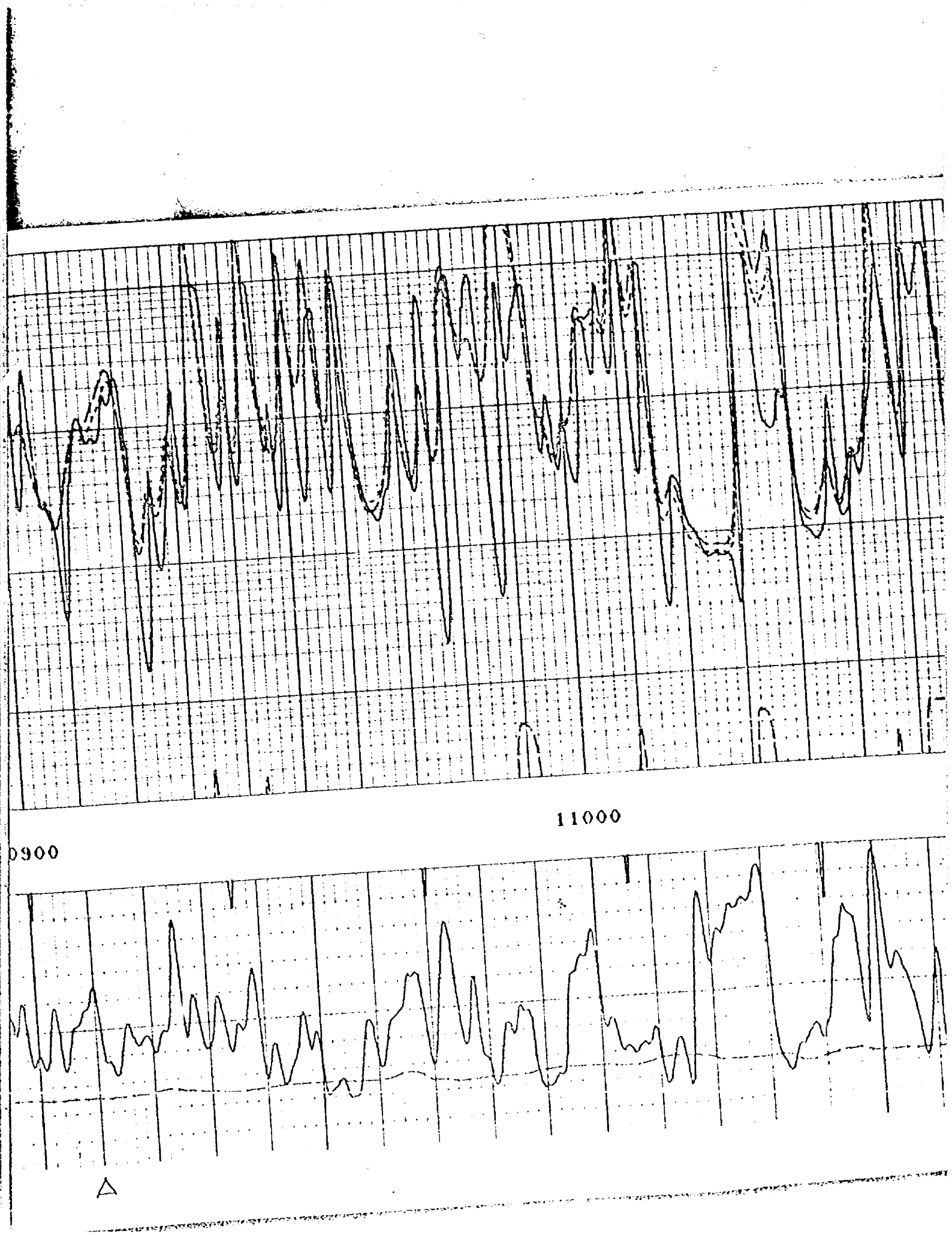
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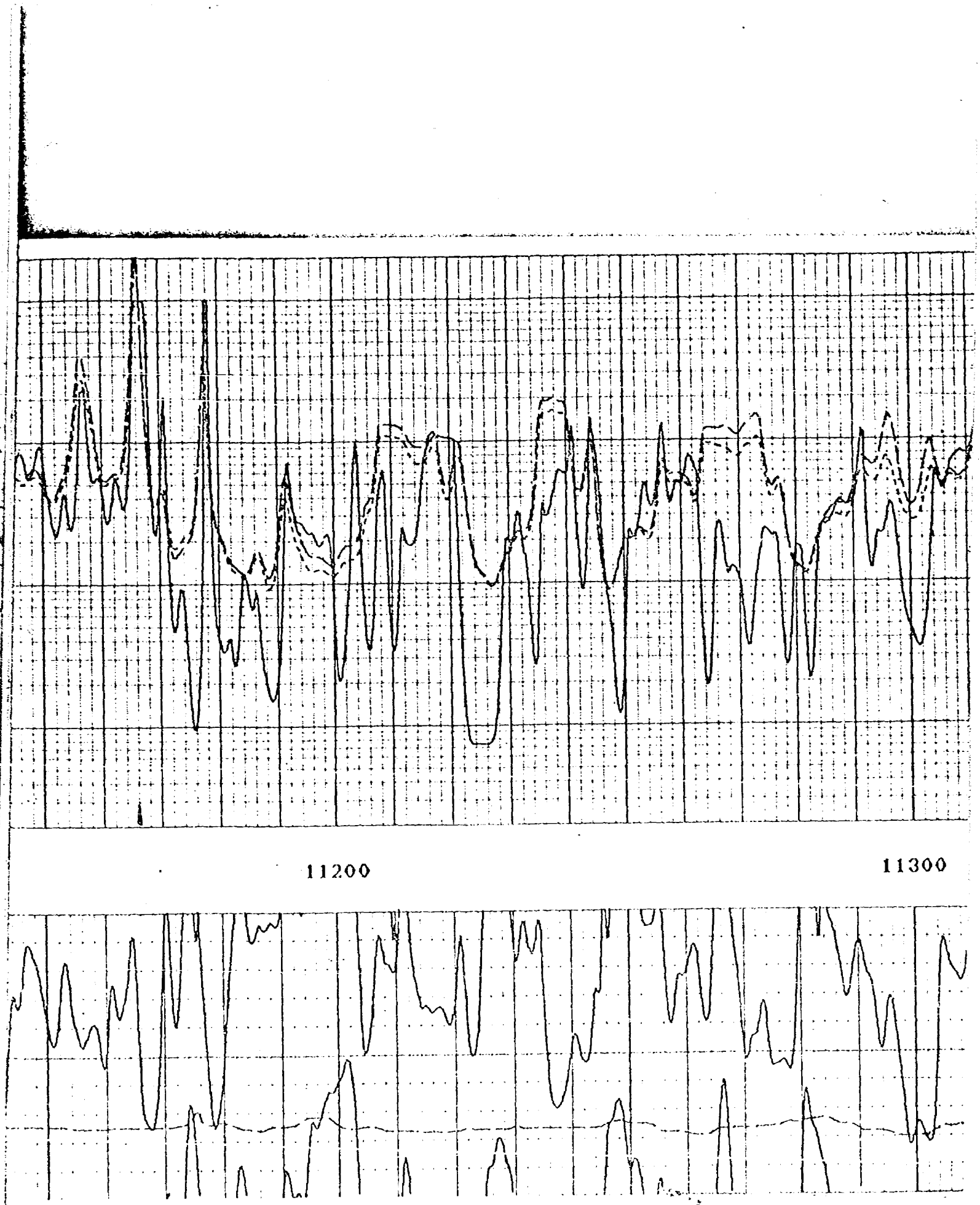
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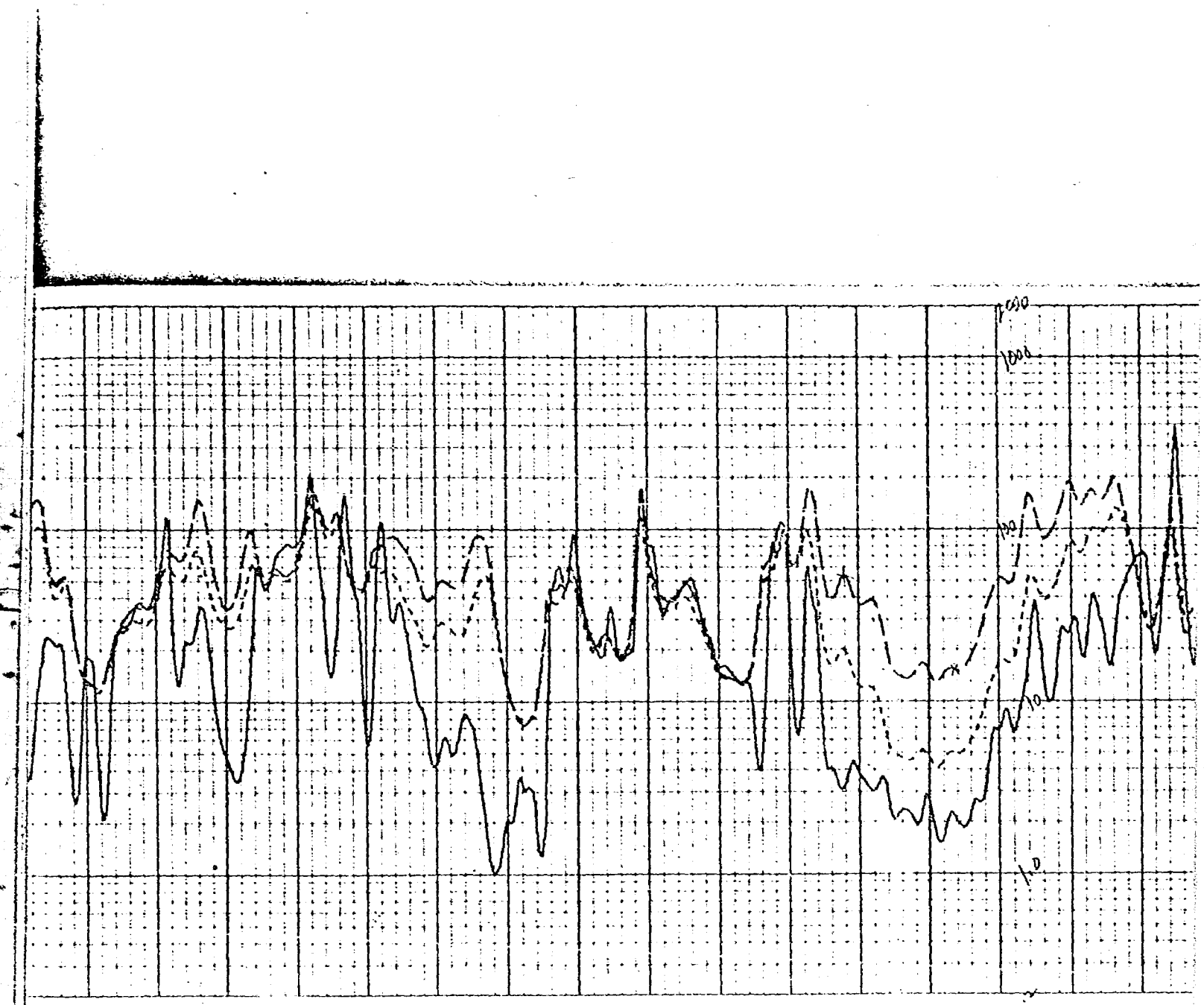

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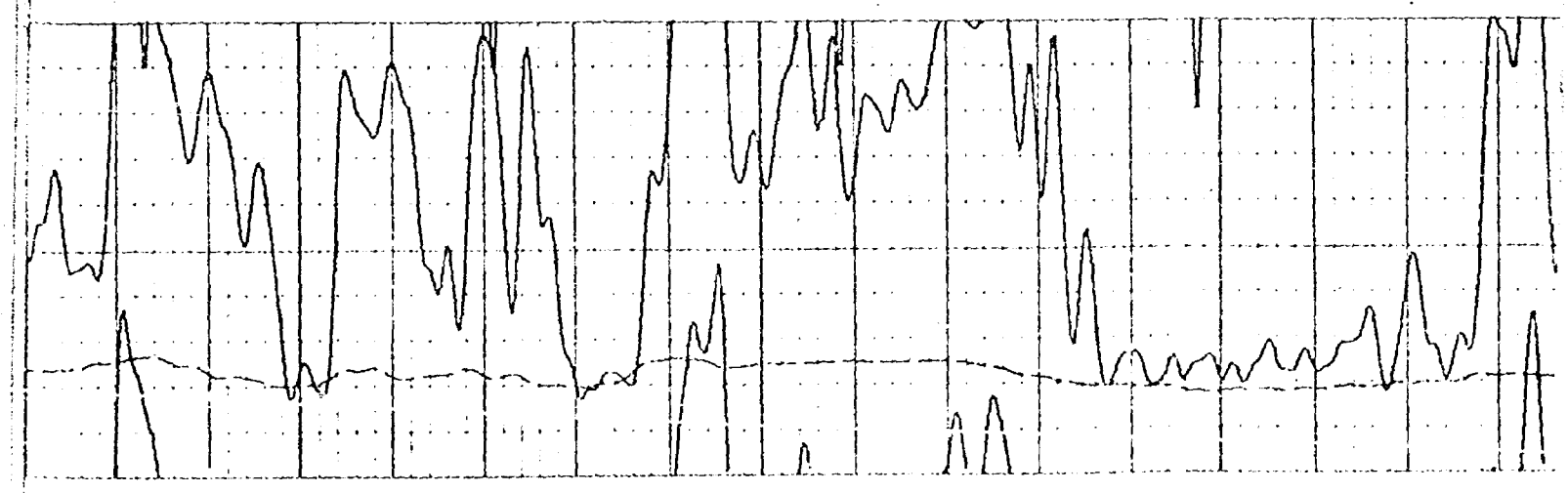

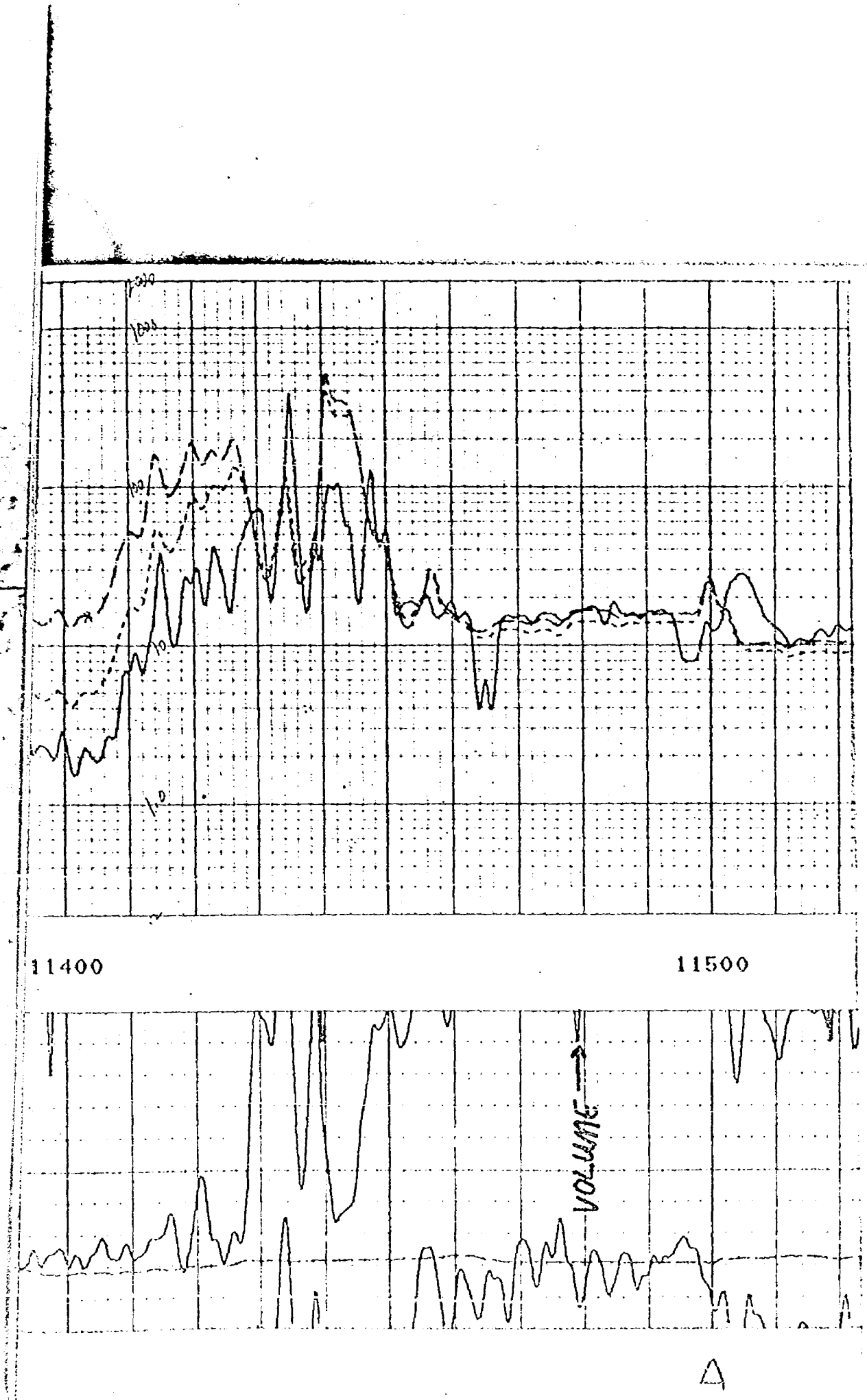
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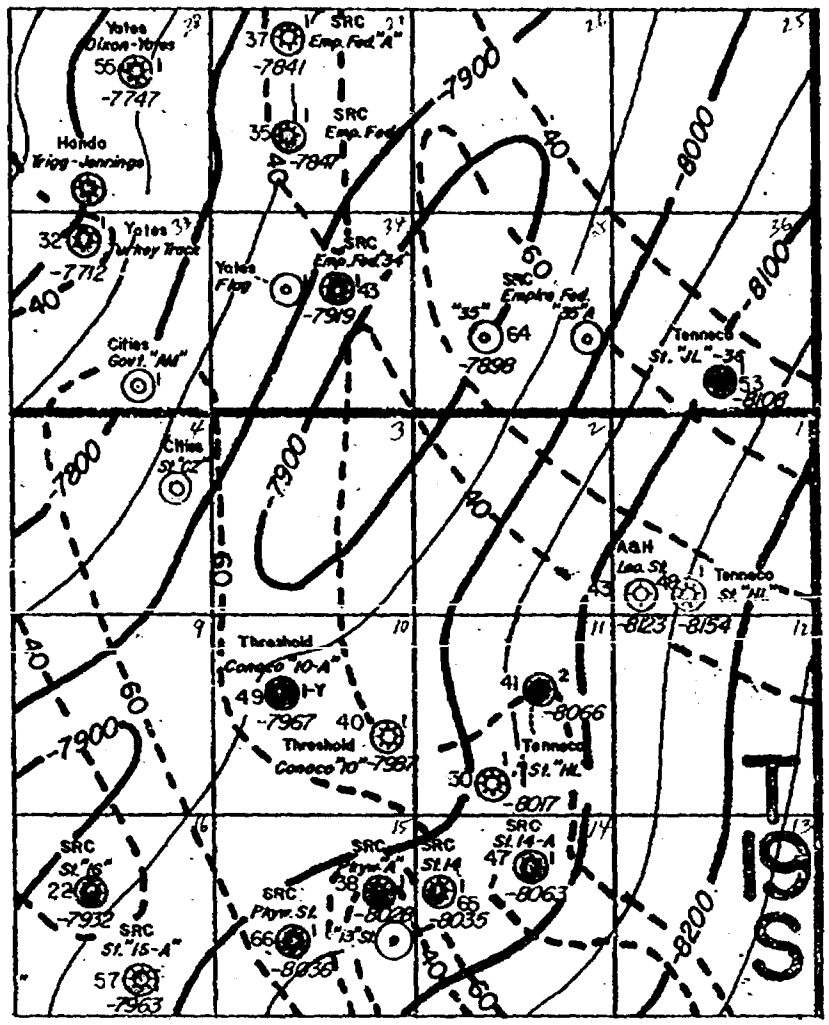


R-29-E

Morrow Penetration

64 ---Feet of Clean (50 API) Morrow Sand in Well

-7898 -----Subsea Depth of Lower Morrow

----- Morrow Gas Well

-7800 Structural Contours of Lower Morrow 50 ft. C.I.

60 Isoliths of Total Clean (50 API) Morrow Sand

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 3

Field Work

FORM 925260 REV.

DresserAtlas

DRESSER

Combination Logging Systems

Compensated **Densilog**

Compensated **Neutron**

FILE NO.

COMPANY SOUTHLAND ROYALTY CO.

WELL EMPIRE FEDERAL "35" NO.1

FIELD WILDCAT

COUNTY EDDY STATE NEW MEXIC

LOCATION: 1980FSL & 1980 FWL

SEC 35 TWP 18-S RGE 29-E

Other Service
DLL/MLL/G
CAL

Permanent Datum GL Elev. 3433.5'

Log Measured from KB Ft. Above Permanent Datum

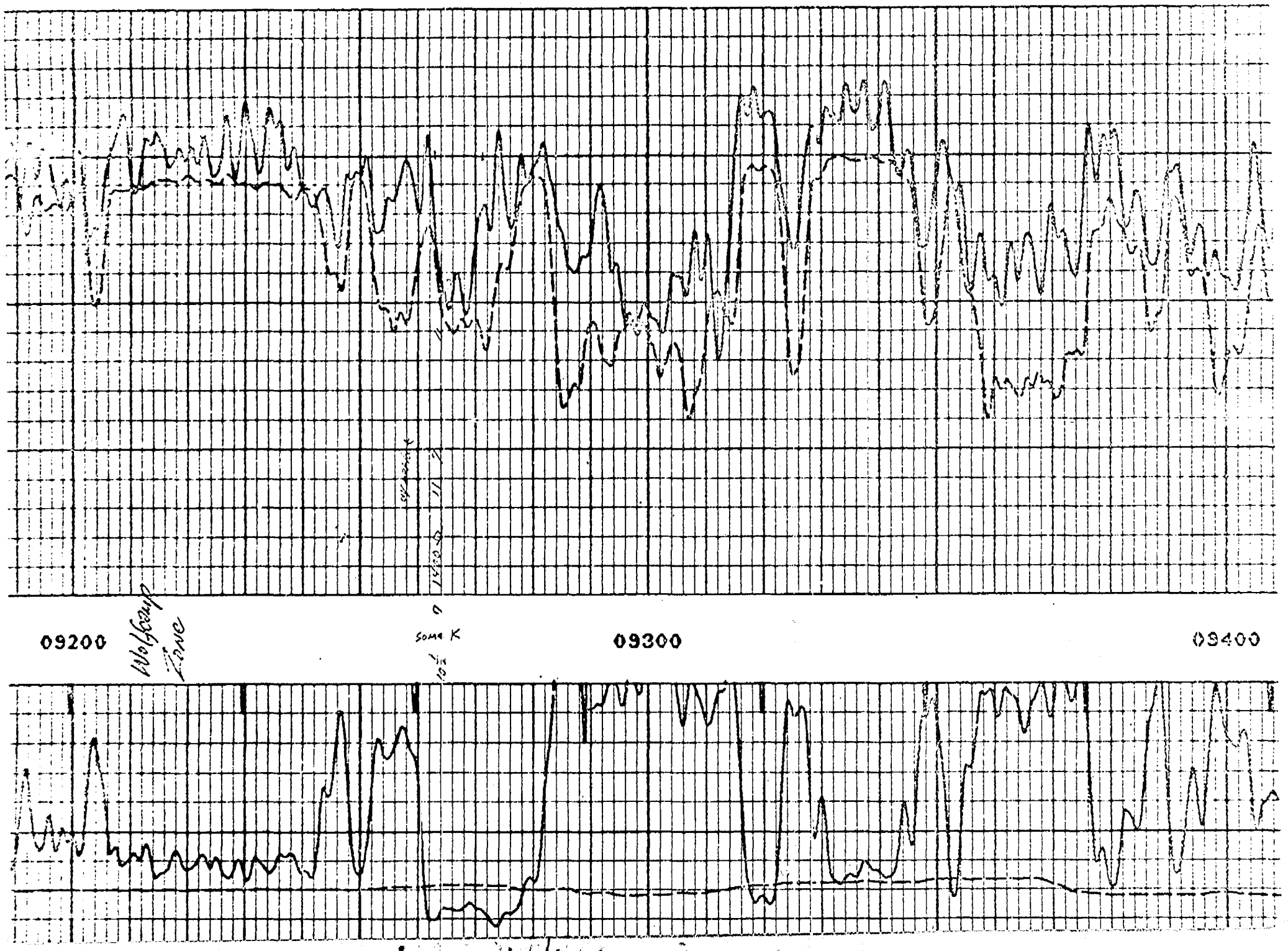
Drilling Measured from KB

Elevations
KB 3447'
DF
GL 3433.5

Date	12-19-80			
Run No.	TWO			
Service Order	50952			
Depth—Driller	11,791'			
Depth—Logger	11,796'			
Bottom Logged Interval	11,799'			
Top Logged Interval	3162'			
Casing—Driller	8 5/8" @ 3200'	@	@	@
Casing—Logger	3162'			
Bit Size	7 7/8"			
Type Fluid in Hole	BGEL/DRISPAC/LOIDKCL			
Density and Viscosity	10.9 45			
pH and Fluid Loss	9.5 5.2 cc	cc	cc	
Source of Sample				
Rm @ Meas. Temp.	.067 @ 60 °F	@ °F	@ °F	@
Rmf @ Meas. Temp.	.054 @ 60 °F	@ °F	@ °F	@
Rmc @ Meas. Temp.	.09 @ 60 °F	@ °F	@ °F	@
Source of Rmf and Rmc	M —			
Rm @ BHT	.025 @ 160 °F	@ °F	@ °F	@
Time Since Circ.	8 HRS.			
Max. Rec. Temp. Deg. F.	160 °F	°F	°F	
Equip. No. and Location	11935 HOBBS			
Recorded By	MCELROY/CLEMENTS			
Witnessed By	PARSONS			

FILED

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 4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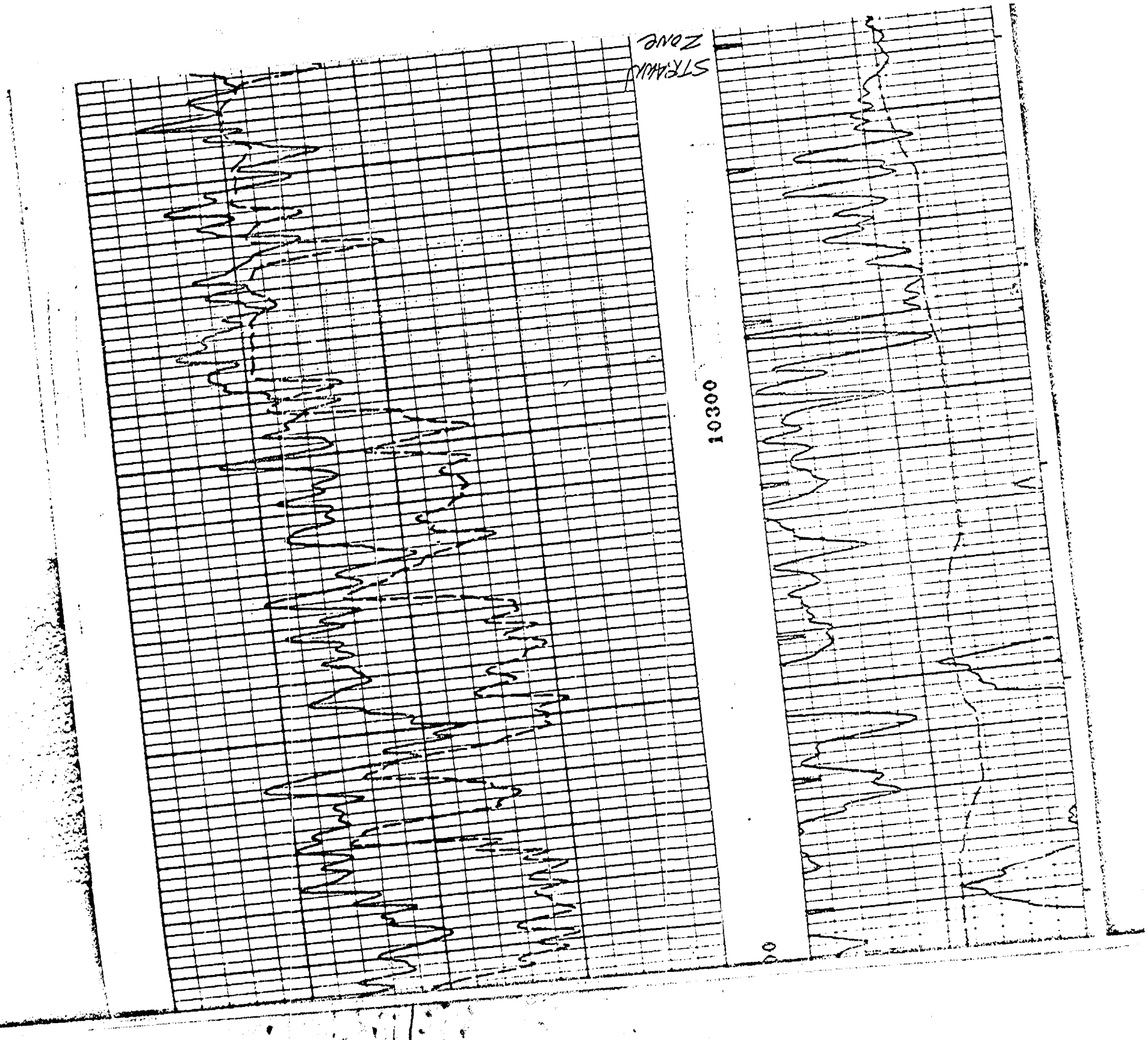
Wolfgang Lane
some K
09300
09400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ZONE
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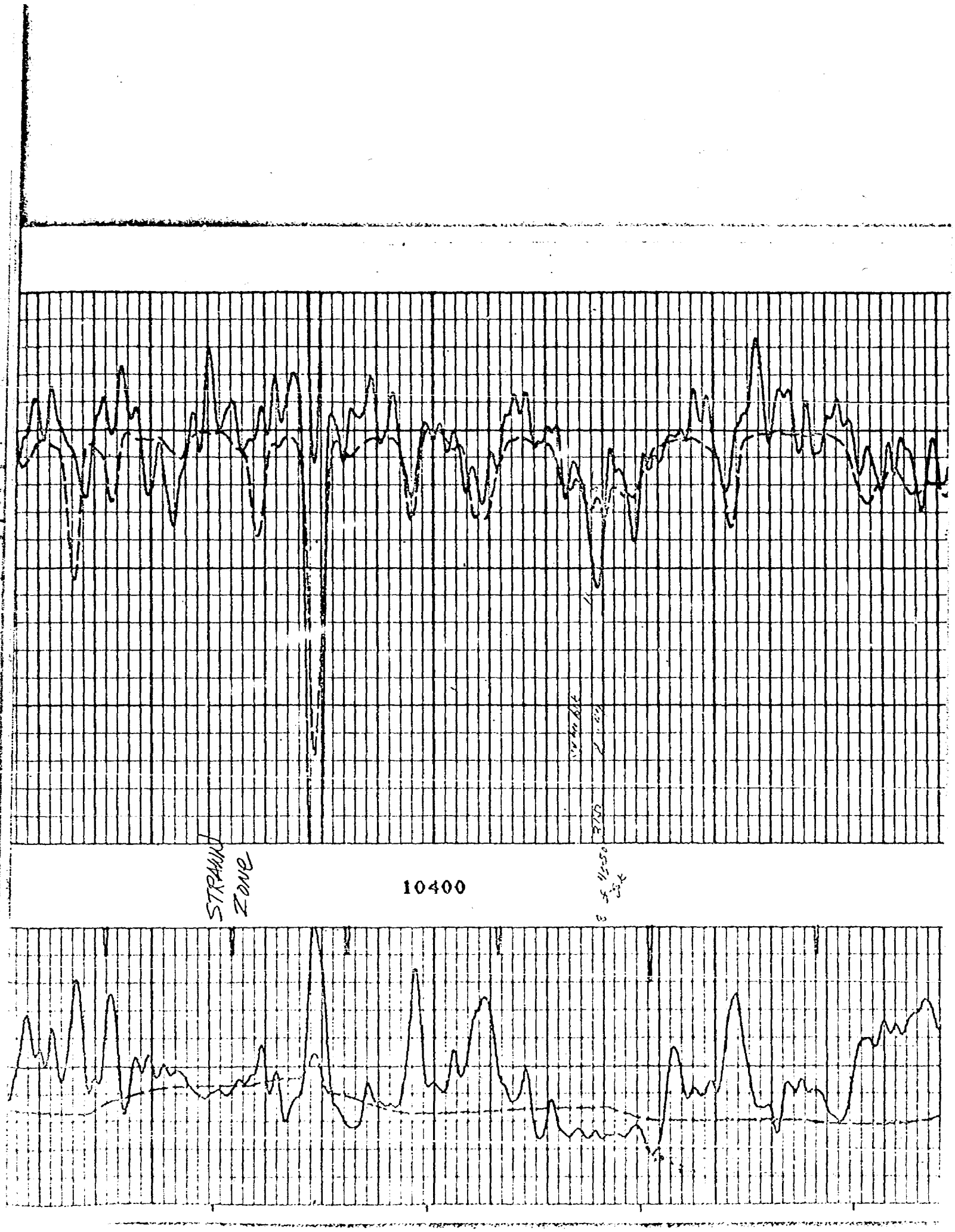
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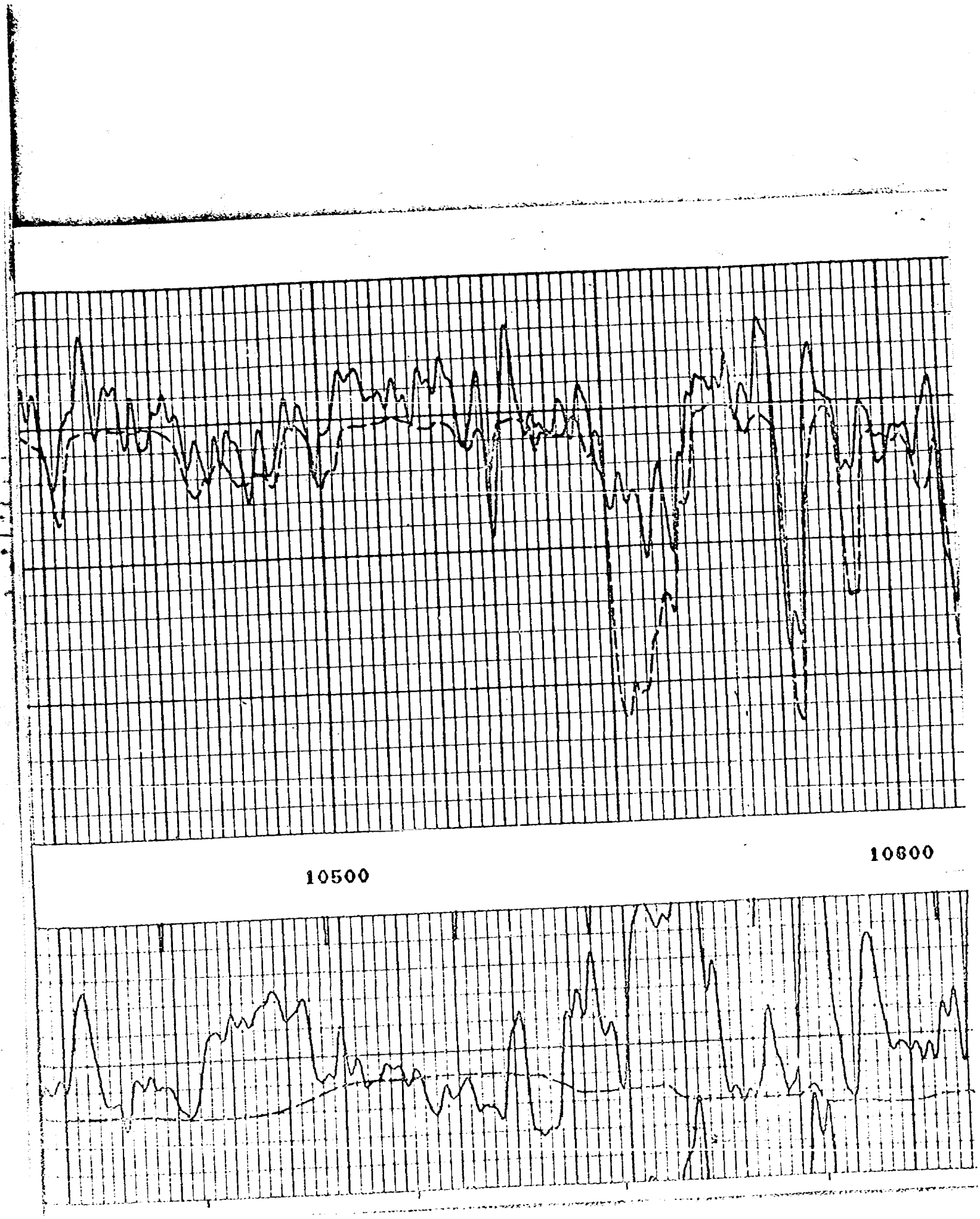
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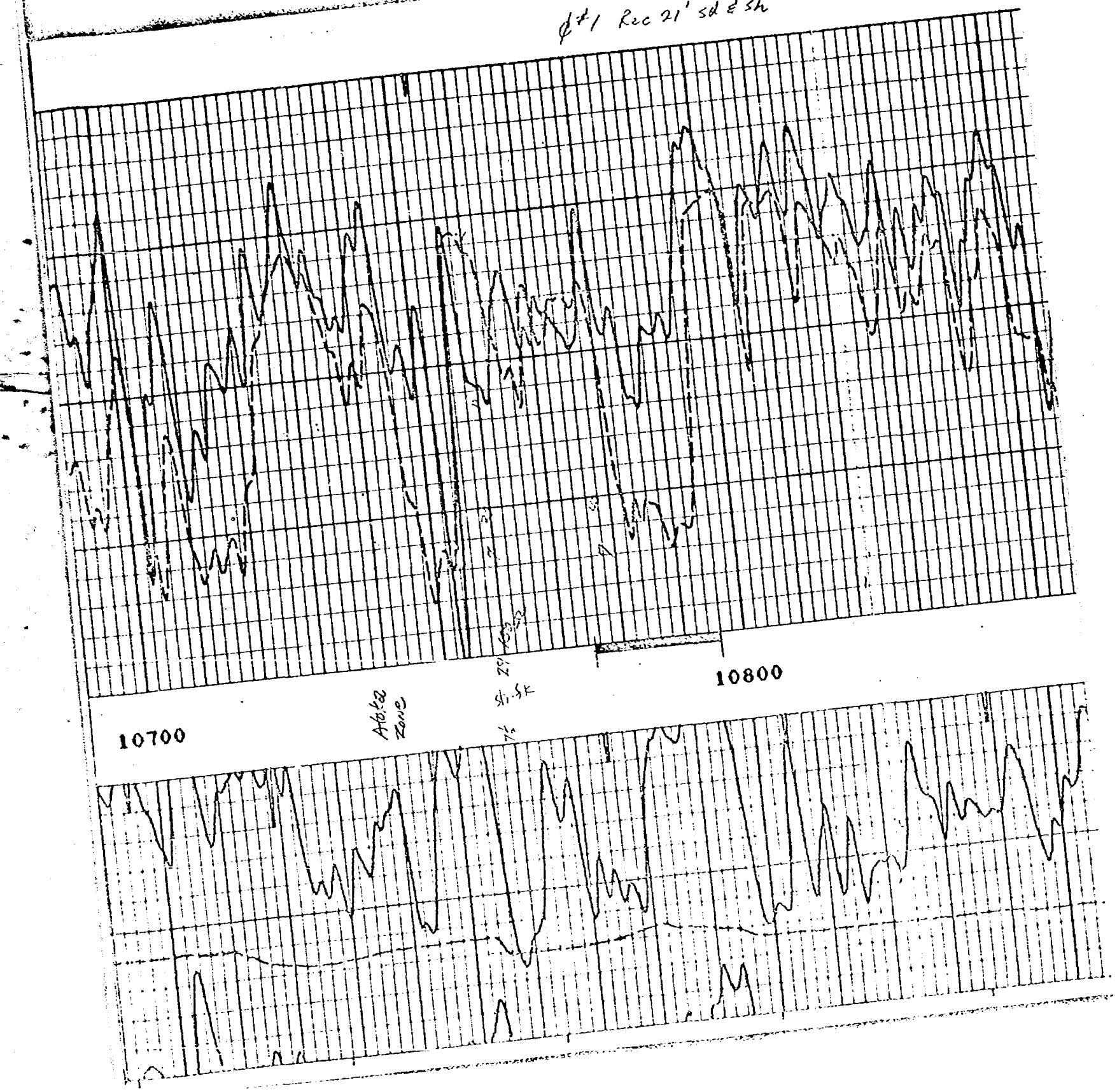
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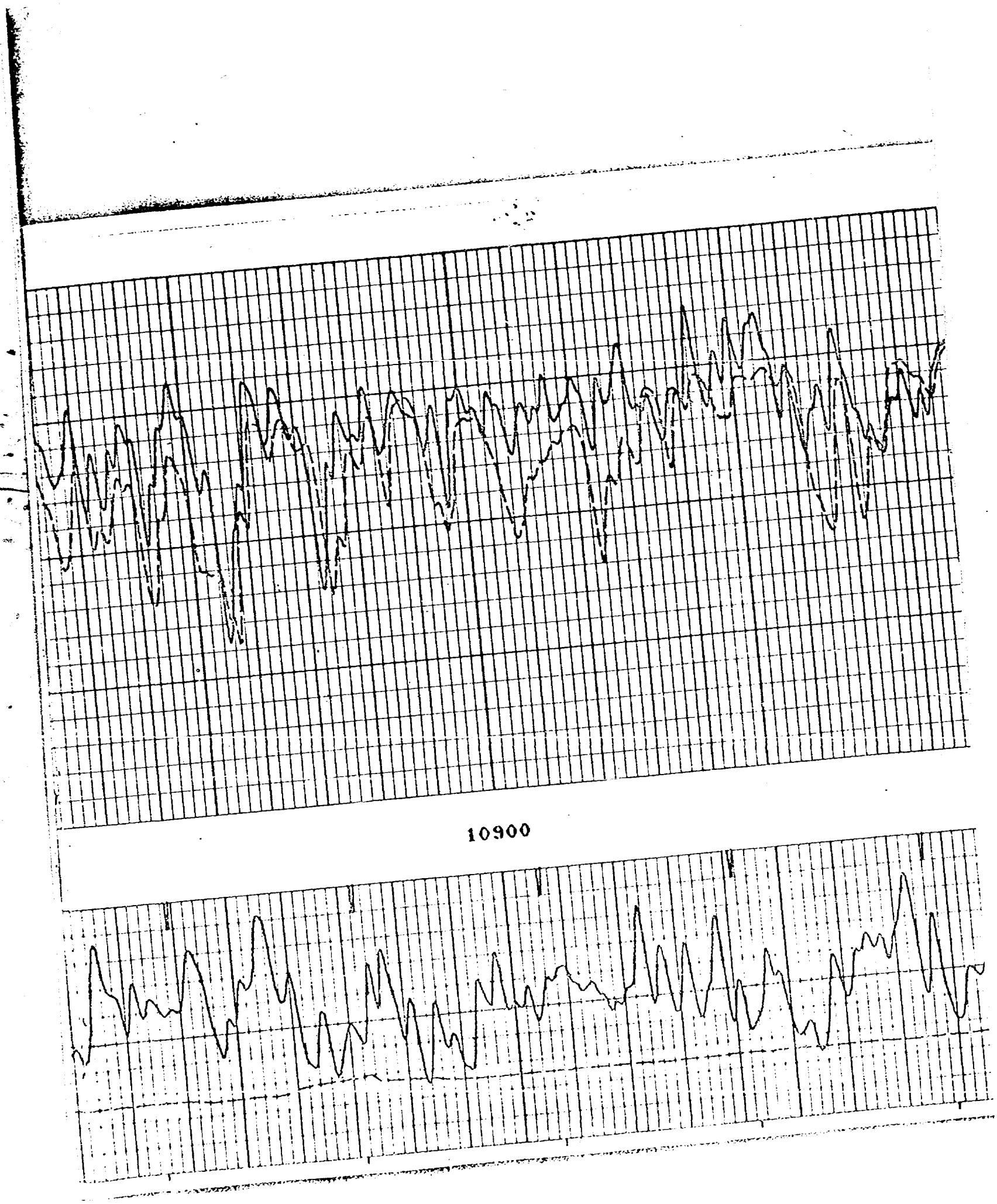

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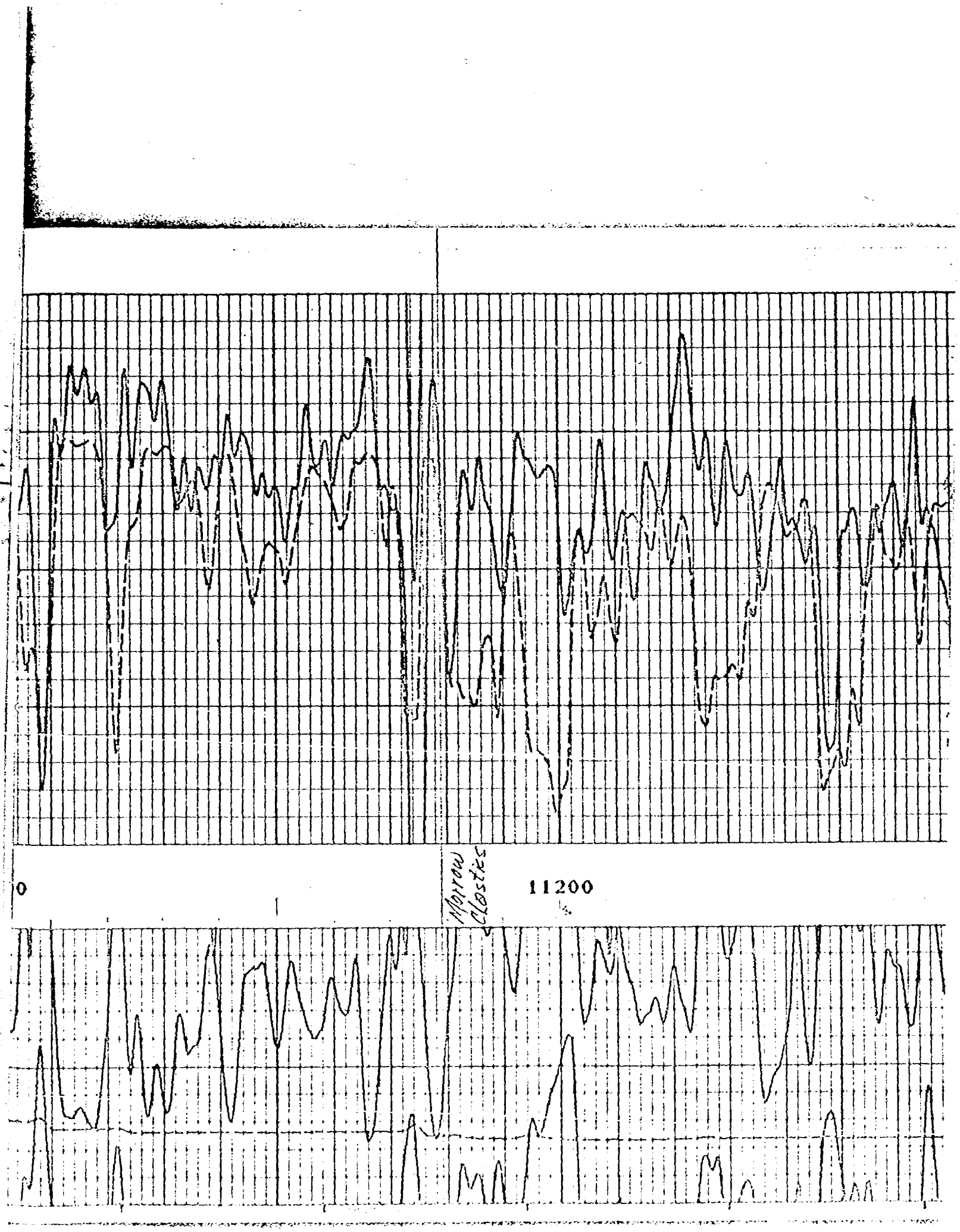
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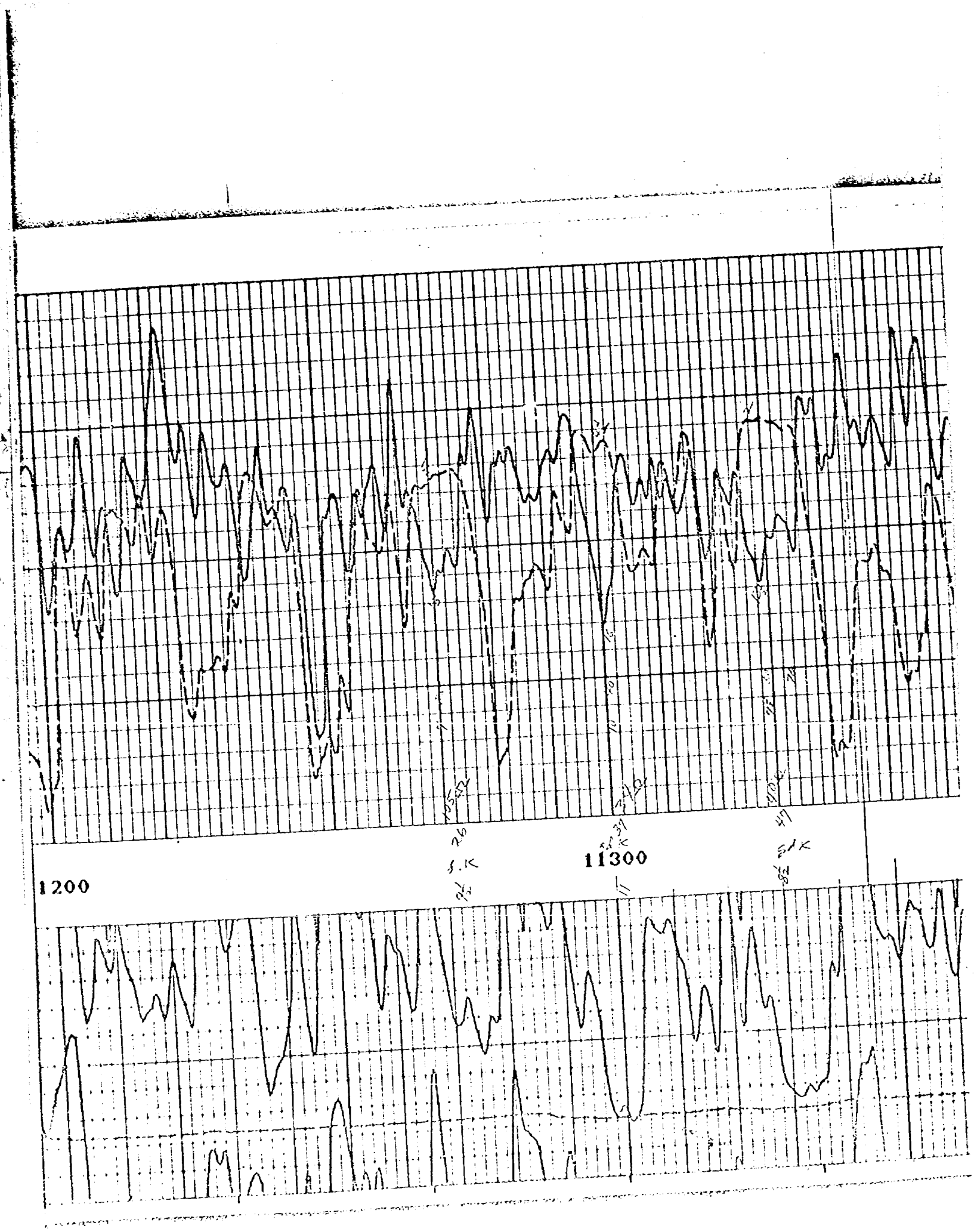
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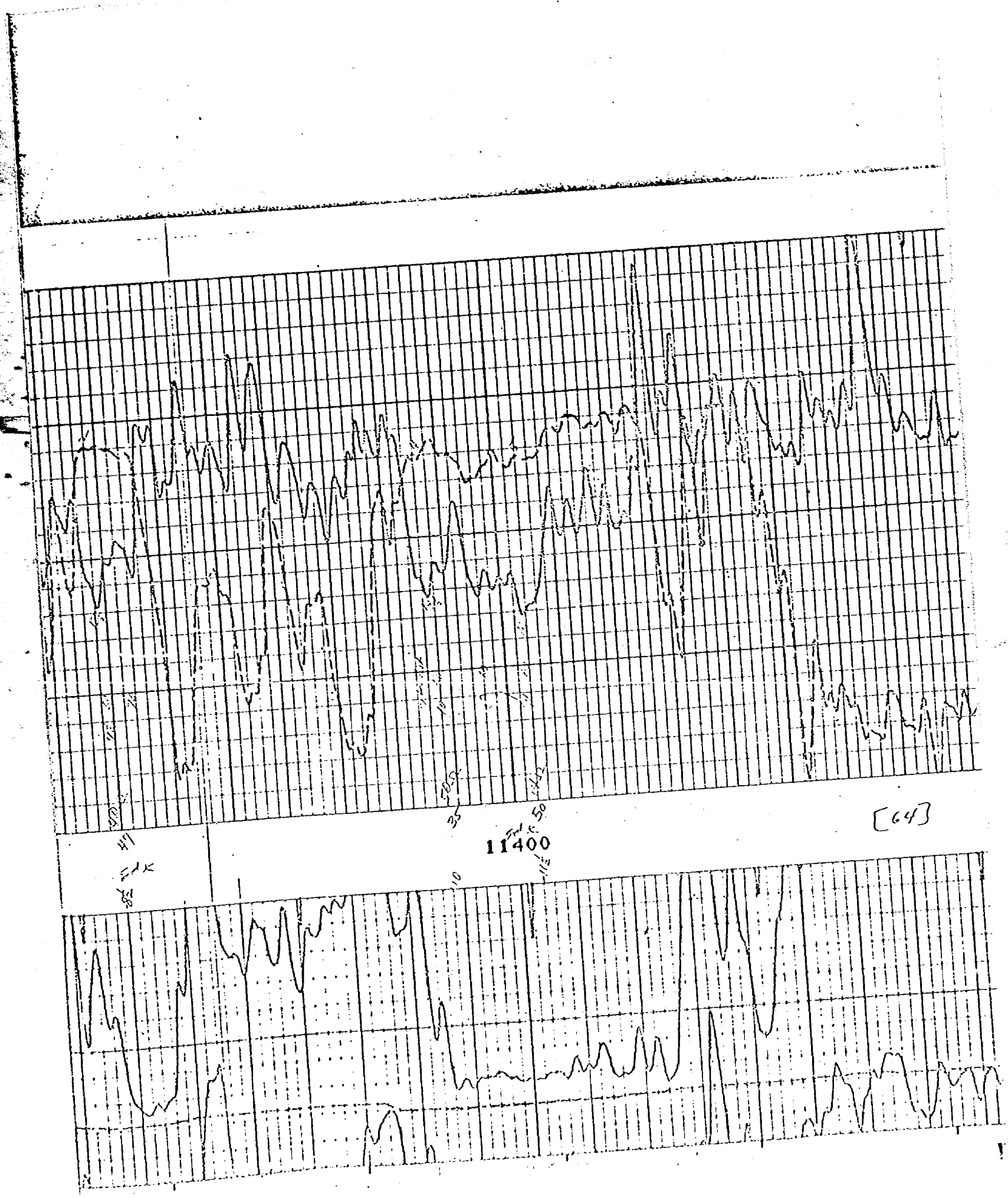
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FORM 9-330B REV. 7-78

DresserAtlas

DRESSER

Combination Logging Systems

Dual Laterolog Micro Laterolog

R

FILE NO. 1222

COMPANY SOUTHLAND ROYALTY

WELL EMPIRE FEDERAL "35" NO. 1

FIELD WILDCAT

COUNTY EDDY STATE NEW MEXICO

LOCATION: 1980' FSL & 1980' FWL

SEC. 35 TWP. 18-S RGE. 29-E

Other Services: CDL/CN/GR/CAL

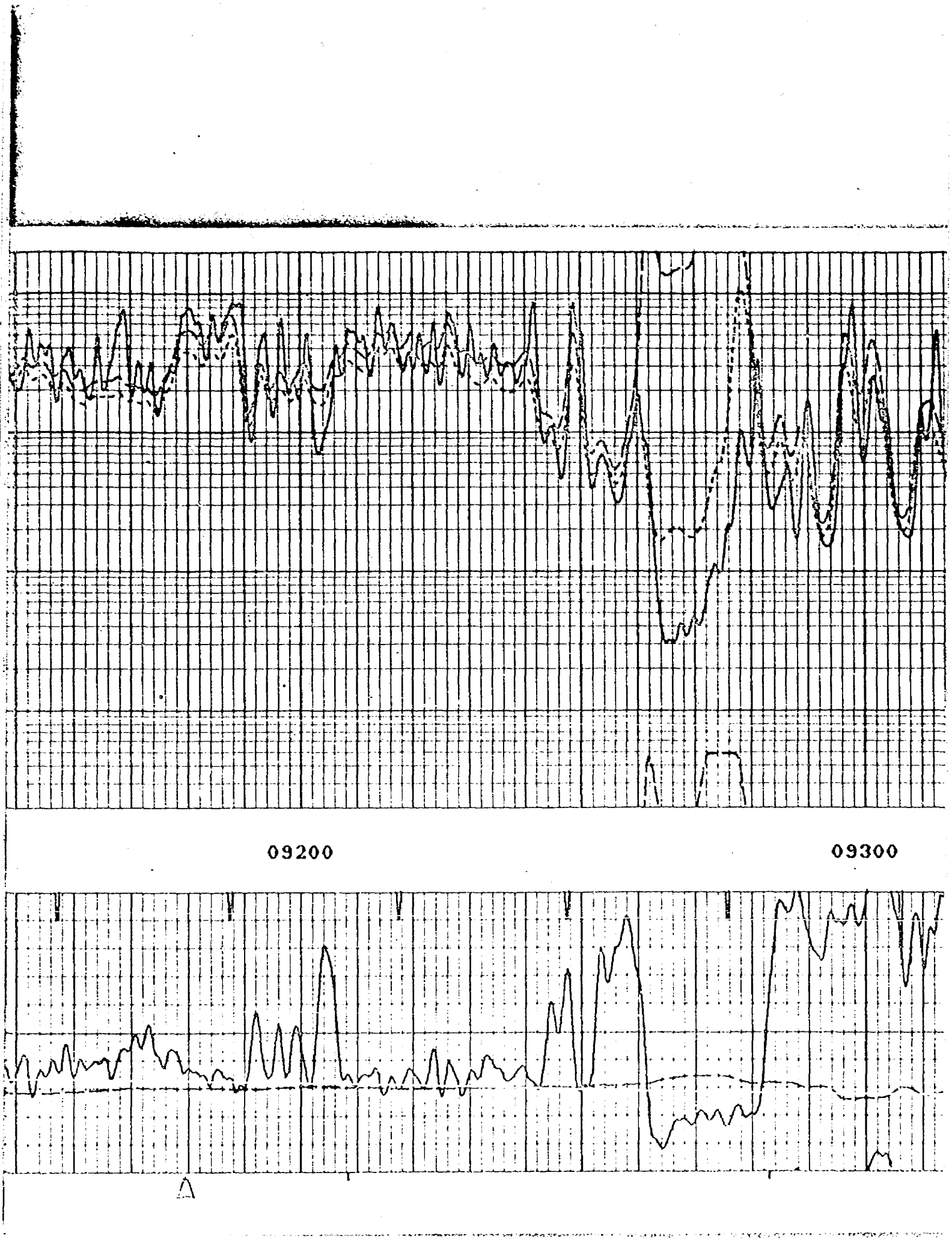
Elevations: KB 3447 DF GL 3433.5'

Elev. 3433.5'

Permanent Datum	GL		13.5 Ft. Above Permanent Datum			
Log Measured from	KB					
Drilling Measured from	KB					
Date	12-19-20					
Run No.	TWO					
Service Order	50952					
Depth—Driller	11,791'					
Depth—Logger	11,796'				@	
Bottom Logged Interval	11,794'				@	
Top Logged Interval	3162'					
Casing—Driller	8 5/8 @ 3200'					
Casing—Logger	3162'					cc
Bit Size	7 7/8"				cc	
Type Fluid in Hole	BGEL/DRISPAC/LCM/KCL					°F
Density and Viscosity	10.0	45	cc		@ °F	@ °F
pH and Fluid Loss	9.5	3.2	cc		@ °F	@ °F
Source of Sample				@ °F	@ °F	@ °F
Rm @ Meas. Temp.	.061 @ 60 °F			@ °F	@ °F	@ °F
Rmf @ Meas. Temp	.054 @ 60 °F			@ °F	@ °F	@ °F
Rmc @ Meas. Temp.	NA @ N/A °F			@ °F	@ °F	°F
Source of Rmf and Rmc	M	—			°F	
Rm @ BHT	.025 @ 160 °F					
Time Since Circ.	15 HRS					
Max. Rec. Temp. Deg. F	150 °F					
Equip. No. and Location	49375 HOBBS					
Recorded By	CLEROY/CLEMENTS					
Witnessed By	ROBISON					

FIELD PRINT

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 5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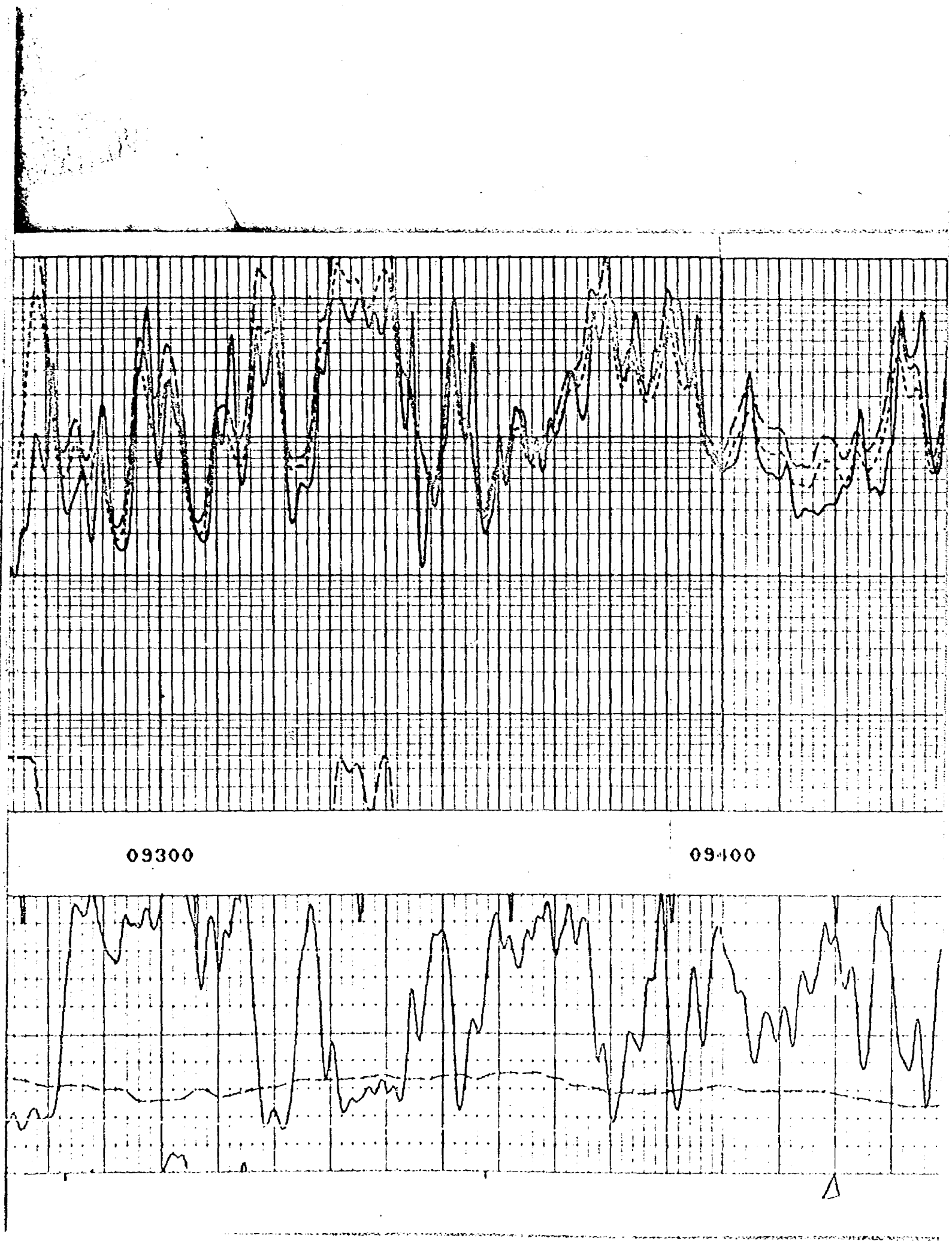
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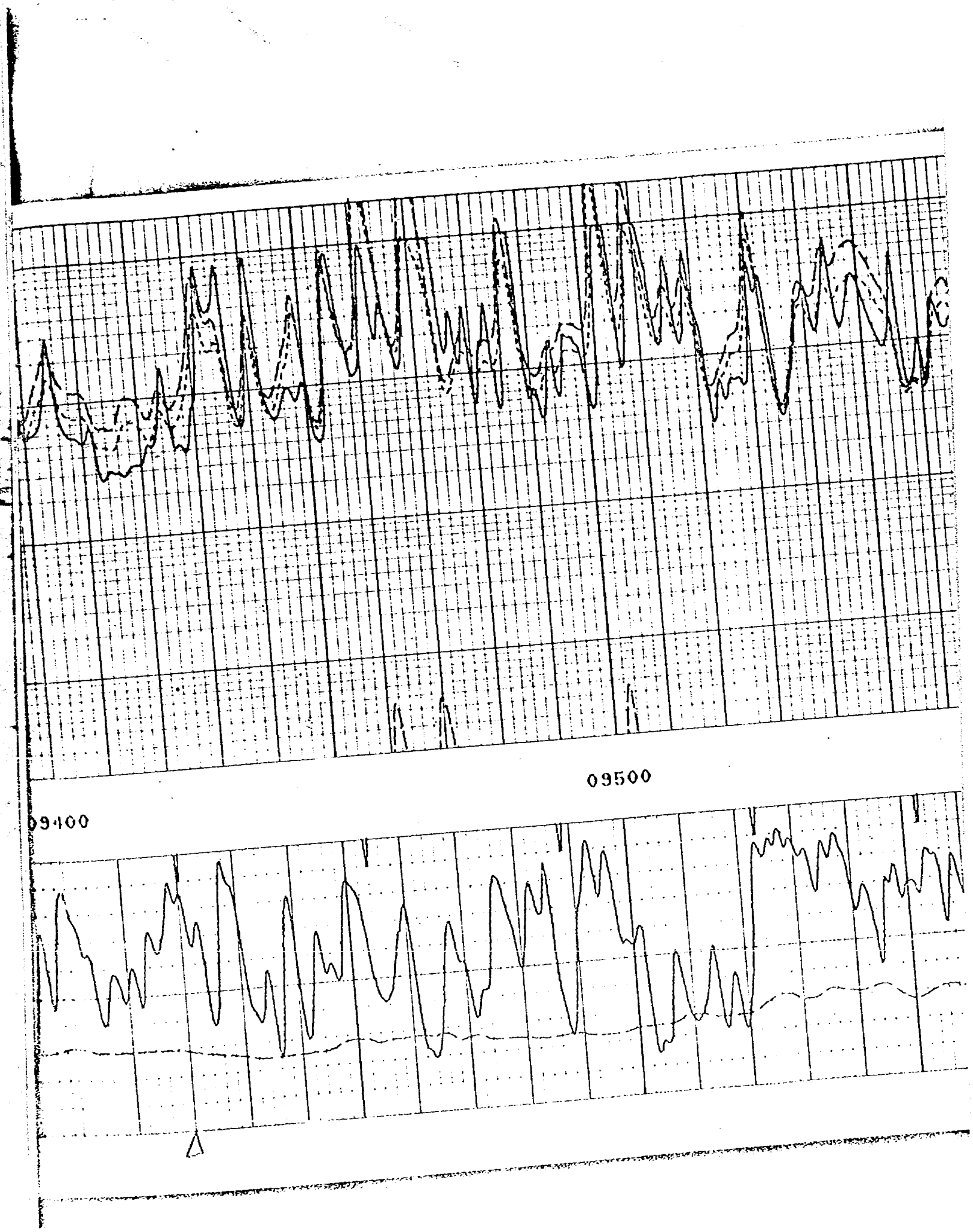
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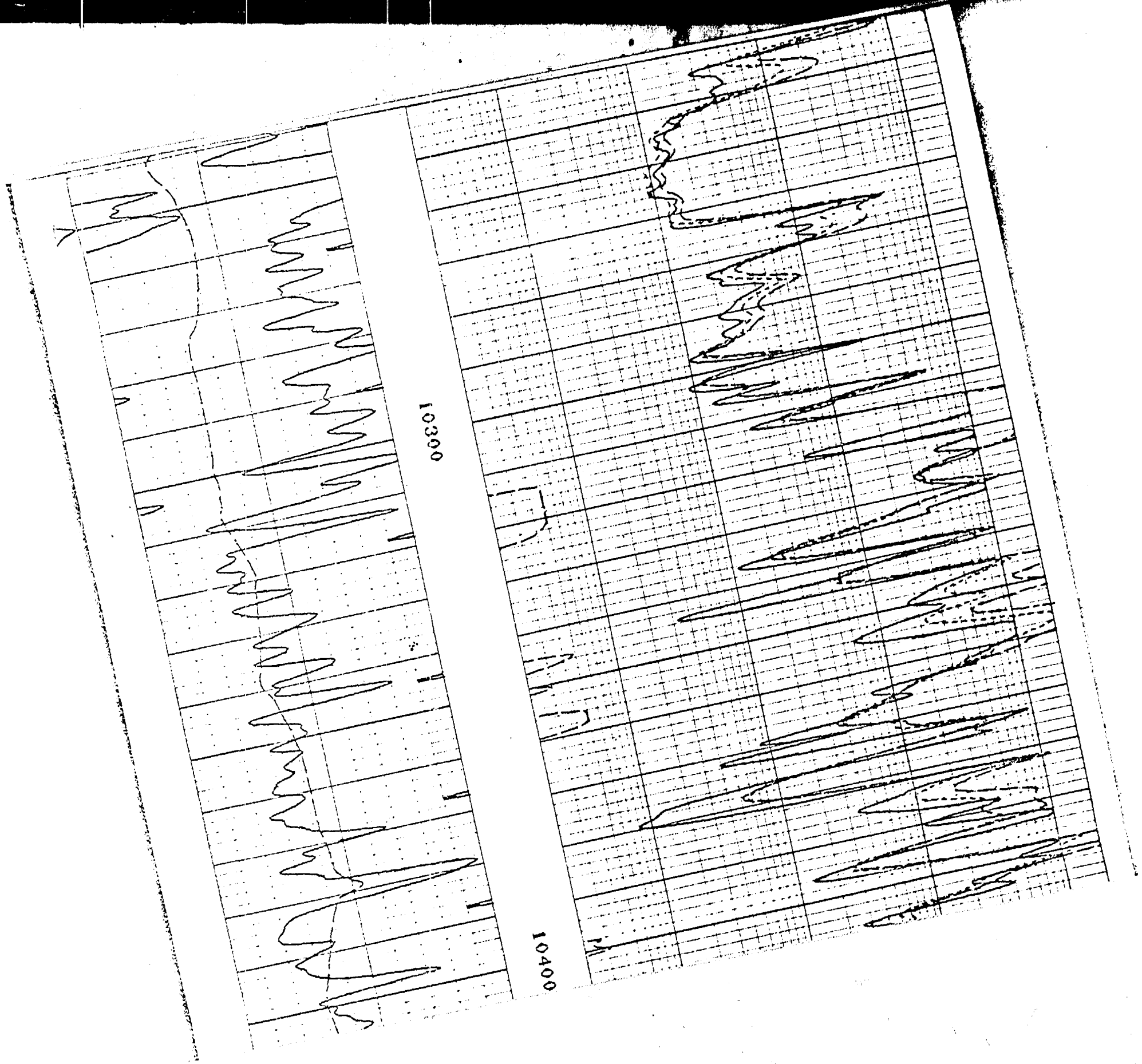
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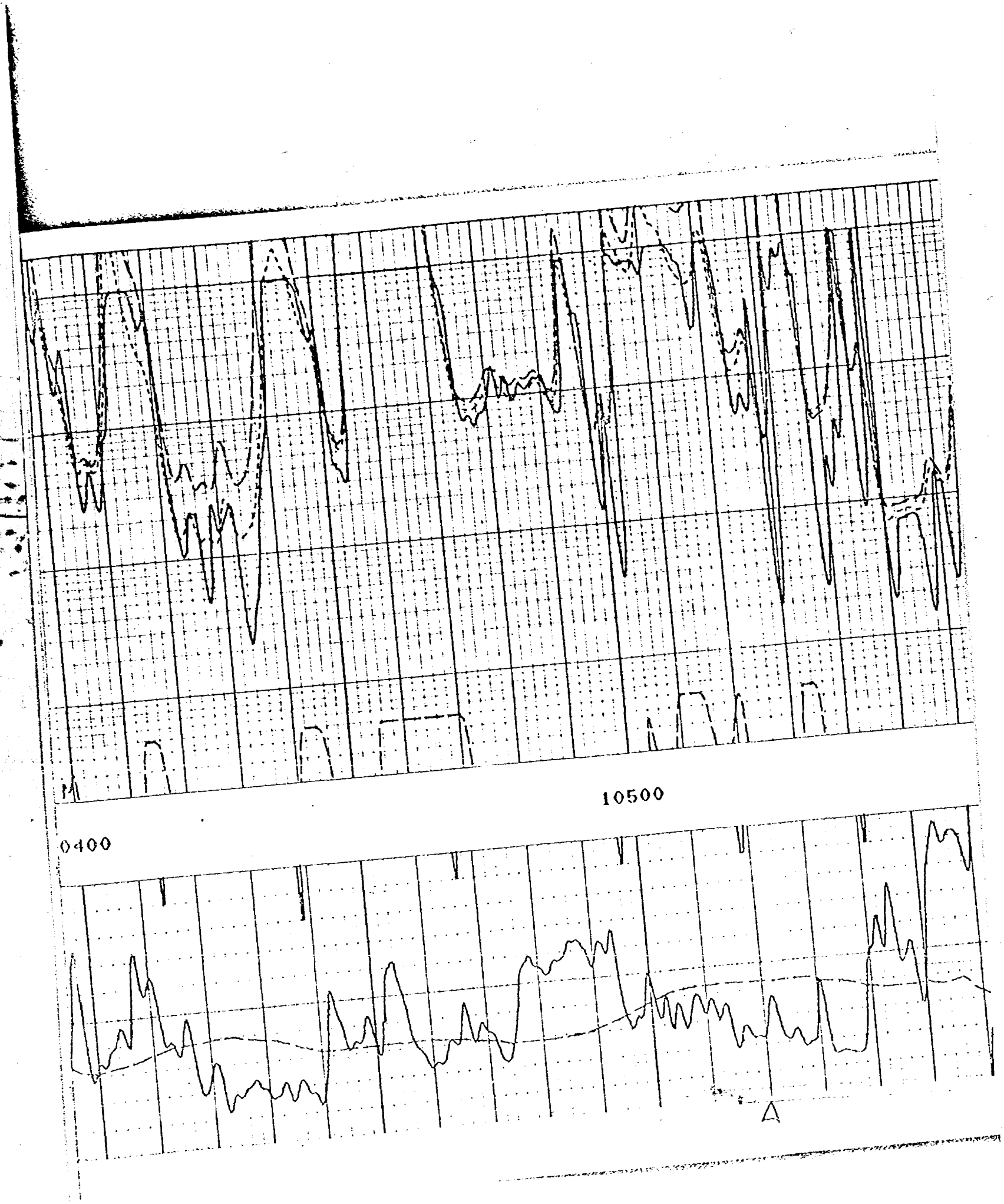
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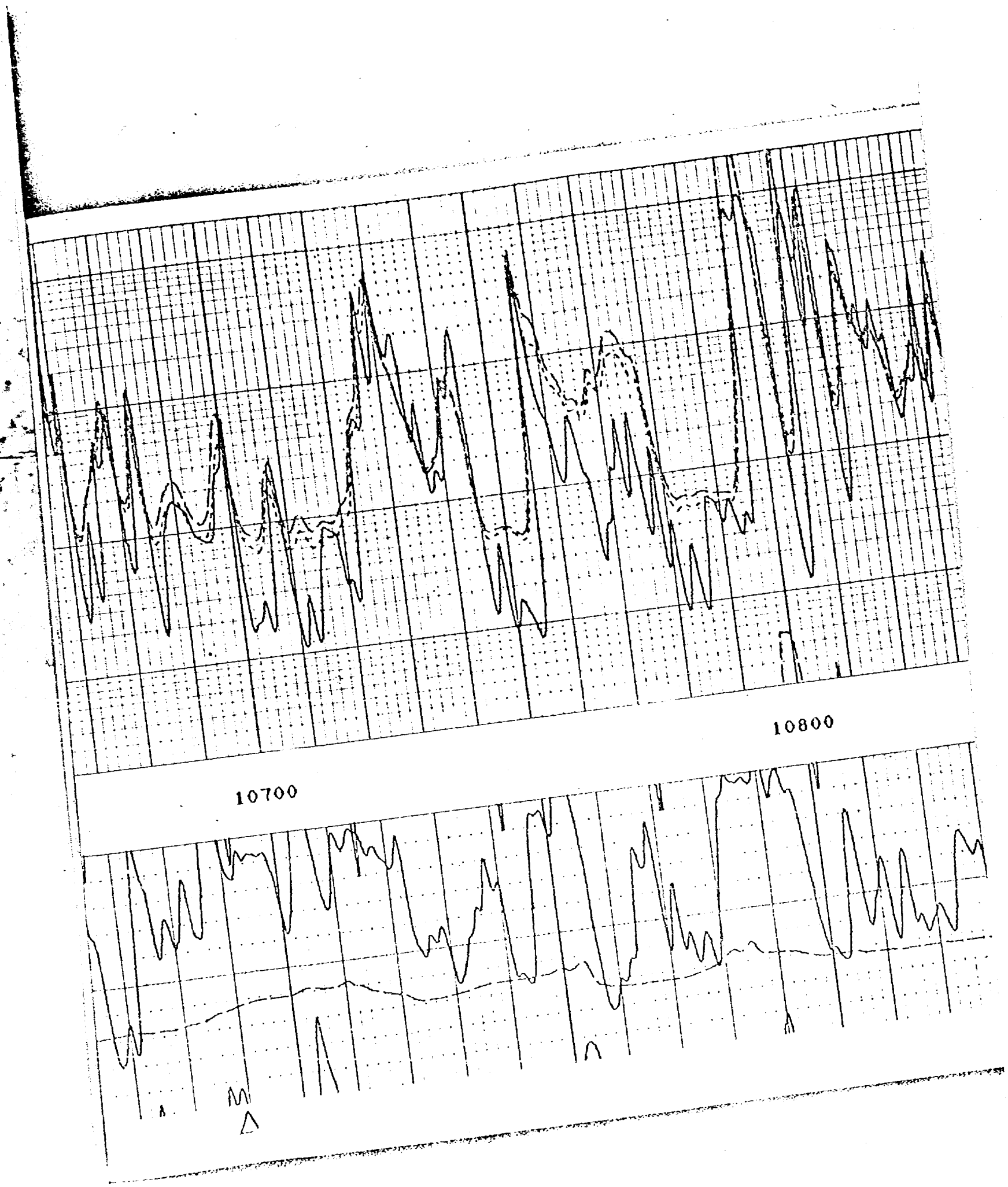
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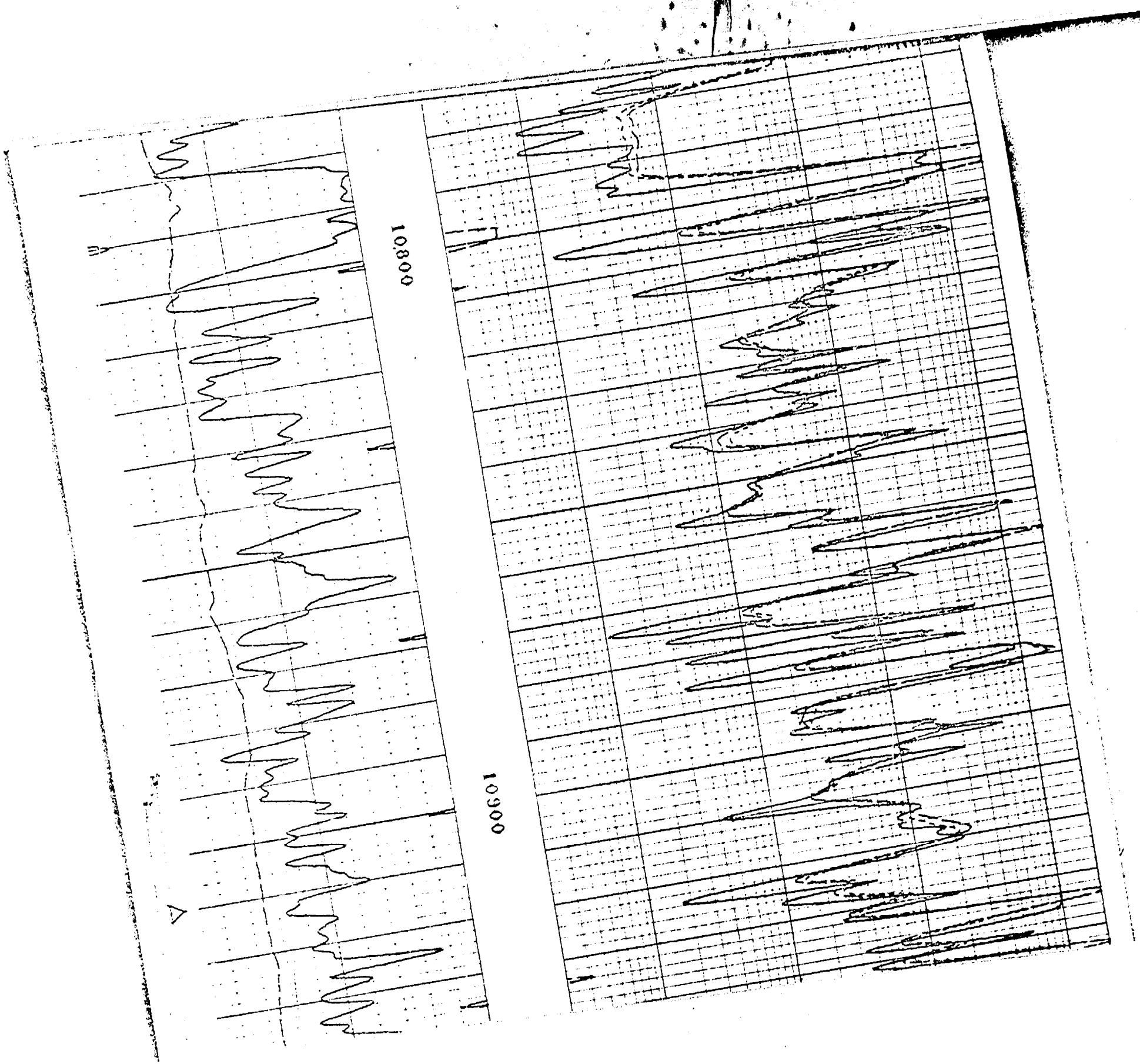
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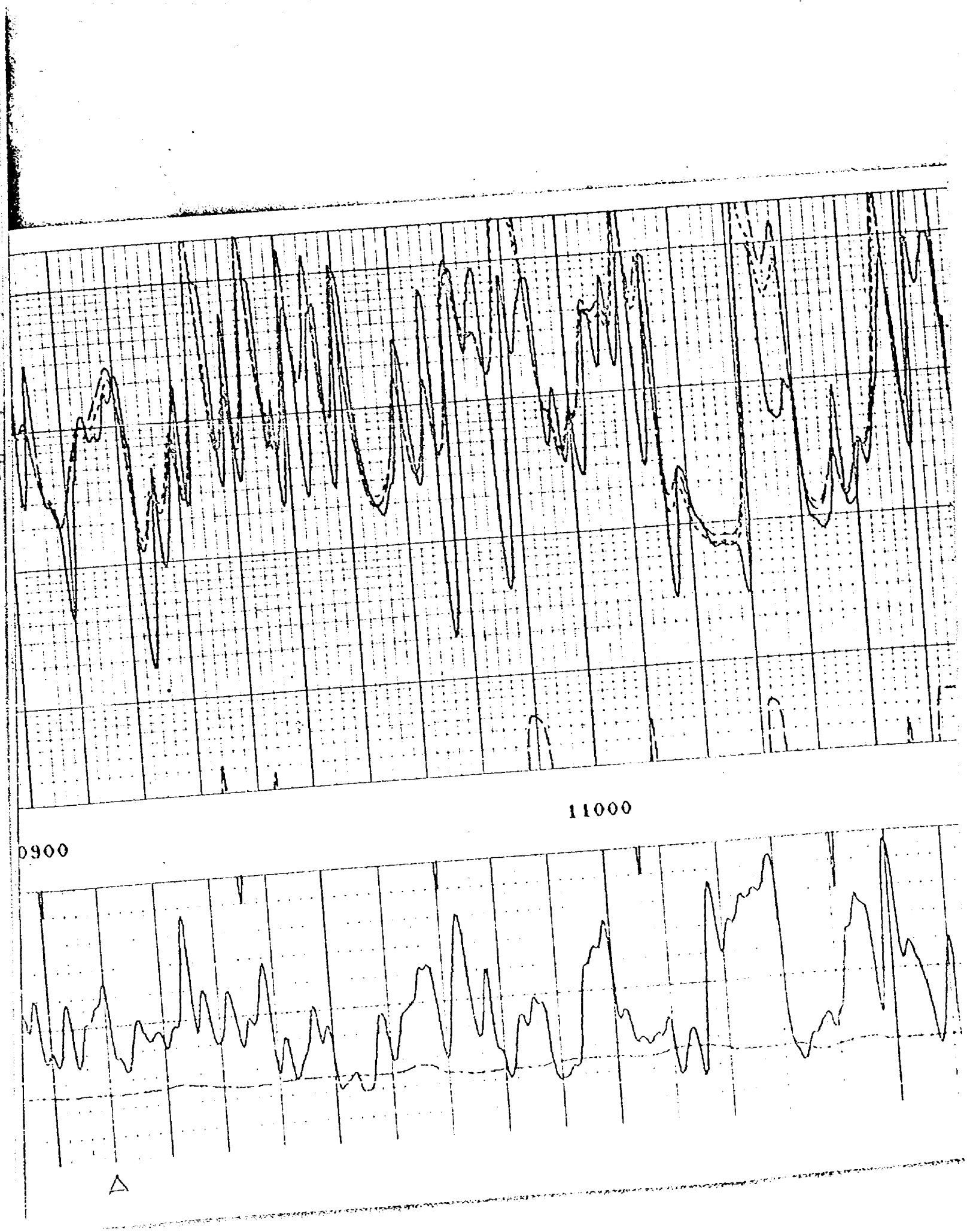
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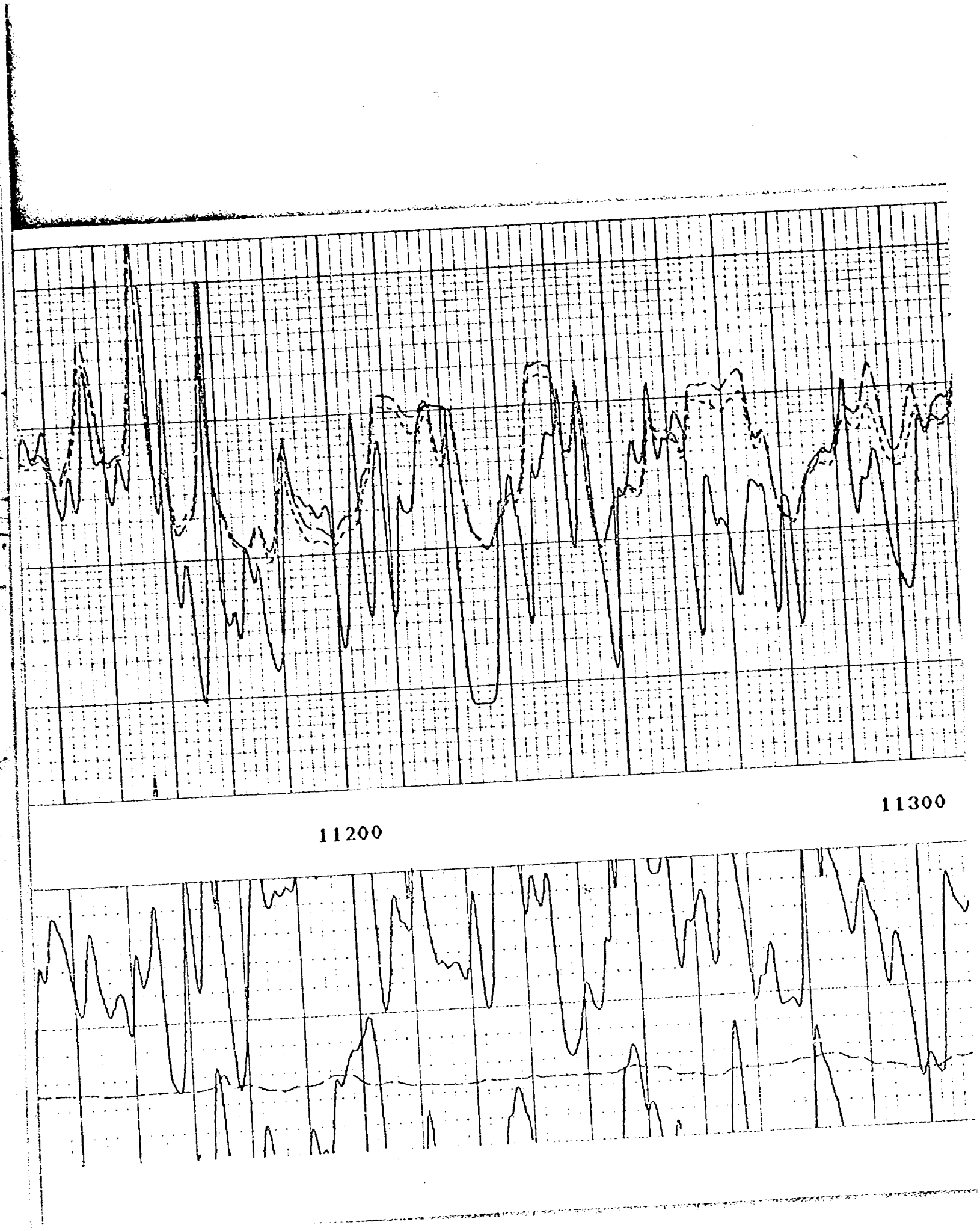
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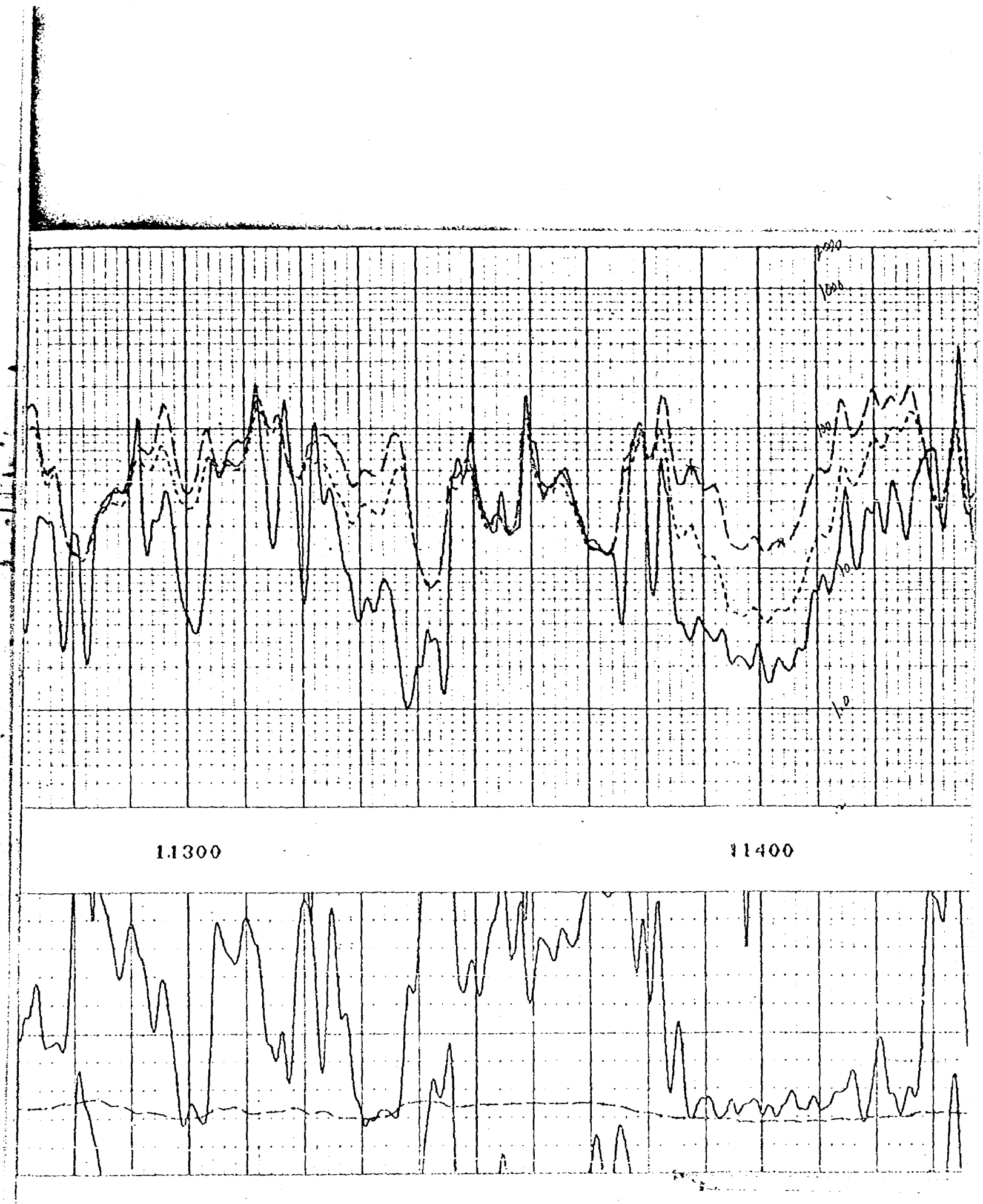
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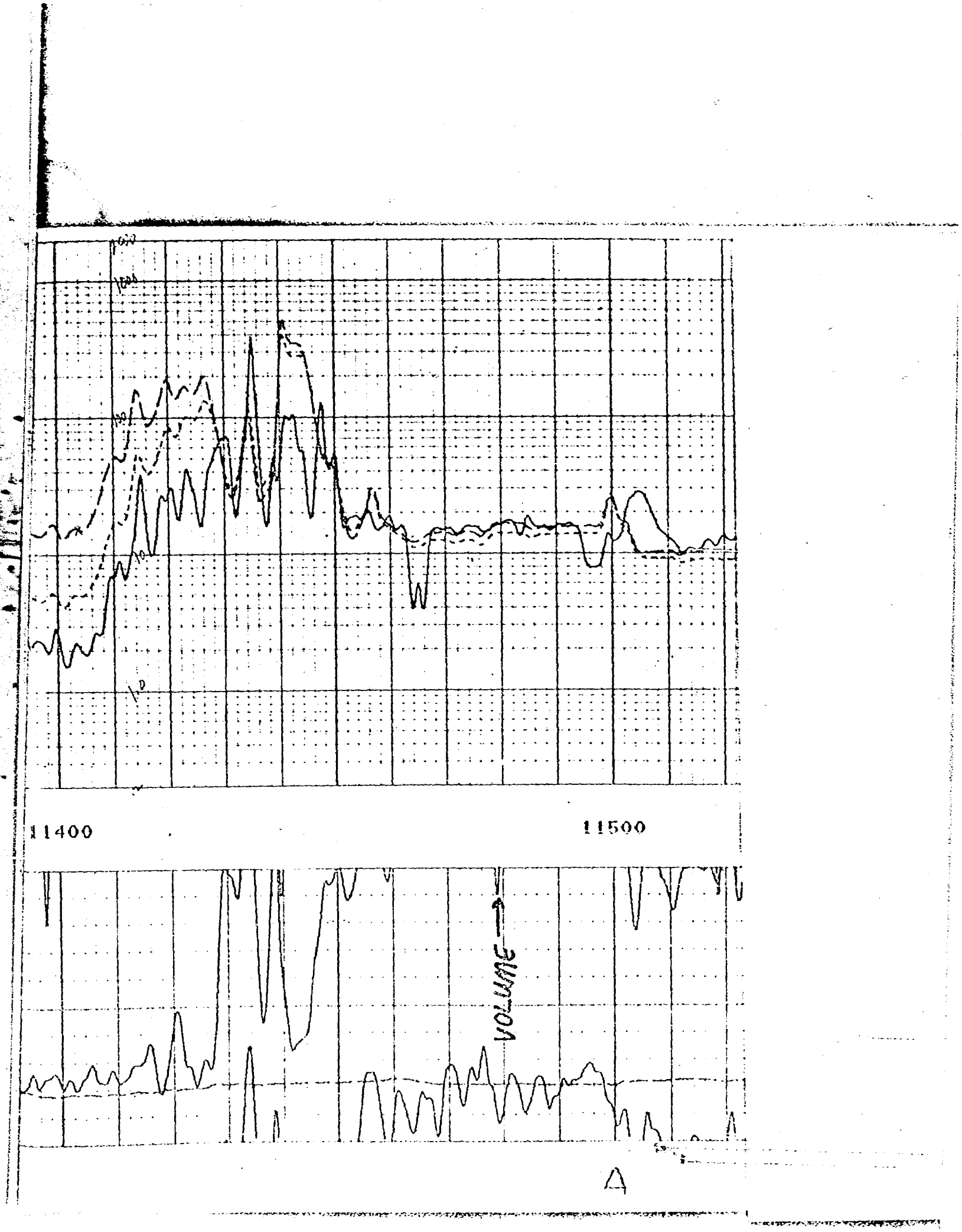

11400
11500
VOLUME →
A

BASSETT-BIRNEY OIL CORPORATION

Oil Producers and Operators

ARTESIA, NEW MEXICO 88210

YATES BUILDING — 207 SOUTH FOURTH

PHONE: (505) 748-1331

September 4, 1980

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis, Landman

Re: Proposed Southland Royalty Company Empire
Federal "35" Com. No. 1 and "35-A" Com. No. 1
Wells, W/2 and E/2 Sec. 35, T-18-S, R-29-E,
Eddy County, New Mexico

Gentlemen:

This acknowledges receipt of your letters of July 8 and July 25, 1980, together with joint operating agreements and AFEs covering the proposed drilling of the subject wells.

The joint operating agreement dated July 8 covering W/2 Section 35 and the AFE for your No. "35" Com. No. 1, credits our company with a 19.026479% (60/315.35) interest, when in fact we own a 38.052957% (120/315.35) interest. The joint operating agreement dated July 17, 1980 covering E/2 Section 35 and the AFE for your No. "35-A" Com. No. 1, credits our company with a 6.3199% (20/316.46) interest, when in fact we own a 12.6398% (40/316.46) interest. Southland Royalty has instituted a suit against, among other parties, Bassett-Birney Oil Corporation, in the United States District Court for the District of New Mexico, Case No. CIV-80-0614 HB, contesting a portion of our title to the working interest underlying the proposed wells. In view of the incorrect statements in your operating agreements and AFEs as to our ownership in the proposed wells and the pending lawsuit, we are unable to approve either the AFEs or joint operating agreements.

Bassett-Birney is willing to pool its interests in the W/2 of Section 35 and in the E/2 of Section 35 for the drilling of the "35" Com. No. 1 Well and the "35-A" Com. No. 1 Well.

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 1

If you have any questions, please do not hesitate to call me.

Very truly yours,

BASSETT-BIRNEY OIL CORPORATION

By: Jack W. McCaw,
Vice President

October 10, 1980

Mr. William F. Carr
Campbell and Black, P.A.
P. O. Box 2208
Santa Fe, New Mexico 87501

Dear Bill:

Enclosed, plase find the following Communitization Agreements, duly executed by Bassett-Birney Oil Corporation:

1. Covering E/2 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico.

2. Covering W/2 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico.

As you will note, these instruments pool the entire interest of Bassett-Birney in the proposed wells. Since Southland, though Operator, has not furnished Bassett-Birney with Communitization Agreements, we prepared these ourselves for Southland's convenience. However, Bassett-Birney remains unwilling to execute the AFE and Operating Agreement furnished with your letter of September 29, 1980, for the reason that the instruments still attempt to place the risk of a dry hole upon Bassett-Birney. Bassett-Birney feels that since Southland is the one proposing the immediate drilling of these wells prior to settlement or judgment upon the disputed title, that Southland should be willing to risk the dry hole, regardless of the outcome of the dispute. We find nothing in our statutes authorizing the Oil Conservation Division to force Bassett-Birney to execute such an Operating Agreement.

Bassett-Birney is willing to execute the Operating Agreement furnished, if the following changes are made in Article XV(B):

(a) In (2), change "credited to it" in line 2 to "credited to it and Robert E. McKee, Inc."

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 2

(b) In (5), delete the words "either" and "or a dry hole" in line 1.

Please let us know Southland's position on these questions.

Sincerely yours,

LOSEE, CARSON & DICKERSON, P.A.

Chad Dickerson

CD:pvm
Enclosures

cc: Mr. Jack W. McCaw

COMMUNITIZATION AGREEMENT

THIS AGREEMENT, entered into as of the 1st day of October, 1980, by and between the parties subscribing, ratifying or consenting hereto, such parties being hereinafter referred to as "parties hereto,"

W I T N E S S E T H:

WHEREAS, the Act of February 25, 1920, 41 Stat. 437, as amended, authorizes communitization or drilling agreements communitizing or pooling a Federal oil and gas lease or any portions thereof with other lands, whether or not owned by the United States, when separate tracts under such Federal lease cannot be independently developed and operated in conformity with an established well-spacing program for the field or area and such communitization or pooling is determined to be in the public interest; and

WHEREAS, the parties hereto own working, royalty, or other leasehold interests, or operating rights under the oil and gas leases and lands subject to this agreement which cannot be independently developed and operated in conformity with the well-spacing program established for the field or area in which said lands are located; and

WHEREAS, the parties hereto desire to communitize and pool their respective mineral interests in lands subject to this agreement for the purpose of developing and producing communitized substances in accordance with the terms and conditions of this agreement:

NOW, THEREFORE, in consideration of the premises and the mutual advantages to the parties hereto, it is mutually convenanted and agreed by and between the parties hereto as follows:

1. The lands covered by this agreement (hereinafter referred to as "communitized area") are described as follows:

Township 18 South, Range 29 East, N.M.P.M.

Section 35: W/2

containing 315.35 acres, more or less,

and this agreement shall extend to and include the Morrow formation underlying said lands and the dry gas and associated liquid hydrocarbons herein referred to as "communitized substances," producible from such formation.

2. Attached hereto, and made a part of this agreement for all purposes, is Exhibit "A" designating the operator of the communitized area and showing the oil and gas interests in all lands within the communitized area, and the authorization, if any, for communitizing or pooling any patented or fee lands within the communitized area.

3. All matters of operation shall be governed by the Operator under and pursuant to the terms and provisions of this agreement. A successor operator may be designated by the owners of the working

interest in the communitized area and four (4) executed copies of a designation of successor operator shall be filed with the Regional Oil and Gas Supervisor.

4. Operator shall furnish the Secretary of the Interior or his authorized representative, a log and history of any well drilled on the communitized area, monthly reports of operations, statements of communitized substances sales and royalties, and such other reports as are deemed necessary to compute monthly the royalty due the United States, as specified in the applicable oil and gas operating regulations.

5. Nondiscrimination: In connection with the performance of work under this agreement, the operator agrees to comply with all of the provisions of Section 202(1) to (7) inclusive of Executive Order 11246 (30 F.R. 12319), as amended, which are hereby incorporated by reference in this agreement.

6. The communitized area shall be developed and operated as an entirety with the understanding and agreement between the parties hereto that all communitized substances produced therefrom shall be allocated among the leaseholds comprising said area in the proportion that the acreage interest of each leasehold bears to the entire acreage interest committed to this agreement.

7. The royalties payable on communitized substances allocated to the individual leases comprising the communitized area and the rentals provided for in said leases shall be determined and paid on the basis prescribed in each of the individual leases. For any federal lease bearing a sliding- or step-scale rate of royalty, such rate shall be determined separately as to the production from each communitization agreement to which such lease may be committed, and separately as to any non-communitized lease production; provided, however, as to leases where the rate of royalty for gas is based on total lease production per day shall be determined by the sum of all communitized production allocated to such a lease and any non-communitized lease production. Payment of rentals under the terms of leases subject to this agreement shall not be affected by this agreement except as provided for under the terms and provisions of said leases or as may herein be otherwise provided. Except as herein modified and changed, the oil and gas leases subject to this agreement shall remain in full force and effect as originally made and issued.

8. There shall be no obligation on the lessees to offset any well or wells completed in the formation covered by this agreement on separate component tracts into which the communitized area is now or may hereafter be divided, nor shall any lessee be required to measure separately communitized substances by reason of the diverse ownership thereof, but the lessees shall not be released from their obligation to protect the communitized area from drainage of communitized substances by a well or wells drilled offsetting said area.

9. The commencement, completion, continued operation or production of a well or wells for communitized substances on the communitized area shall be construed and considered as the commencement, completion, continued operation or production on each and all of the lands within and comprising said communitized area, and operations or production pursuant to this agreement shall be deemed to be operations or production as to each lease committed hereto.

10. Production of communitized substances and disposal thereof shall be in conformity with allocation, allotments and quotas made or fixed by any duly authorized person or regulatory body under applicable Federal or State statutes. The agreement shall be subject to all applicable Federal and State laws or executive orders, rules and regulations, and no party hereto shall suffer a forfeiture or be liable in damages for failure to comply with any of the provisions of this agreement if such compliance is prevented by, or if such failure results from, compliance with any such laws, orders, rules or regulations.

11. This agreement shall be effective as of the date hereof upon execution by the necessary parties, notwithstanding the date of execution, and upon approval by the Secretary of the Interior, or his duly authorized representative, and shall remain in force and effect for a period of two (2) years and so long thereafter as communitized substances are or can be produced from the communitized area in paying quantities from the communitized area and upon fulfillment of all requirements of the Secretary of the Interior, or his duly authorized representative, with respect to any dry hole or abandoned well, this agreement may be terminated at any time by mutual agreement of the parties hereto. This agreement shall not terminate upon cessation of production if, within sixty (60) days thereafter, reworking or drilling operations on the communitized area are commenced and are thereafter conducted with reasonable diligence during the period of nonproduction.

12. It is agreed by the parties hereto that the Secretary of the Interior, or his duly authorized representative, shall have the right of supervision over all operations within the communitized area to the same extent and degree as provided in the oil and gas leases under which the United States of America is lessor and in the applicable oil and gas operation regulations of the Department of the Interior.

13. The covenants herein shall be construed to be covenants running with the land with respect to the communitized interests of the parties hereto and their successors in interest until this agreement terminates; and any grant, transfer or conveyance of any such land or interest subject hereto, whether voluntary or not, shall be and hereby is conditioned upon the assumption of all obligations hereunder by the grantee, transferee, or other successor in interest, and as to Federal land shall be subject to approval by the Secretary of the Interior.

14. This agreement shall be binding upon the parties hereto and shall extend to and be binding upon their respective heirs, personal representatives, administrators, successors and assigns.

15. This communitization agreement shall also serve as a written designation of pooled unit, under and pursuant to the provisions of the oil and gas leases included within the communitized area and covering oil, gas and other minerals owned by private individuals.

16. This agreement may be executed in any number of counterparts, no one of which needs to be executed by all parties, or may be ratified or consented to by separate instrument, in writing, specifically referring hereto, and shall be binding upon all parties who have executed such a counterpart, ratification or consent hereto with the same force and effect as if all parties had signed the same document.

IN WITNESS WHEREOF the parties hereto have executed this agreement as of the day and year first above written and have set opposite their respective names the date of execution.

ATTEST: BASSETT-BIRNEY OIL CORPORATION

OCT 10 1980
Date

Secretary

By: Jack W. McCaw
VICE President

SOUTHLAND ROYALTY COMPANY

Date

By: _____
Attorney-in-Fact

ATTEST: TENNECO OIL COMPANY

Date

Secretary

By: _____
President

ATTEST: ROBERT E. McKEE, INC.

Date

Secretary

By: _____
President

FEATHERSTONE FARMS, LTD.

Date

By: _____
Partner

STATE OF NEW MEXICO)
: ss.
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this 10th day of October, 1980, by Jack W. McCaw VICE President of BASSETT-BIRNEY OIL CORPORATION, a New Mexico corporation, on behalf of said corporation.

My commission expires:
August 1, 1984

Kim Bilberry
Notary Public

OFFICIAL SEAL
Signature:
KIM BILBERRY
NOTARY PUBLIC - NEW MEXICO
NOTARY BOND FILED WITH SECRETARY OF STATE
My Commission Expires 8-1-84

STATE OF TEXAS)
: ss.
COUNTY OF MIDLAND)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, Attorney-in-Fact for SOUTHLAND ROYALTY COMPANY, a Texas corporation, on behalf of said corporation.

My commission expires:
_____

_____
Notary Public

STATE OF TEXAS)
: ss.
COUNTY OF BEXAR)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, President of TENNECO OIL COMPANY, a Delaware corporation, on behalf of said corporation.

My commission expires:
_____

_____
Notary Public

STATE OF TEXAS)
: ss.
COUNTY OF EL PASO)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, President of ROBERT E. McKEE, INC., a Texas corporation, on behalf of said corporation.

My commission expires:
_____

_____
Notary Public

STATE OF NEW MEXICO)
: ss.
COUNTY OF CHAVES)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, Partner, on behalf of FEATHERSTONE FARMS, LTD., a New Mexico limited partnership.

My commission expires:
_____

_____
Notary Public

EXHIBIT "A" TO COMMUNITIZATION AGREEMENT DATED OCTOBER 1, 1980, EMBRACING THE N/2 SECTION 35, TOWNSHIP 18 SOUTH, RANGE 29 EAST, N.M.P.M.

Operator of Communitized Area: Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Tract No. 1

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: NE/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

Tenneco Oil Company	100%

O.R.R.I. and Percentage:

Heirs and devisees of C. Melvin Neal, deceased	2.500000%

P.P.I. and Percentage:

*Robert E. McKee General Contractor, Inc.	4.21875%
†Robert J. Leonard	3.12500%
†Patrick J. Leonard	3.12500%
†Timothy T. Leonard	3.12500%

*Pursuant to Production Payment Agreement dated March 9, 1960, recorded Book 106, Page 399, from Leonard Oil Company to Robert E. McKee General Contractor, Inc., until $80,612.50 shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

†Pursuant to Assignment dated October 1, 1965, recorded Book 160, Page 67, from Leonard Oil Company to Tenneco Oil Company, until $3 million shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

Tract No. 2

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: NW/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

Tenneco Oil Company	100%

O.R.R.I. and Percentage:

Jimmie Marie Terry, Trustee of the Sandra Leigh Runyan Trust dated November 16, 1972	.66667%
Jimmie Marie Terry, Trustee of the Susan Lynn Perry Trust dated November 16, 1972	.66667%
Billie L. Kruse, Trustee of the Barbara Kruse Frankenfield Trust dated October 2, 1966	.66666%

P.P.I. and Percentage:

*Robert E. McKee General Contractor, Inc.	4.46875%
†Robert J. Leonard	3.12500%
†Patrick J. Leonard	3.12500%
†Timothy T. Leonard	3.12500%

*Pursuant to Production Payment Agreement dated March 9, 1960, recorded Book 106, Page 399, from Leonard Oil Company to Robert E. McKee General Contractor, Inc., until $98,612.50 shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

†Pursuant to Assignment dated October 1, 1965, recorded Book 160, Page 67, from Leonard Oil Company to Tenneco Oil Company, until $3 million shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

Tract No. 3

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: SE/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

*Bassett-Birney Oil Corporation 100%

*Title to 1/2 disputed between Bassett-Birney Oil Corporation and Southland Royalty Company.

O.R.R.I. and Percentage:

Heirs and devisees of C. Melvin Neal, deceased 2.50000%

Tract No. 4

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: SW/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

*Bassett-Birney Oil Corporation 100%

*Title to 1/2 disputed between Bassett-birney Oil Corporation and Southland Royalty Company.

O.R.R.I. and Percentage:

Jimmie Marie Terry, Trustee of the Sandra Leigh Runyan Trust dated November 16, 1972 .66667%
Jimmie Marie Terry, Trustee of the Susan Lynn Perry Trust dated November 16, 1972 .66667%
Billie L. Kruse, Trustee of the Barbara Kruse Frankenfield Trust dated October 2, 1966 .66666%

Tract No. 5

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: NW/4 SW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

*Bassett-Birney Oil Corporation 100%

*Title to 1/2 disputed by Bassett-Birney Oil Corporation and Southland Royalty Company.

O.R.R.I. and Percentage:

Neil B. Watson 5%

Tract No. 6

Lessor: United States

Lessee of Record: Featherstone Farms, Ltd.

Serial No. of Lease: NM 010907-A

Date of Lease: April 1, 1953

Description of Lands Committed: Lots 3 and 4 (S/2 SW/4), NE/4 SW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 115.35

Working Interest and Percentage:

Before Payout:

Southland Royalty Company 100%

After Payout:

Southland Royalty Company 50%
Featherstone Farms, Ltd. 50%

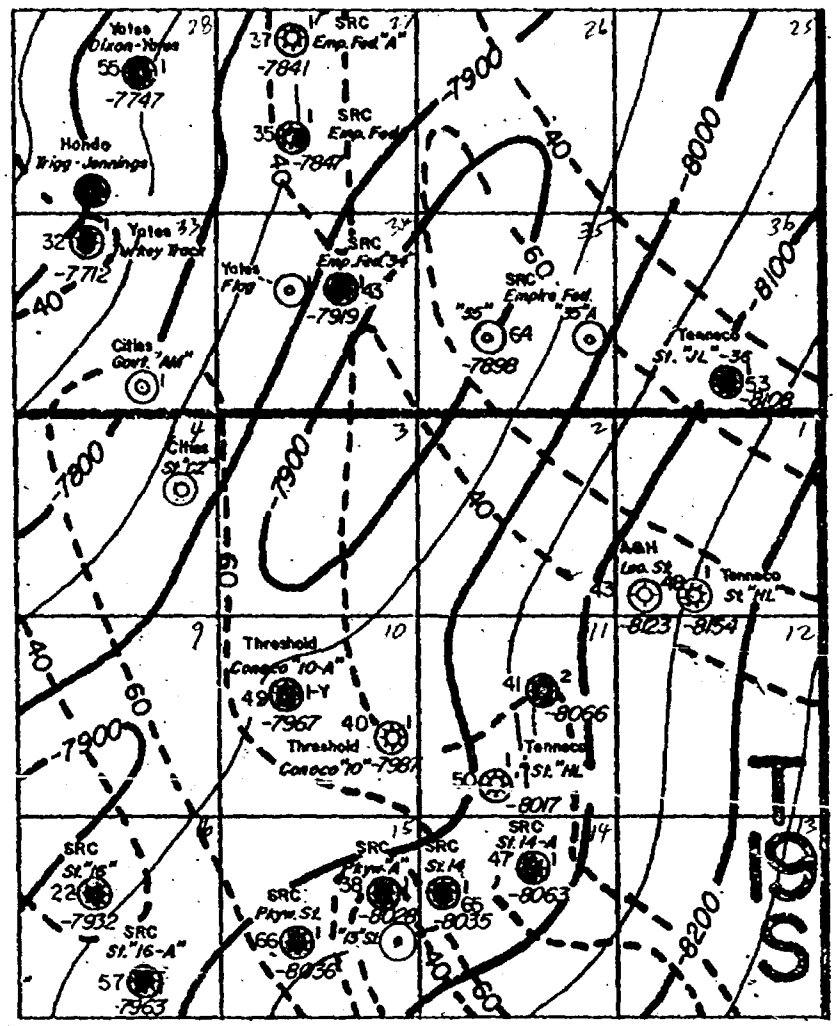
O.R.R.I. and Percentage:

Before Payout:

Featherstone Farms, Ltd. 6.25%

RECAPITULATION

Tract Number	No. of Acres Committed	Percentage of Interest in Communitized Area
1	40.00	12.684328
2	40.00	12.684328
3	40.00	12.684328
4	40.00	12.684328
5	40.00	12.684328
6	115.35	36.578408
TOTAL	315.35	100.000008



Base Middle Morrow Shale

Morrow Penetration

64 ---Feet of Clean (50 API) Morrow Sand in Well

-7898 ---Subsea Depth of Lower Morrow

---Morrow Gas Well

-7800 Structural Contours of Lower Morrow 50 ft. C.I.

60 Isoliths of Total Clean (50 API) Morrow Sand

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 3

FORM 9-552 REV.

Dresser Atlas

DRESSER

Combination Logging Systems

Compensated Densilog

Compensated Neutron

FILE NO.

COMPANY SOUTHLAND ROYALTY CO.

WELL EMPIRE FEDERAL "35" NO. 1

FIELD WILDCAT

COUNTY EDDY STATE NEW MEXIC

LOCATION: 1980 FSL & 1980 FWL

SEC 35 TWP 18-S RGE 29-E

Other Service: RLL/MLL/G CAL

Permanent Datum GL Elev. 3433.5'

Log Measured from KB ft. Above Permanent Datum

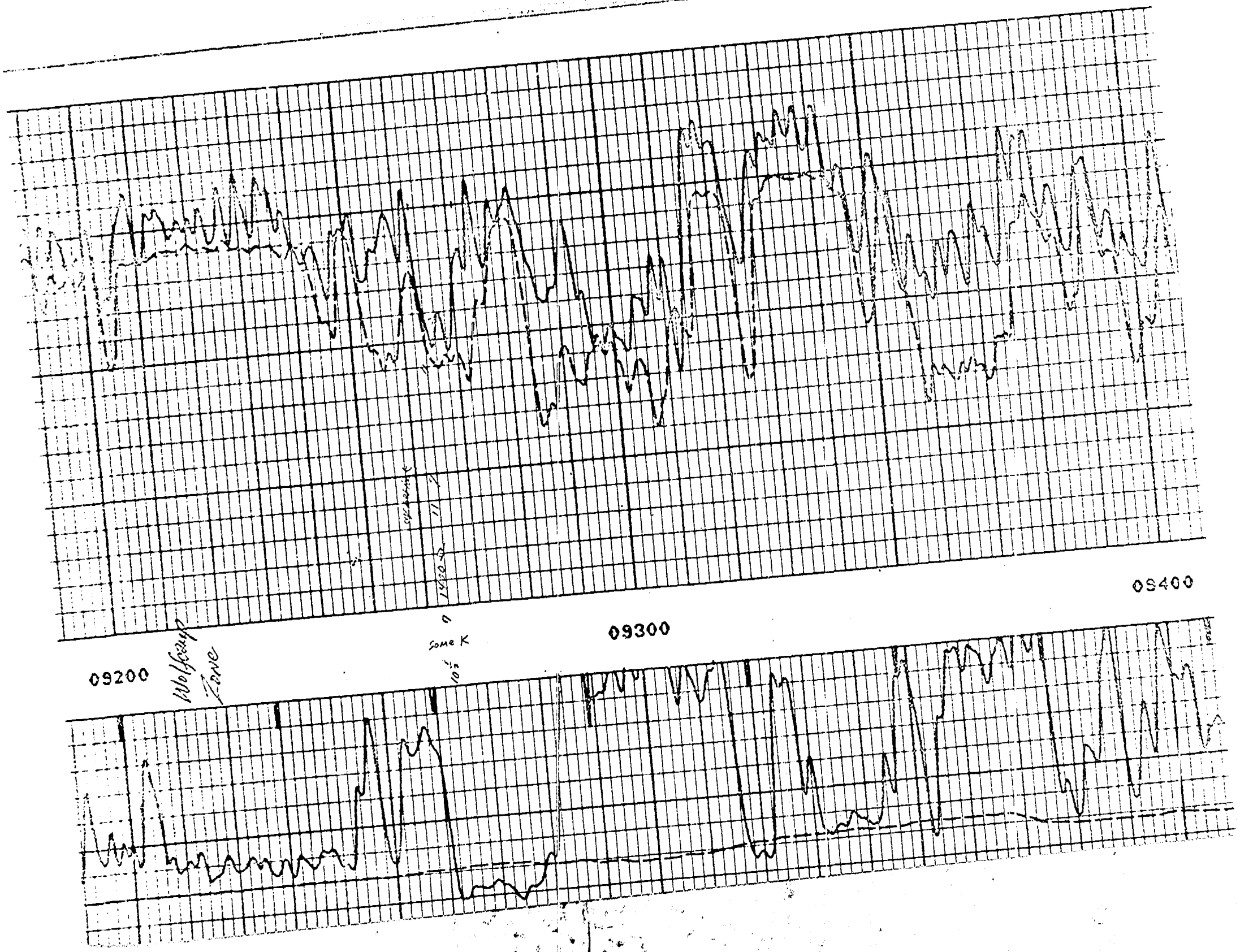
Drilling Measured from KB

Elevations: KB 3447' DF GL 3433.5

Date	12-19-80			
Run No.	ONE			
Service Order	50452			
Depth—Driller	11,791'			
Depth—Logger	11,796'			
Bottom Logged Interval	11,799'			
Top Logged Interval	3162'			
Casing—Driller	8⅝" @ 3200'	@	@	@
Casing—Logger	3166'			
Bit Size	7⅞"			
Type Fluid in Hole	GEL/DISP/LOIDEX			
Density and Viscosity	10.3 42			
pH and Fluid Loss	9.2 5.2 cc	cc	cc	
Source of Sample				
Rm @ Meas. Temp.	.067 @ 60 °F	@ °F	@ °F	@
Rmf @ Meas. Temp.	.054 @ 60 °F	@ °F	@ °F	@
Rmc @ Meas. Temp.	.08 @ 60 °F	@ °F	@ °F	@
Source of Rmf and Rmc	M —			
Rm @ BHT	.025 @ 160 °F	@ °F	@ °F	@
Time Since Circ.	6 HRS.			
Max. Rec. Temp. Deg. F	160 °F	°F	°F	
Equip. No. and Location	8931 HOBBS			
Recorded By	[illegible]			
Witnessed By	[illegible]			

FILED

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 4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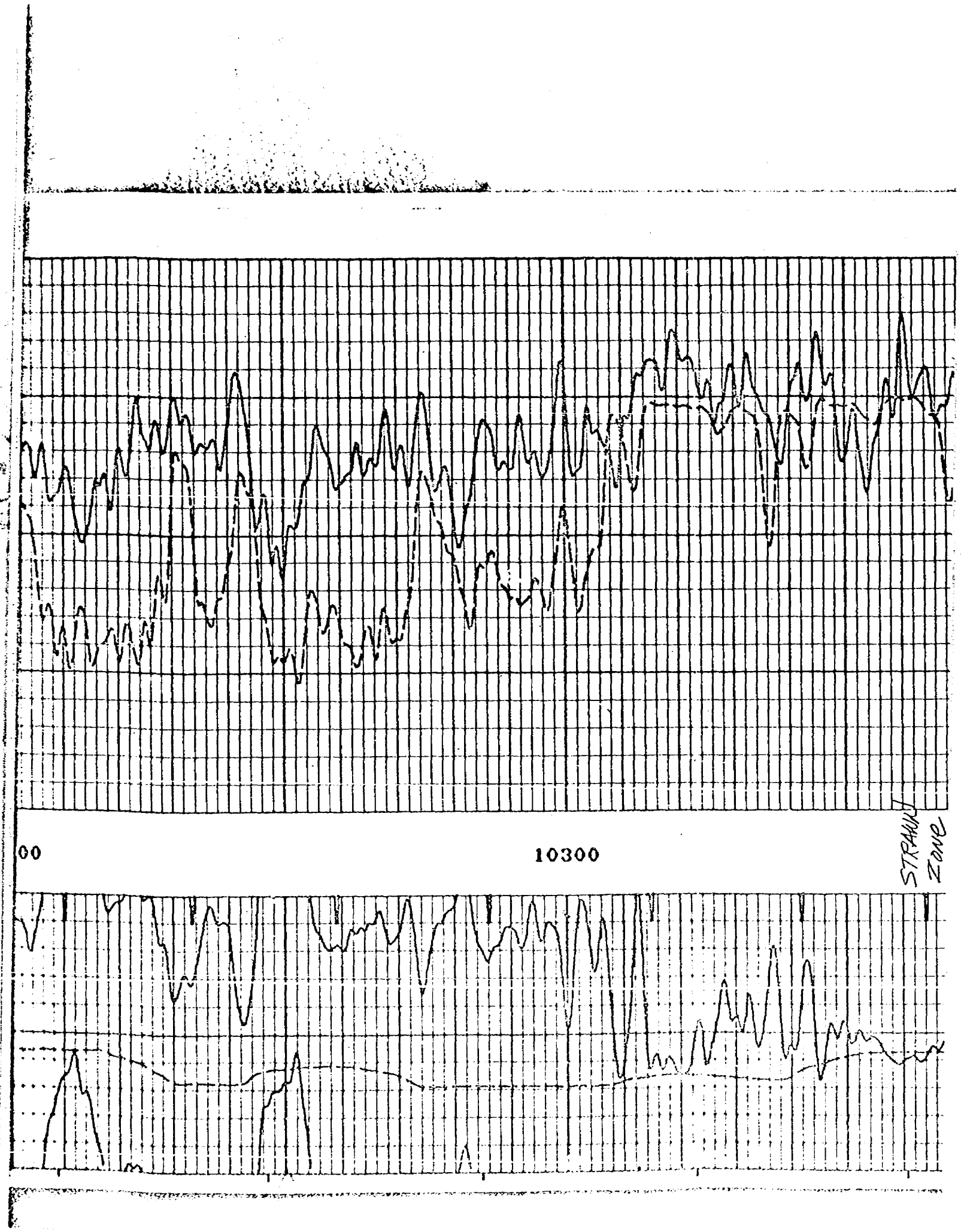
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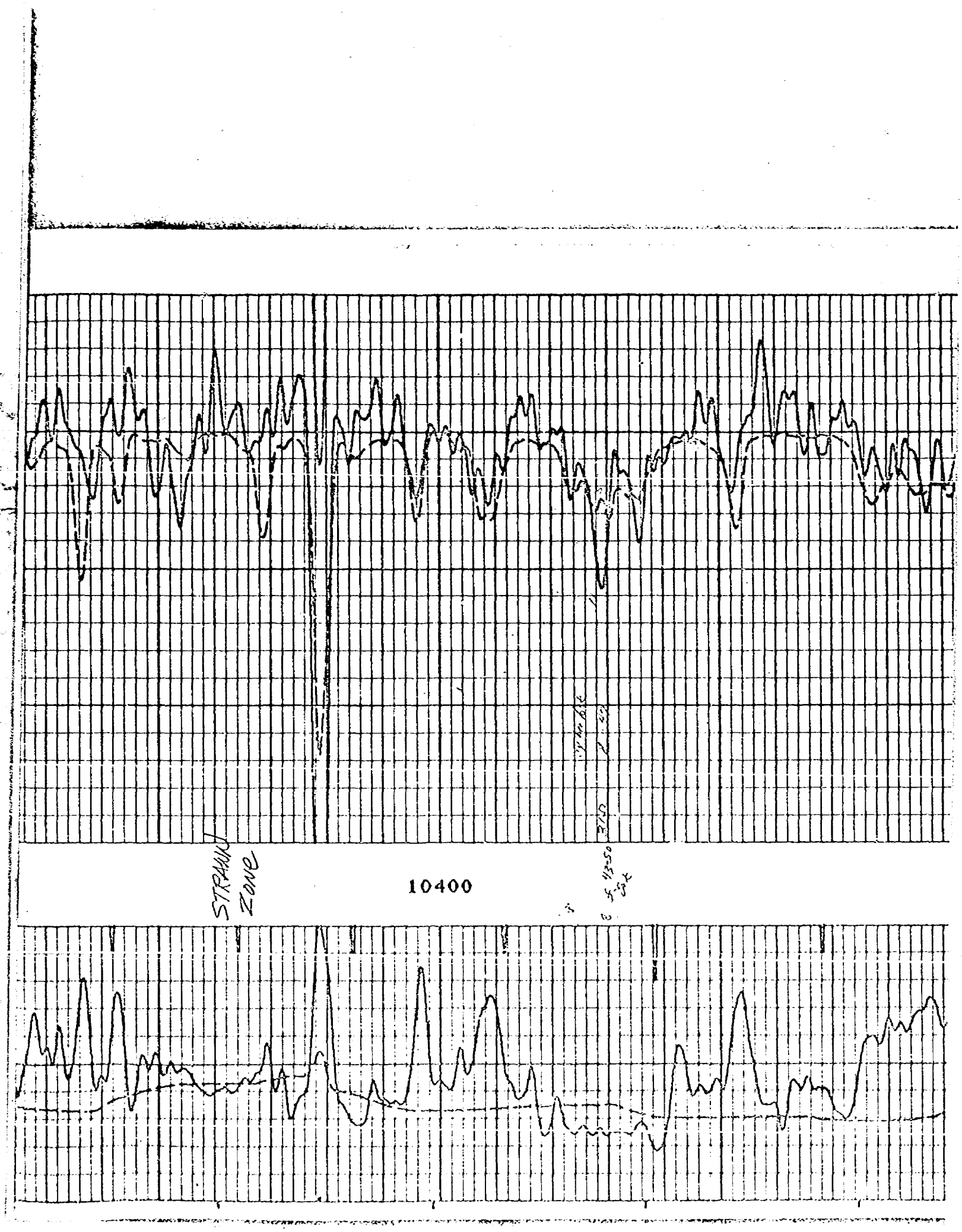
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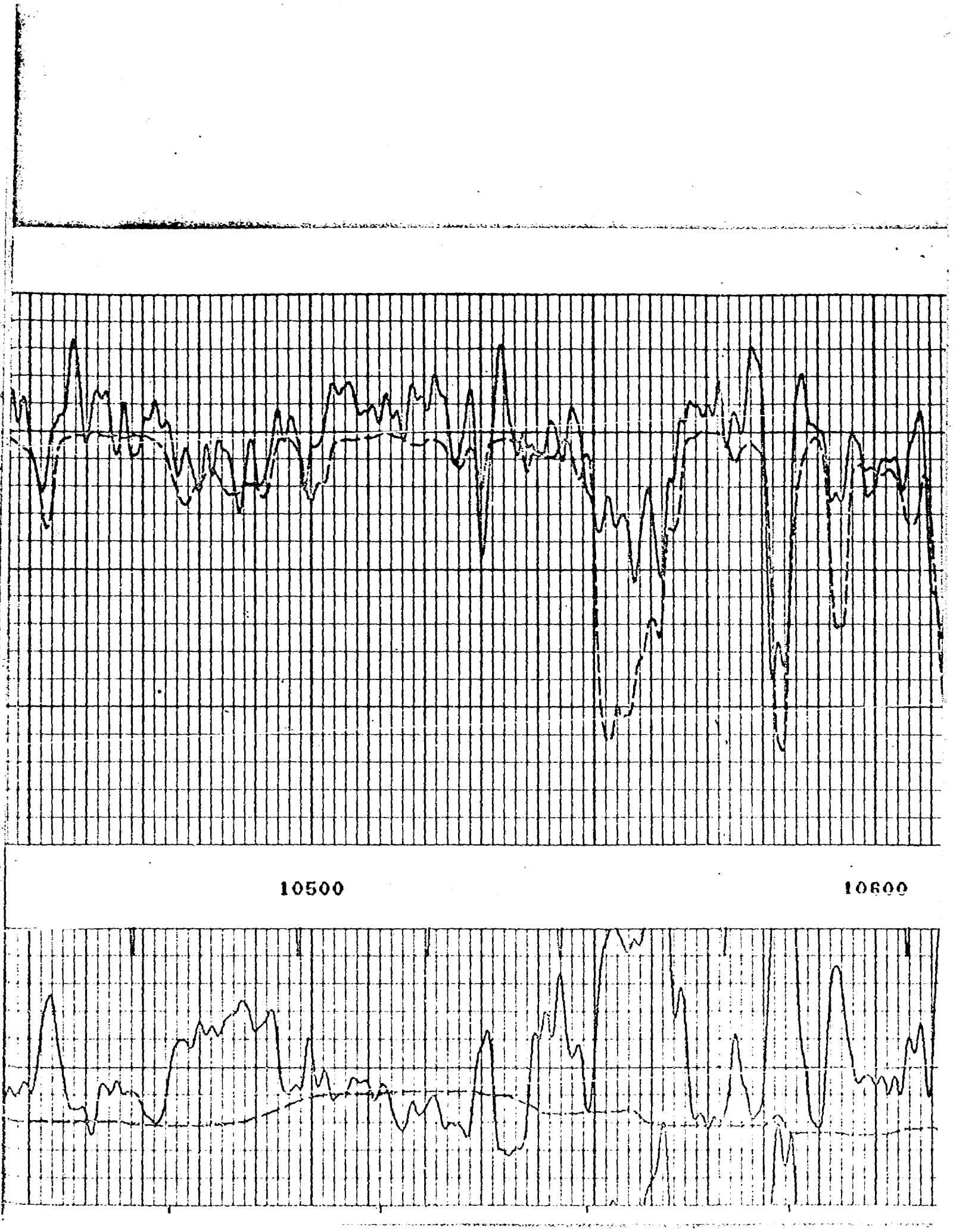
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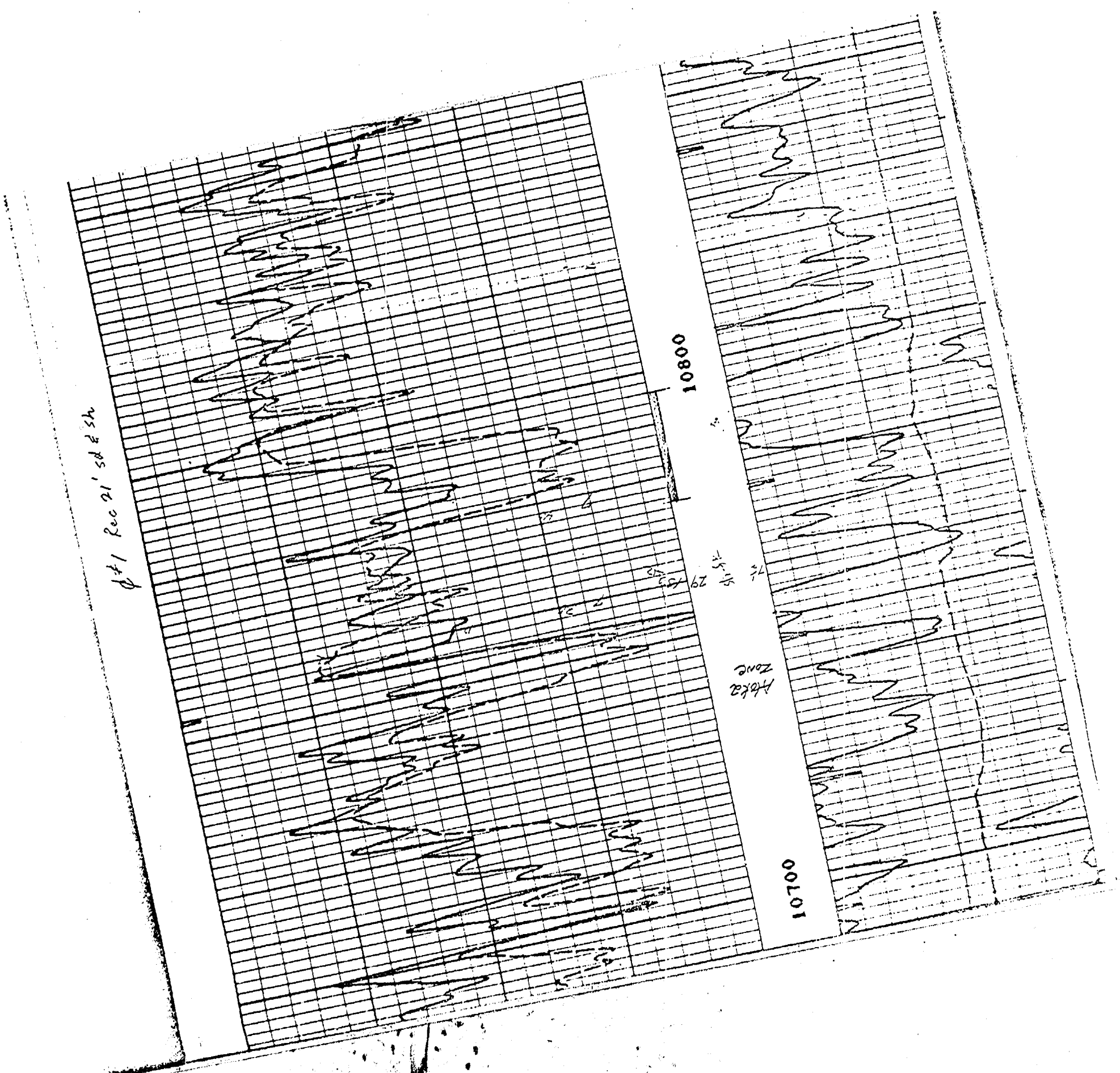
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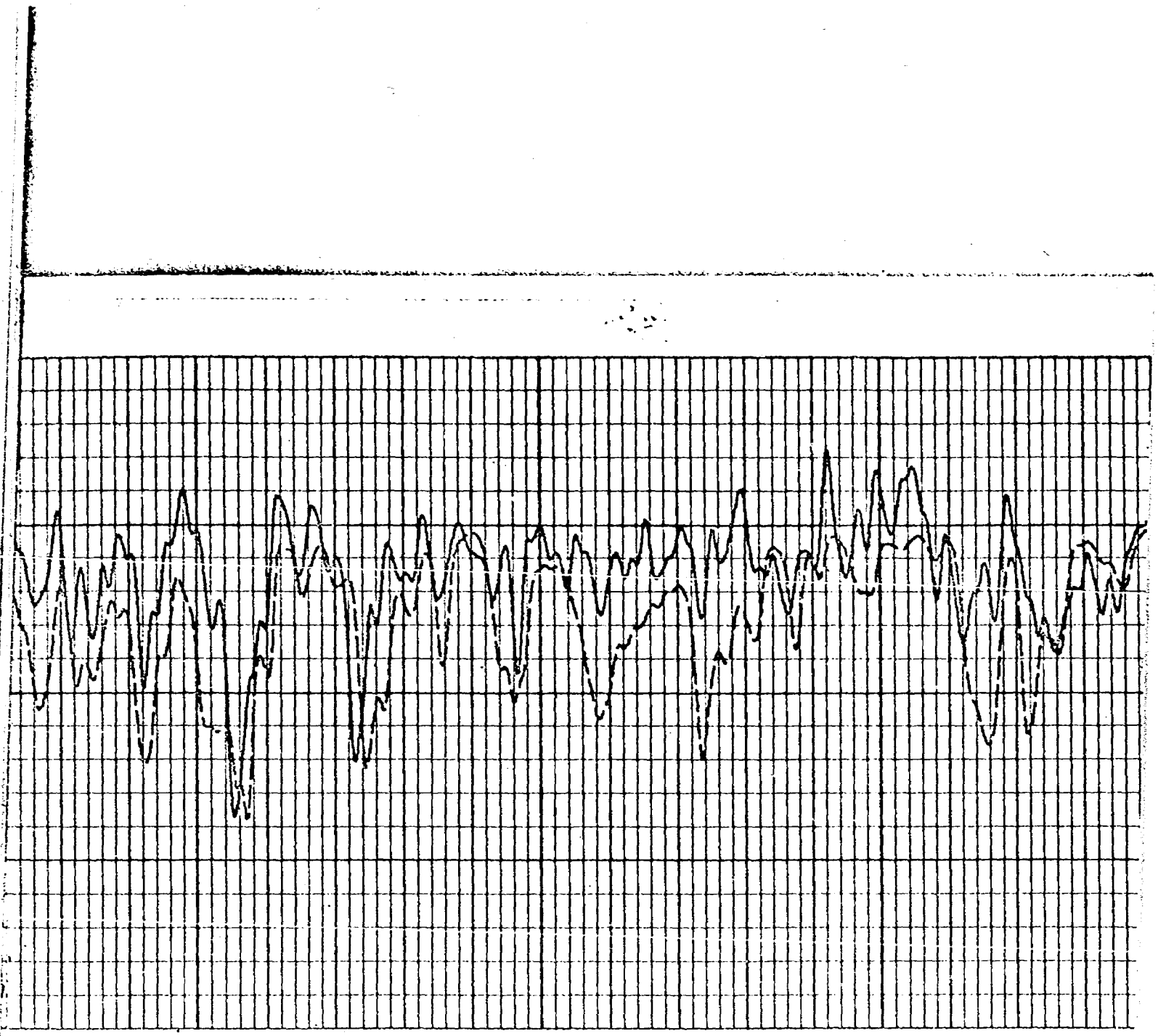

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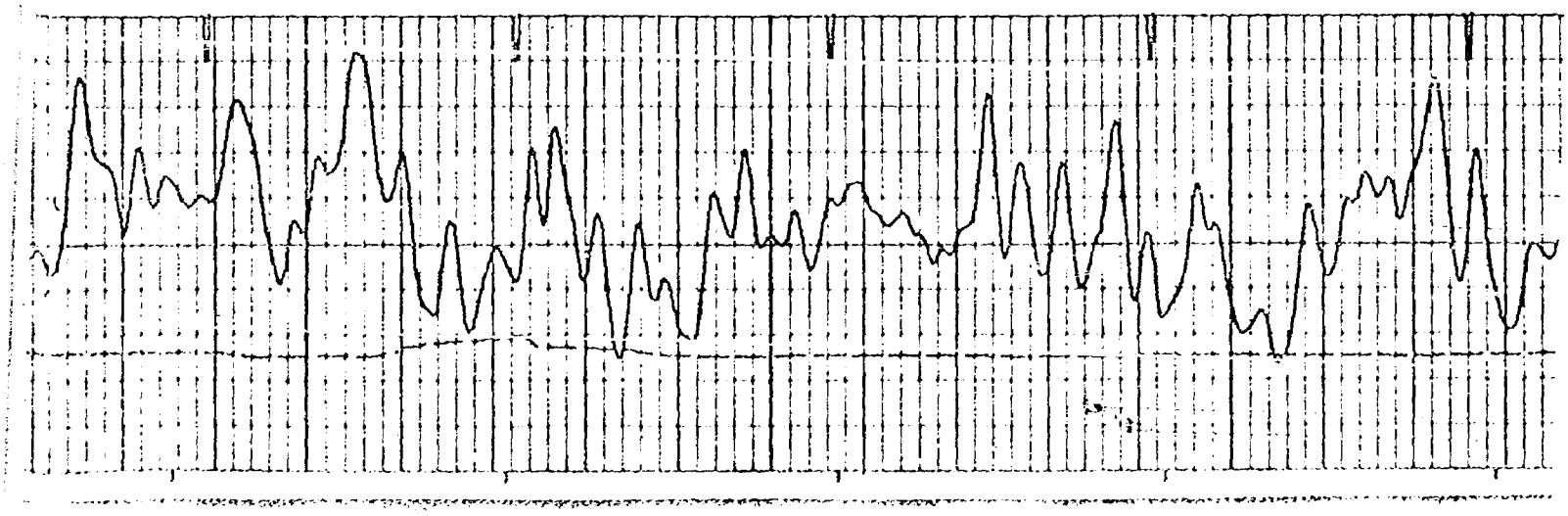

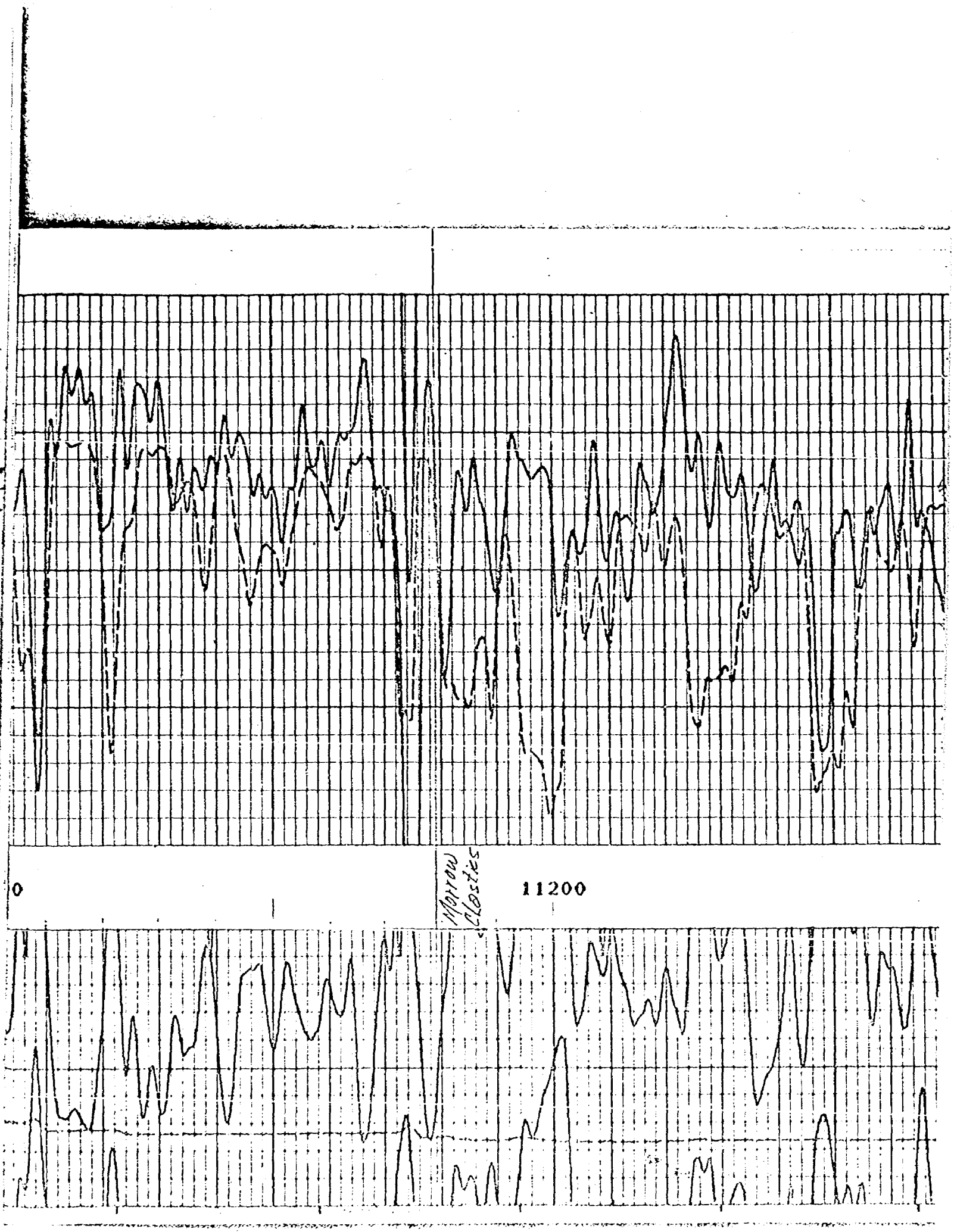
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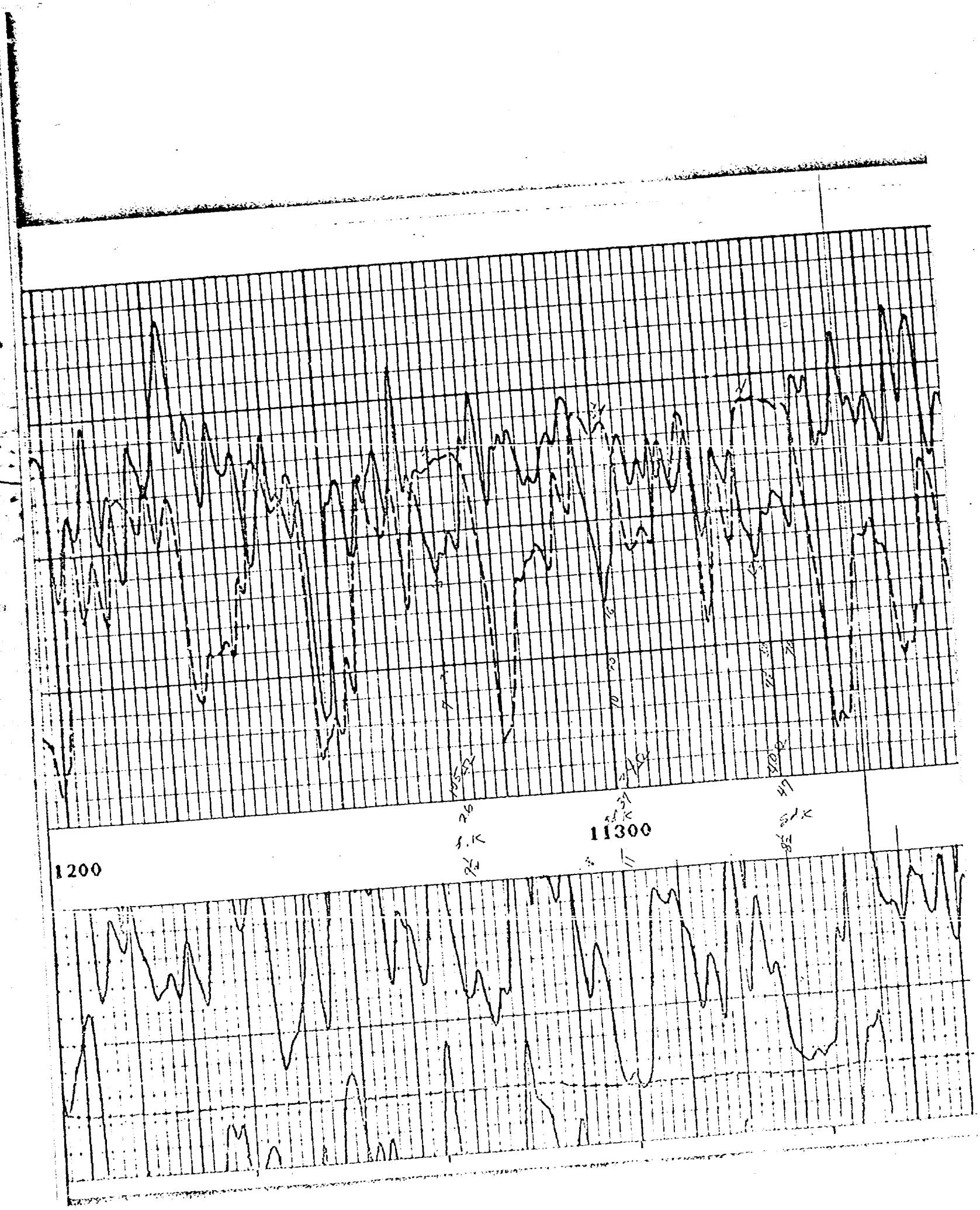
Morrow Clastics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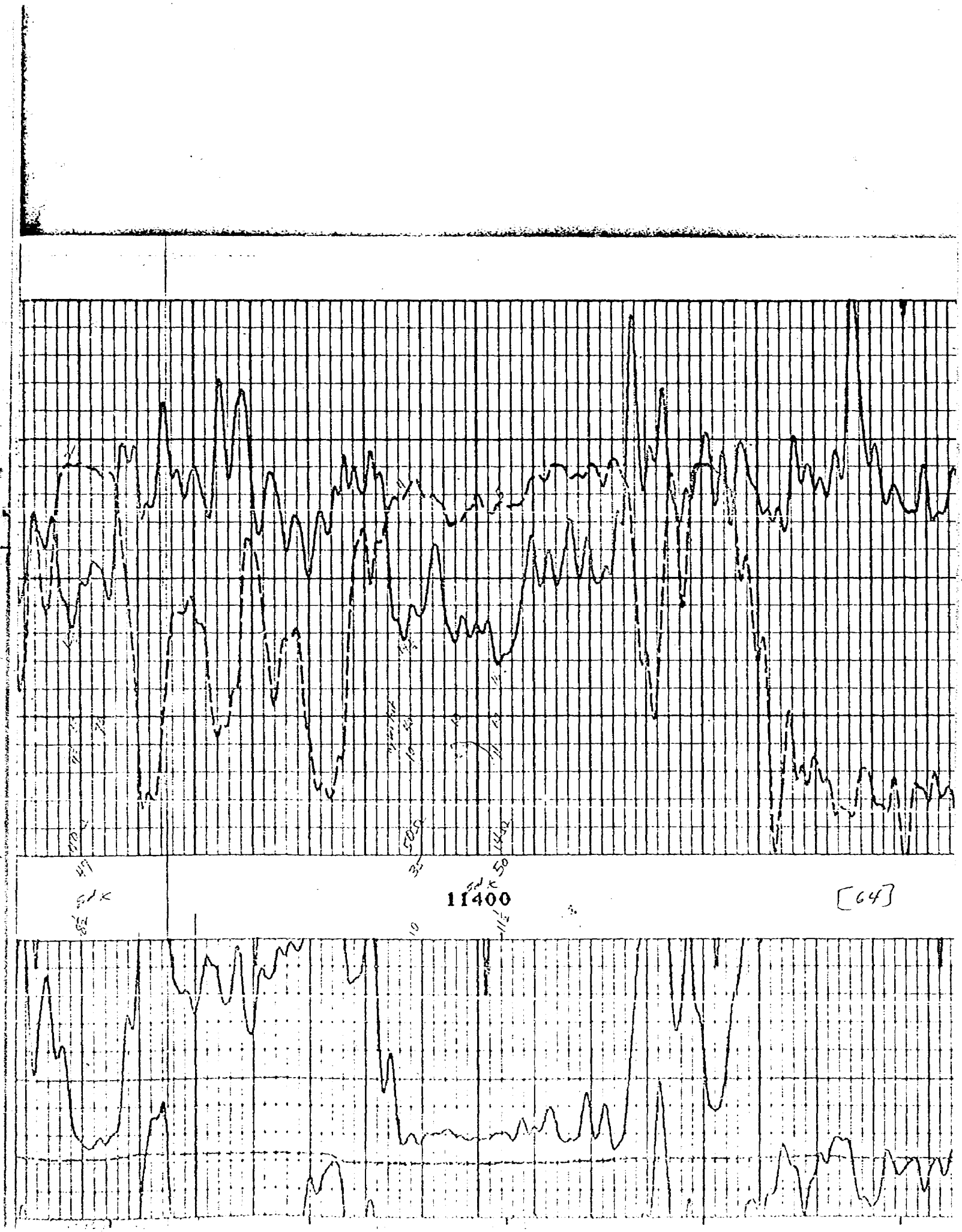

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FORM 925286 REV. 7-78

Dresser Atlas

DRESSER

Combination Logging Systems

Dual Laterolog
Micro Laterolog

R

FILE NO.

COMPANY SOUTHLAND ROYALTY

WELL EMPIRE FEDERAL "35" NO. 1

FIELD WILDCAT

COUNTY EDDY STATE NEW MEXICO

LOCATION: 1980' FSL & 1980' FWL

SEC 35 TWP 18-S RGE 29-E

Other Services: CDL/CN/GR, CAL

Permanent Datum GL Elev. 3433.5'

Log Measured from KB, 13.5 Ft. Above Permanent Datum

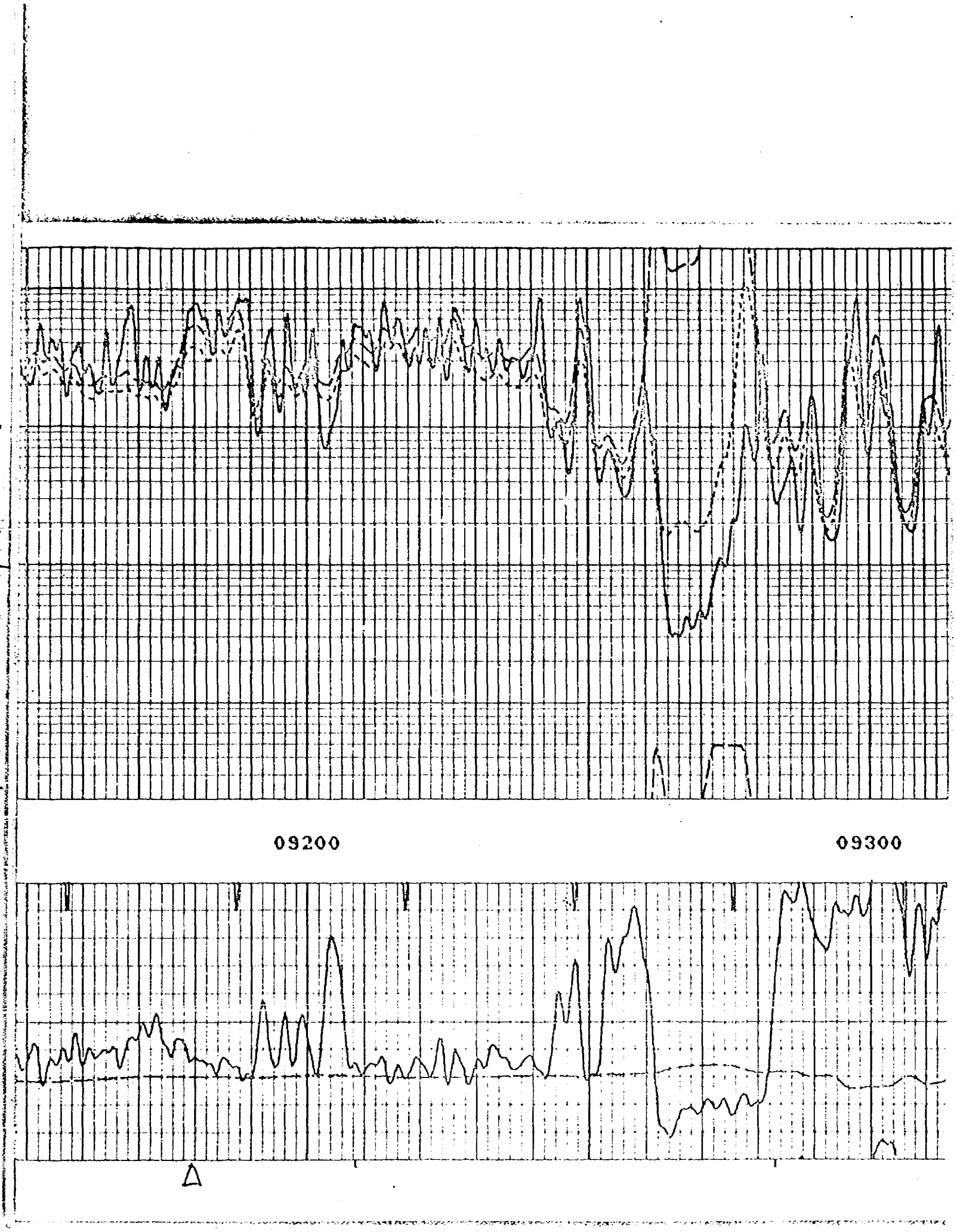
Drilling Measured from KB

Elevations: KB 3447, DF , GL 3433.5'

Date	12-19-20			
Run No.	TWO			
Service Order	50952			
Depth—Driller	11,791'			
Depth—Logger	11,796'			
Bottom Logged Interval	11,794'			
Top Logged Interval	3162'			
Casing—Driller	8 5/8 @ 3200'	@	@	@
Casing—Logger	3162'			
Bit Size	7 7/8"			
Type Fluid in Hole	BGEL/DRISPAC/LOIM/KCL			
Density and Viscosity	10.9 45			
pH and Fluid Loss	9.5 5.2 cc	cc	cc	cc
Source of Sample				
Rm @ Meas. Temp.	.067 @ 60 °F	@ °F	@ °F	@ °F
Rmf @ Meas. Temp	.054 @ 60 °F	@ °F	@ °F	@ °F
Rmc @ Meas. Temp.	NA @ NA °F	@ °F	@ °F	@ °F
Source of Rmf and Rmc	M —			
Rm @ BHT	.025 @ 160 °F	@ °F	@ °F	@ °F
Time Since Circ.	15 HRS			
Max. Rec. Temp. Deg. F	160 °F	°F	°F	°F
Equip. No. and Location	4937 5 HOBBS			
Recorded By	MCLEROY/CLEMENTS			
Witnessed By	[illegible]			

FIELD PRINT

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 5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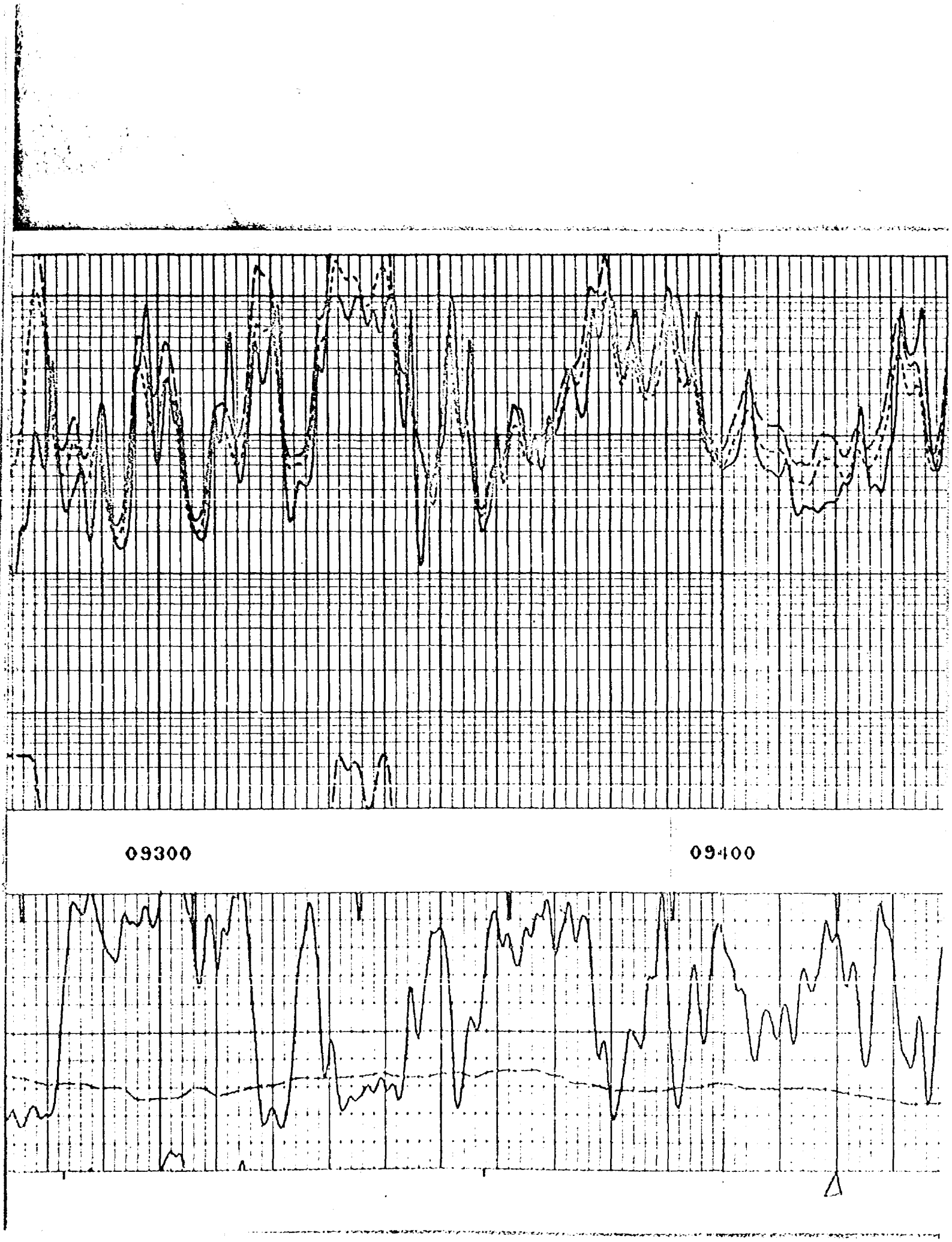
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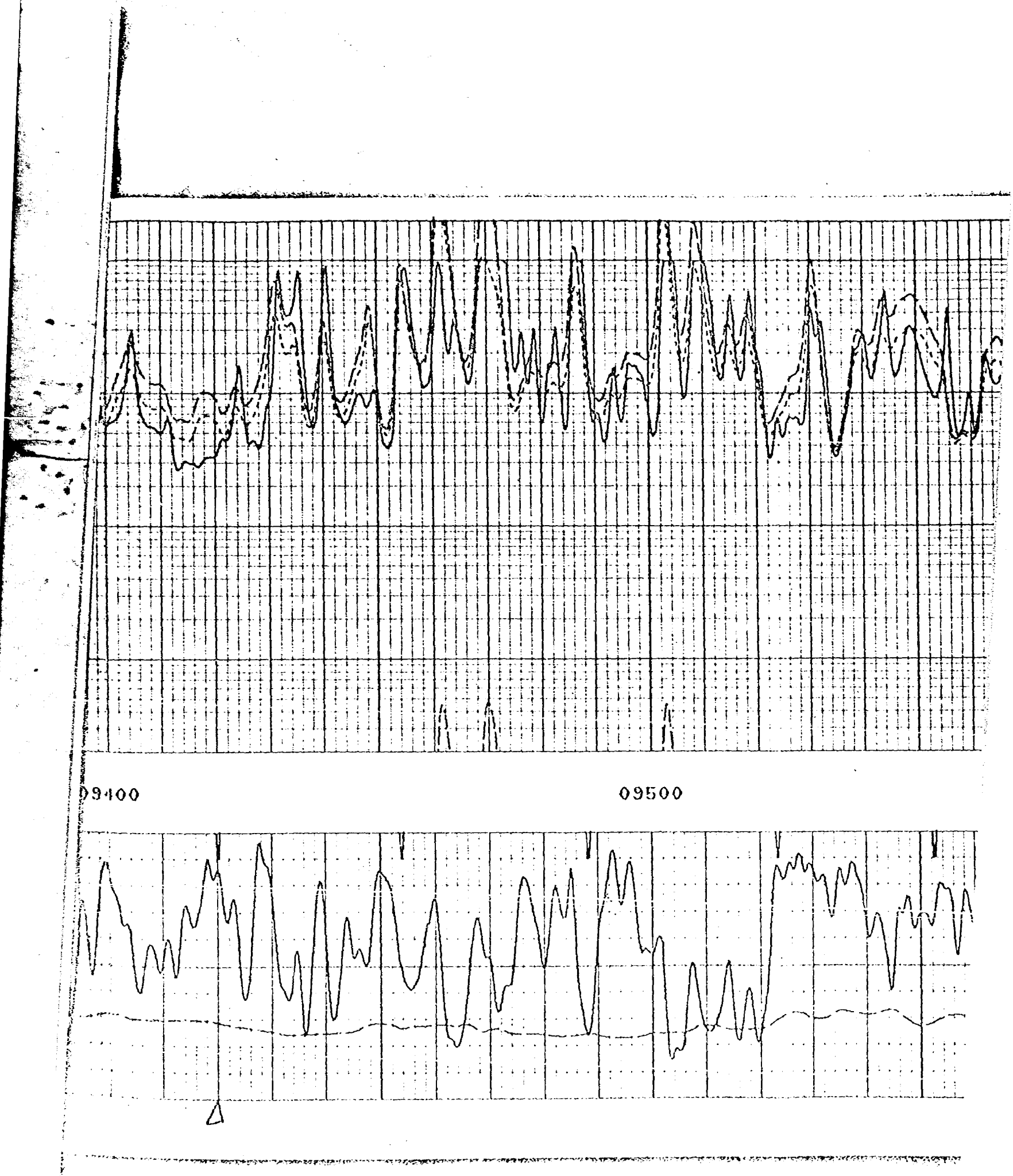
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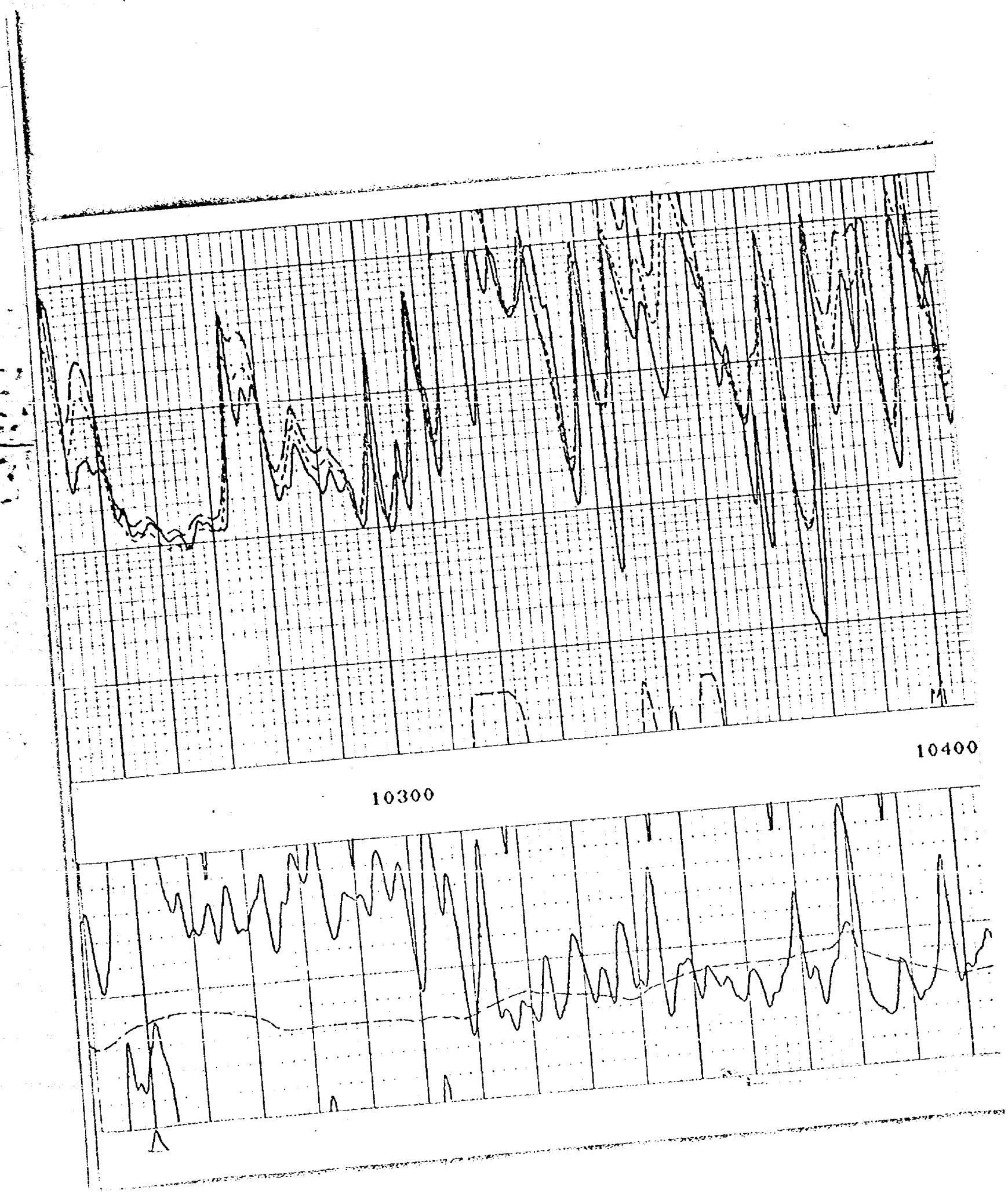
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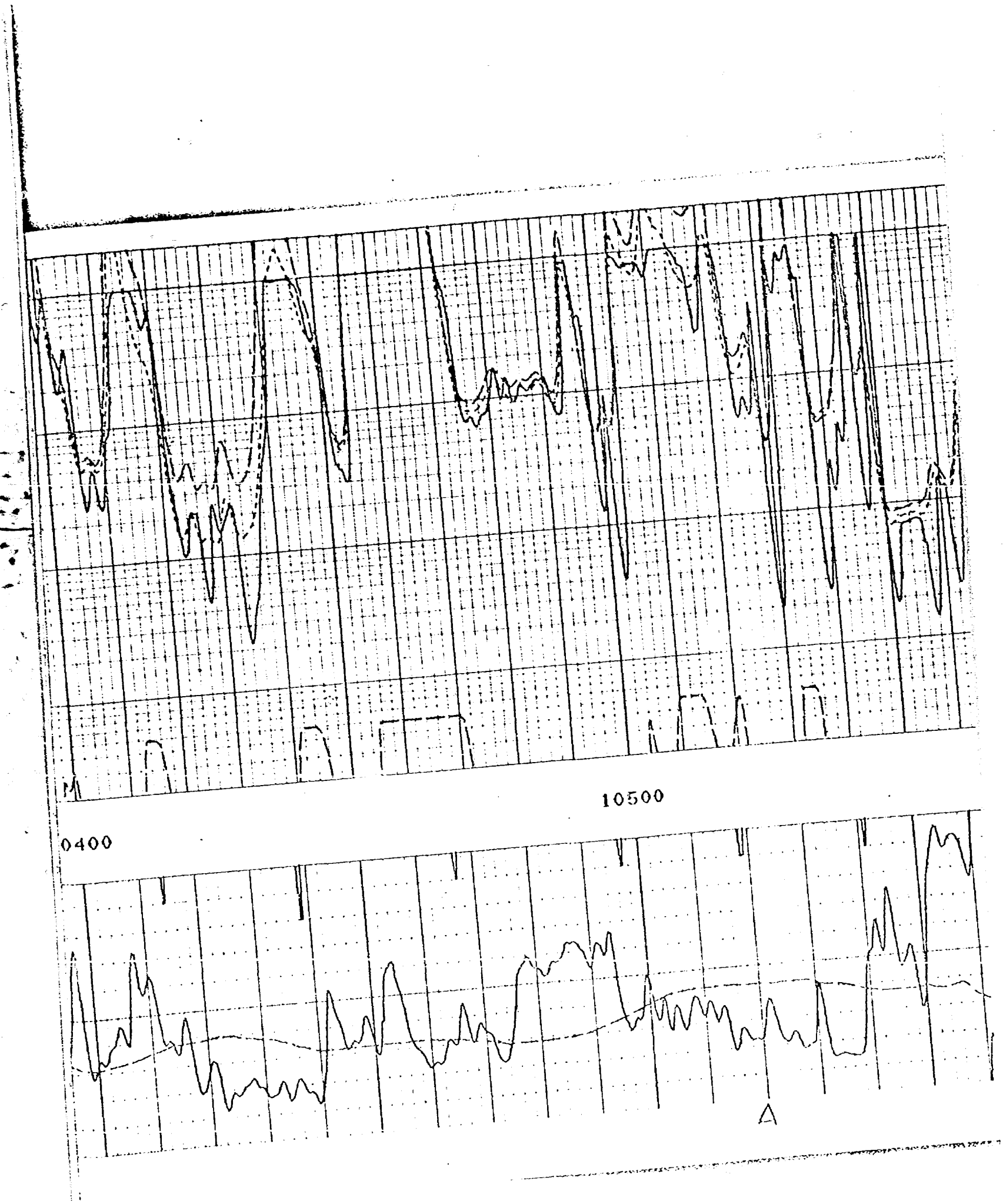
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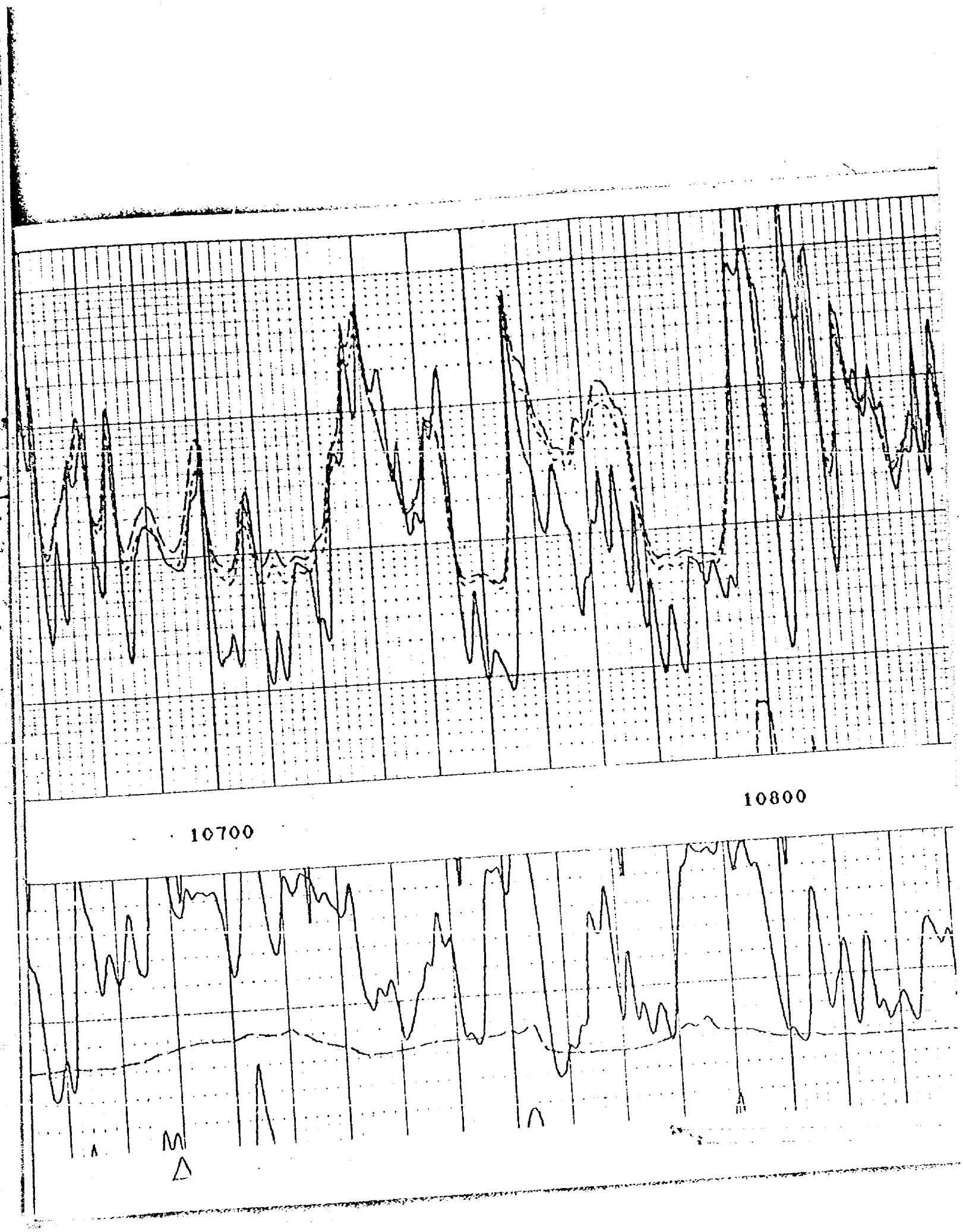
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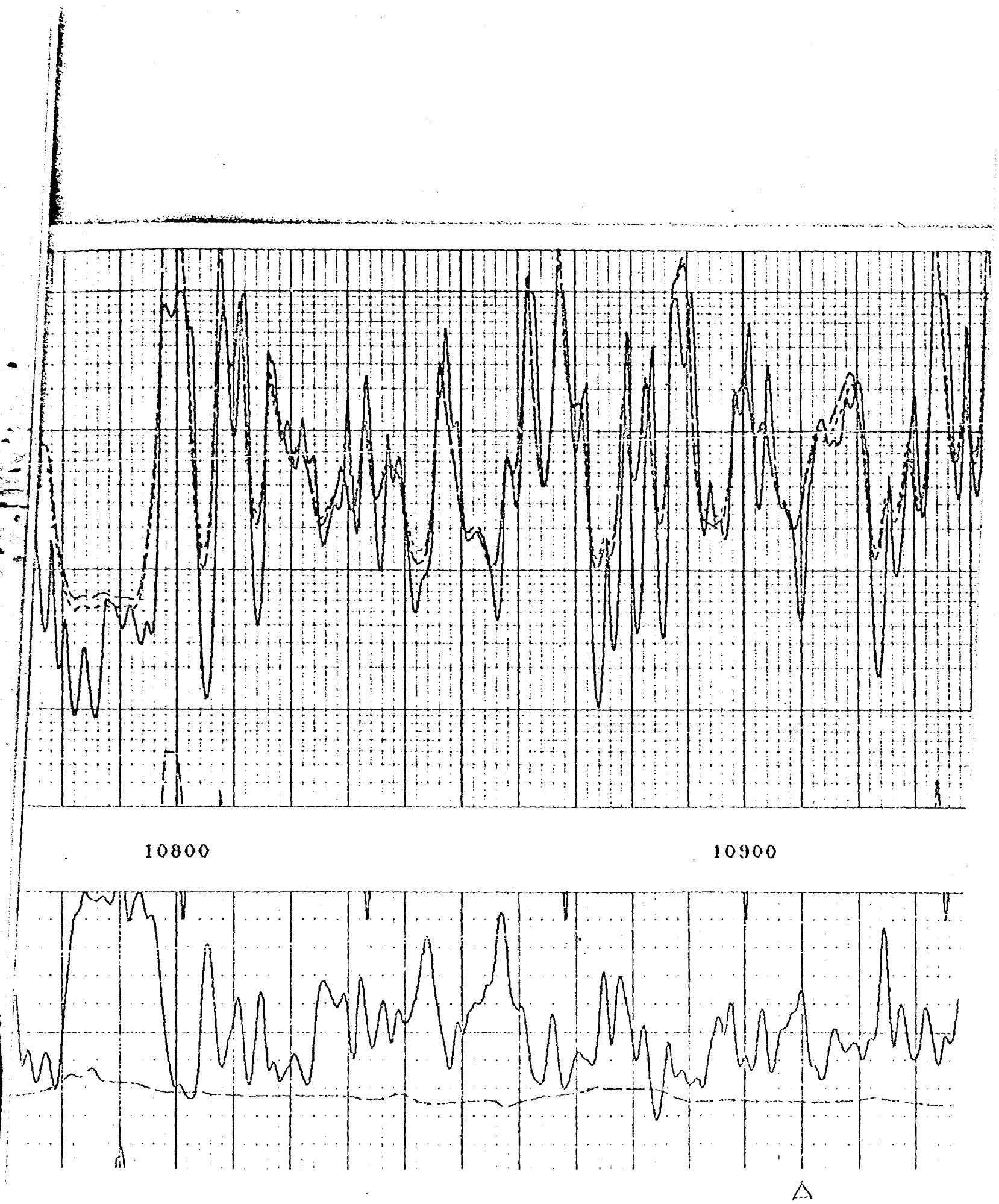
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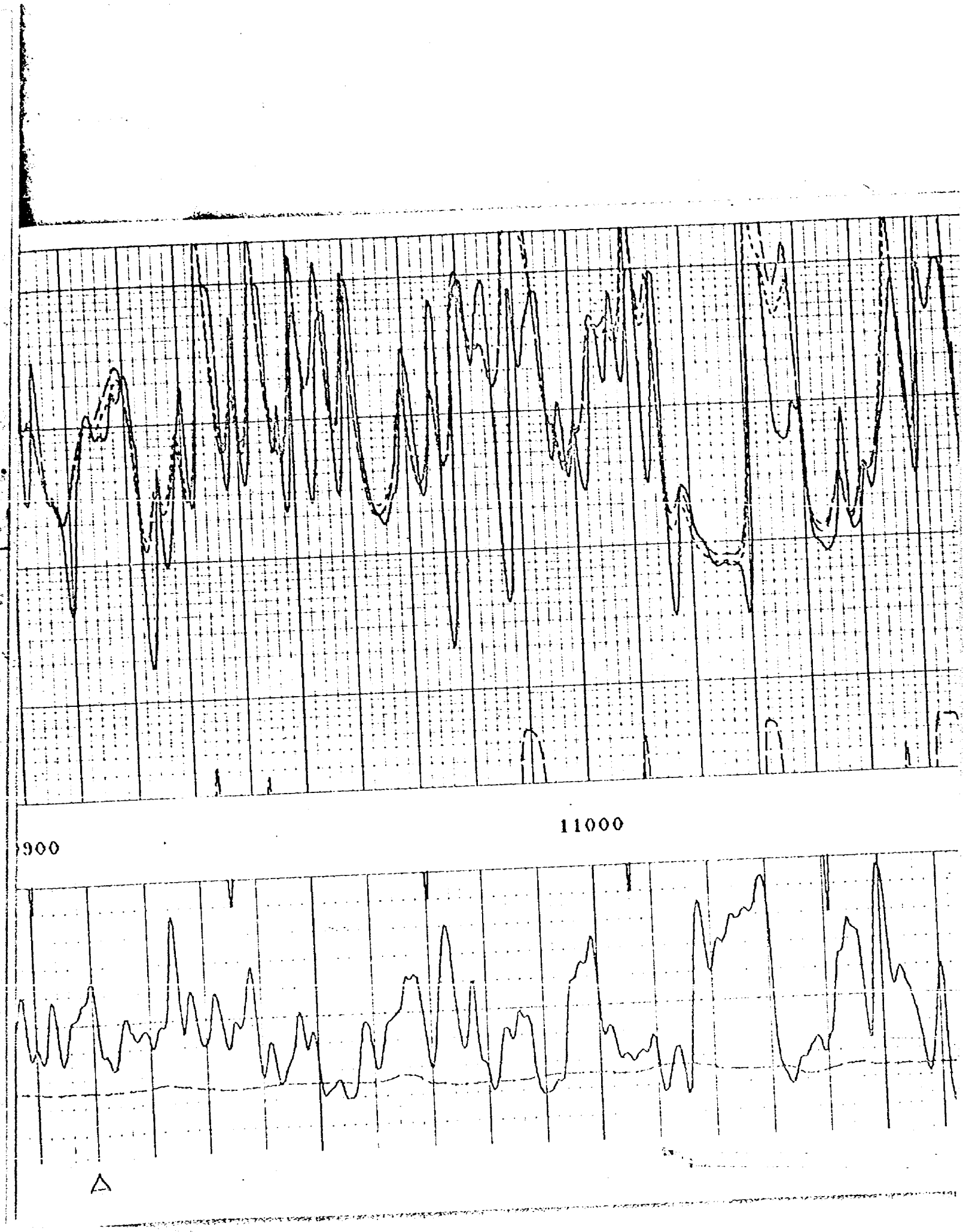
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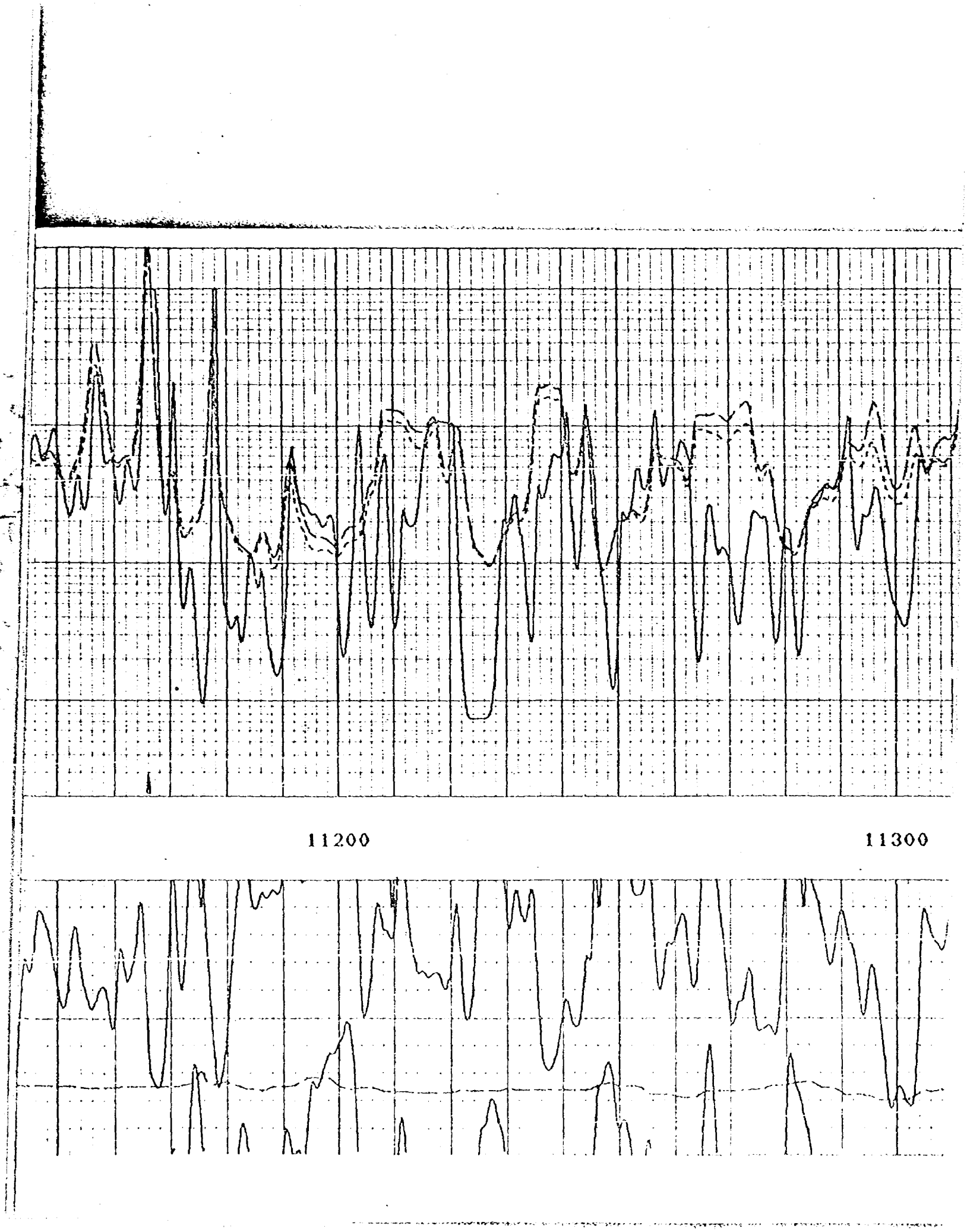

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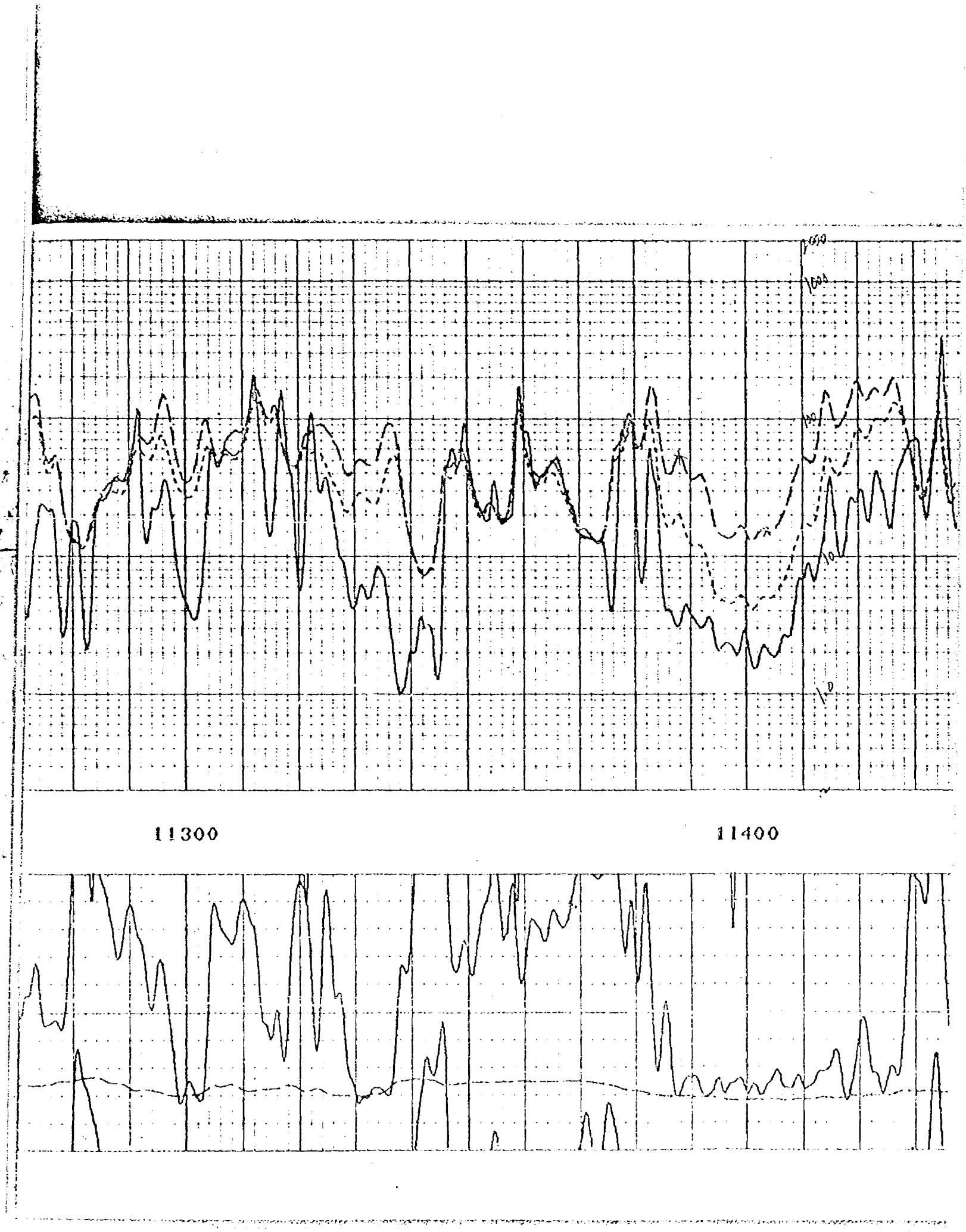
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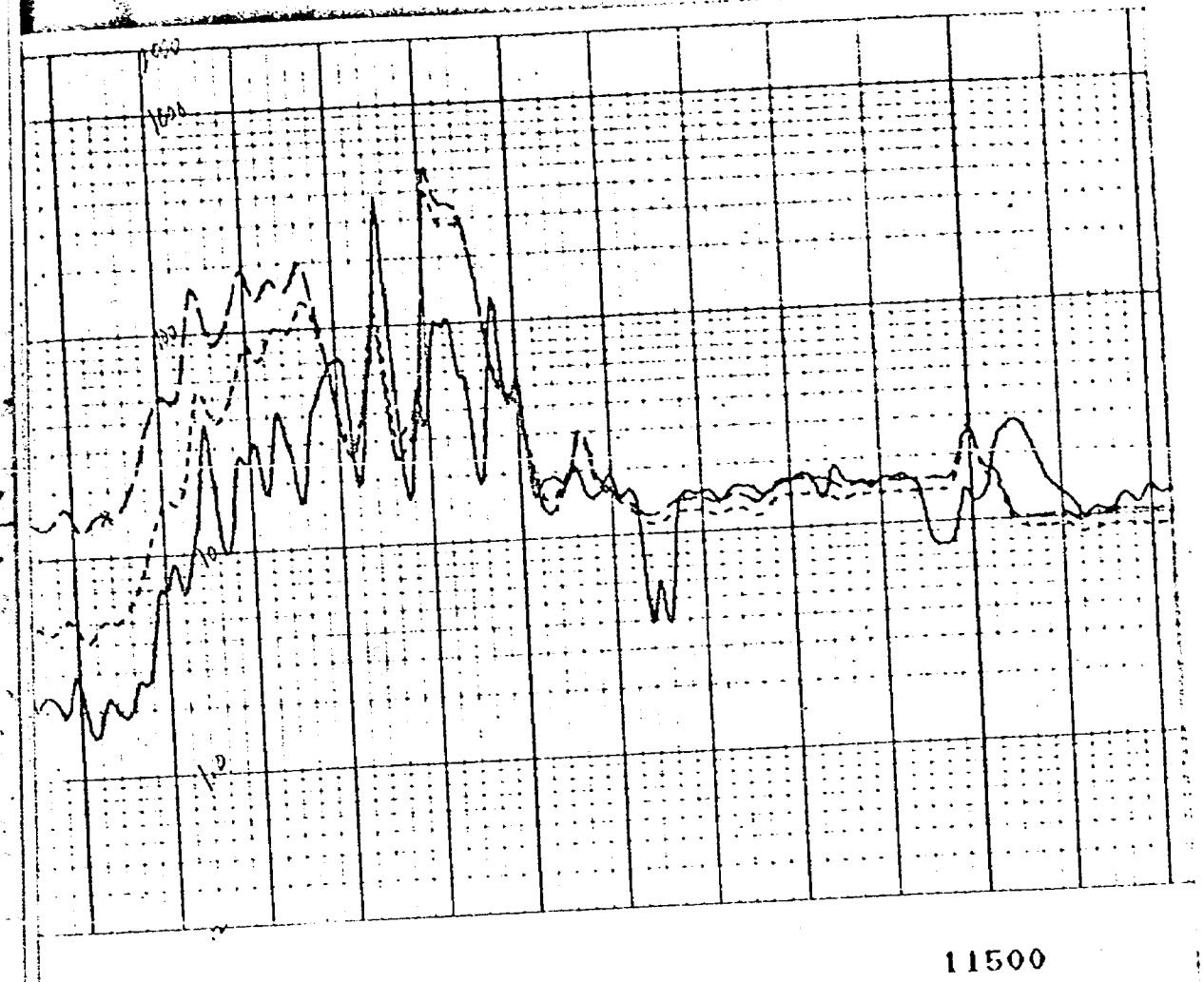
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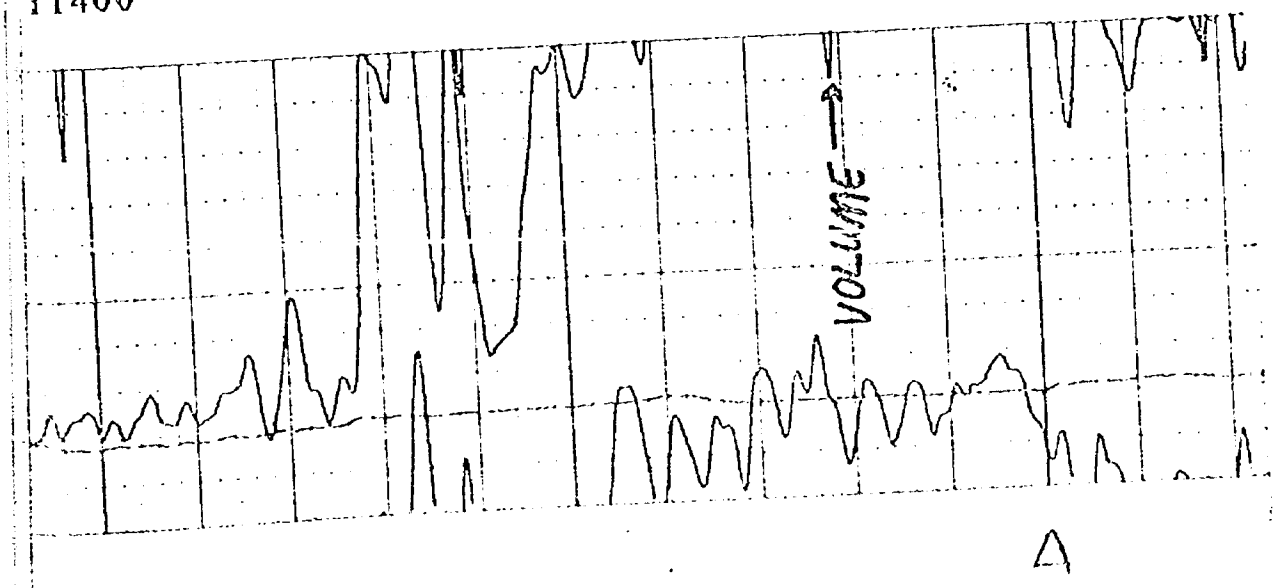
11400
VOLUME

September 4, 1980

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis, Landman

Re: Proposed Southland Royalty Company Empire
Federal "35" Com. No. 1 and "35-A" Com. No. 1
Wells, W/2 and E/2 Sec. 35, T-18-S, R-29-E,
Eddy County, New Mexico

Gentlemen:

This acknowledges receipt of your letters of July 8 and July 25, 1980, together with joint operating agreements and AFEs covering the proposed drilling of the subject wells.

The joint operating agreement dated July 8 covering W/2 Section 35 and the AFE for your No. "35" Com. No. 1, credits our company with a 19.026479% (60/315.35) interest, when in fact we own a 38.052957% (120/315.35) interest. The joint operating agreement dated July 17, 1980 covering E/2 Section 35 and the AFE for your No. "35-A" Com. No. 1, credits our company with a 6.3199% (20/316.46) interest, when in fact we own a 12.6398% (40/316.46) interest. Southland Royalty has instituted a suit against, among other parties, Bassett-Birney Oil Corporation, in the United States District Court for the District of New Mexico, Case No. CIV-80-0614 HB, contesting a portion of our title to the working interest underlying the proposed wells. In view of the incorrect statements in your operating agreements and AFEs as to our ownership in the proposed wells and the pending lawsuit, we are unable to approve either the AFEs or joint operating agreements.

Bassett-Birney is willing to pool its interests in the W/2 of Section 35 and in the E/2 of Section 35 for the drilling of the "35" Com. No. 1 Well and the "35-A" Com. No. 1 Well.

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 1

September 4, 1980

If you have any questions, please do not hesitate to call me.

Very truly yours,

BASSETT-BIRNEY OIL CORPORATION

By Jack W. McCaw

Jack W. McCaw,
Vice President

October 10, 1980

Mr. William F. Carr
Campbell and Black, P.A.
P. O. Box 2208
Santa Fe, New Mexico 87501

Dear Bill:

Enclosed, plase find the following Communitization Agreements, duly executed by Bassett-Birney Oil Corporation:

1. Covering E/2 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico.

2. Covering W/2 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico.

As you will note, these instruments pool the entire interest of Bassett-Birney in the proposed wells. Since Southland, though Operator, has not furnished Bassett-Birney with Communitization Agreements, we prepared these ourselves for Southland's convenience. However, Bassett-Birney remains unwilling to execute the AFE and Operating Agreement furnished with your letter of September 29, 1980, for the reason that the instruments still attempt to place the risk of a dry hole upon Bassett-Birney. Bassett-Birney feels that since Southland is the one proposing the immediate drilling of these wells prior to settlement or judgment upon the disputed title, that Southland should be willing to risk the dry hole, regardless of the outcome of the dispute. We find nothing in our statutes authorizing the Oil Conservation Division to force Bassett-Birney to execute such an Operating Agreement.

Bassett-Birney is willing to execute the Operating Agreement furnished, if the following changes are made in Article XV(B):

(a) In (2), change "credited to it" in line 2 to "credited to it and Robert E. McKee, Inc."

Case No. 7025
N.M. Oil Conservation Div.
De Novo Hearing of 1/19/81
Bassett-Birney Oil Corp.
Exhibit No. 2

(b) In (5), delete the words "either" and "or a dry hole" in line 1.

Please let us know Southland's position on these questions.

Sincerely yours,

LOSEE, CARSON & DICKERSON, P.A.

Chad Dickerson

CD:pvm
Enclosures

cc: Mr. Jack W. McCaw

COMMUNITIZATION AGREEMENT

THIS AGREEMENT, entered into as of the 1st day of October, 1980, by and between the parties subscribing, ratifying or consenting hereto, such parties being hereinafter referred to as "parties hereto,"

W I T N E S S E T H:

WHEREAS, the Act of February 25, 1920, 41 Stat. 437, as amended, authorizes communitization or drilling agreements communitizing or pooling a Federal oil and gas lease or any portions thereof with other lands, whether or not owned by the United States, when separate tracts under such Federal lease cannot be independently developed and operated in conformity with an established well-spacing program for the field or area and such communitization or pooling is determined to be in the public interest; and

WHEREAS, the parties hereto own working, royalty, or other leasehold interests, or operating rights under the oil and gas leases and lands subject to this agreement which cannot be independently developed and operated in conformity with the well-spacing program established for the field or area in which said lands are located; and

WHEREAS, the parties hereto desire to communitize and pool their respective mineral interests in lands subject to this agreement for the purpose of developing and producing communitized substances in accordance with the terms and conditions of this agreement:

NOW, THEREFORE, in consideration of the premises and the mutual advantages to the parties hereto, it is mutually convenanted and agreed by and between the parties hereto as follows:

1. The lands covered by this agreement (hereinafter referred to as "communitized area") are described as follows:

Township 18 South, Range 29 East, N.M.P.M.

Section 35: W/2

containing 315.35 acres, more or less,

and this agreement shall extend to and include the Morrow formation underlying said lands and the dry gas and associated liquid hydrocarbons herein referred to as "communitized substances," producible from such formation.

2. Attached hereto, and made a part of this agreement for all purposes, is Exhibit "A" designating the operator of the communitized area and showing the oil and gas interests in all lands within the communitized area, and the authorization, if any, for communitizing or pooling any patented or fee lands within the communitized area.

3. All matters of operation shall be governed by the Operator under and pursuant to the terms and provisions of this agreement. A successor operator may be designated by the owners of the working

interest in the communitized area and four (4) executed copies of a designation of successor operator shall be filed with the Regional Oil and Gas Supervisor.

4. Operator shall furnish the Secretary of the Interior or his authorized representative, a log and history of any well drilled on the communitized area, monthly reports of operations, statements of communitized substances sales and royalties, and such other reports as are deemed necessary to compute monthly the royalty due the United States, as specified in the applicable oil and gas operating regulations.

5. Nondiscrimination: In connection with the performance of work under this agreement, the operator agrees to comply with all of the provisions of Section 202(1) to (7) inclusive of Executive Order 11246 (30 F.R. 12319), as amended, which are hereby incorporated by reference in this agreement.

6. The communitized area shall be developed and operated as an entirety with the understanding and agreement between the parties hereto that all communitized substances produced therefrom shall be allocated among the leaseholds comprising said area in the proportion that the acreage interest of each leasehold bears to the entire acreage interest committed to this agreement.

7. The royalties payable on communitized substances allocated to the individual leases comprising the communitized area and the rentals provided for in said leases shall be determined and paid on the basis prescribed in each of the individual leases. For any federal lease bearing a sliding- or step-scale rate of royalty, such rate shall be determined separately as to the production from each communitization agreement to which such lease may be committed, and separately as to any non-communitized lease production; provided, however, as to leases where the rate of royalty for gas is based on total lease production per day shall be determined by the sum of all communitized production allocated to such a lease and any non-communitized lease production. Payment of rentals under the terms of leases subject to this agreement shall not be affected by this agreement except as provided for under the terms and provisions of said leases or as may herein be otherwise provided. Except as herein modified and changed, the oil and gas leases subject to this agreement shall remain in full force and effect as originally made and issued.

8. There shall be no obligation on the lessees to offset any well or wells completed in the formation covered by this agreement on separate component tracts into which the communitized area is now or may hereafter be divided, nor shall any lessee be required to measure separately communitized substances by reason of the diverse ownership thereof, but the lessees shall not be released from their obligation to protect the communitized area from drainage of communitized substances by a well or wells drilled offsetting said area.

9. The commencement, completion, continued operation or production of a well or wells for communitized substances on the communitized area shall be construed and considered as the commencement, completion, continued operation or production on each and all of the lands within and comprising said communitized area, and operations or production pursuant to this agreement shall be deemed to be operations or production as to each lease committed hereto.

10. Production of communitized substances and disposal thereof shall be in conformity with allocation, allotments and quotas made or fixed by any duly authorized person or regulatory body under applicable Federal or State statutes. The agreement shall be subject to all applicable Federal and State laws or executive orders, rules and regulations, and no party hereto shall suffer a forfeiture or be liable in damages for failure to comply with any of the provisions of this agreement if such compliance is prevented by, or if such failure results from, compliance with any such laws, orders, rules or regulations.

11. This agreement shall be effective as of the date hereof upon execution by the necessary parties, notwithstanding the date of execution, and upon approval by the Secretary of the Interior, or his duly authorized representative, and shall remain in force and effect for a period of two (2) years and so long thereafter as communitized substances are or can be produced from the communitized area in paying quantities from the communitized area and upon fulfillment of all requirements of the Secretary of the Interior, or his duly authorized representative, with respect to any dry hole or abandoned well, this agreement may be terminated at any time by mutual agreement of the parties hereto. This agreement shall not terminate upon cessation of production if, within sixty (60) days thereafter, reworking or drilling operations on the communitized area are commenced and are thereafter conducted with reasonable diligence during the period of nonproduction.

12. It is agreed by the parties hereto that the Secretary of the Interior, or his duly authorized representative, shall have the right of supervision over all operations within the communitized area to the same extent and degree as provided in the oil and gas leases under which the United States of America is lessor and in the applicable oil and gas operation regulations of the Department of the Interior.

13. The covenants herein shall be construed to be covenants running with the land with respect to the communitized interests of the parties hereto and their successors in interest until this agreement terminates; and any grant, transfer or conveyance of any such land or interest subject hereto, whether voluntary or not, shall be and hereby is conditioned upon the assumption of all obligations hereunder by the grantee, transferee, or other successor in interest, and as to Federal land shall be subject to approval by the Secretary of the Interior.

14. This agreement shall be binding upon the parties hereto and shall extend to and be binding upon their respective heirs, personal representatives, administrators, successors and assigns.

15. This communitization agreement shall also serve as a written designation of pooled unit, under and pursuant to the provisions of the oil and gas leases included within the communitized area and covering oil, gas and other minerals owned by private individuals.

16. This agreement may be executed in any number of counterparts, no one of which needs to be executed by all parties, or may be ratified or consented to by separate instrument, in writing, specifically referring hereto, and shall be binding upon all parties who have executed such a counterpart, ratification or consent hereto with the same force and effect as if all parties had signed the same document.

IN WITNESS WHEREOF the parties hereto have executed this agreement as of the day and year first above written and have set opposite their respective names the date of execution.

BASSETT-BIRNEY OIL CORPORATION

ATTEST:

OCT 10 1980
Date

Secretary

By: _____
VICE President

SOUTHLAND ROYALTY COMPANY

_____
Date

By: _____
Attorney-in-Fact

TENNECO OIL COMPANY

ATTEST:

_____
Date

_____
Secretary

By: _____
President

ROBERT E. McKEE, INC.

ATTEST:

_____
Date

_____
Secretary

By: _____
President

FEATHERSTONE FARMS, LTD.

By: _____
Partner

_____
Date

STATE OF NEW MEXICO)
: ss.
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this 10th day of October, 1980, by Jack W. McCaus VICE President of BASSETT-BIRNEY OIL CORPORATION, a New Mexico corporation, on behalf of said corporation.

Kim Bilberry
Notary Public

My commission expires:
August 4, 1984

OFFICIAL SEAL
Signature: KIM BILBERRY
NOTARY PUBLIC - NEW MEXICO
NOTARY BOND FILED WITH SECRETARY OF STATE
My Commission Expires 8-1-84

STATE OF TEXAS)
: ss.
COUNTY OF MIDLAND)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, Attorney-in-Fact for SOUTHLAND ROYALTY COMPANY, a Texas corporation, on behalf of said corporation.

My commission expires:
_____

_____
Notary Public

STATE OF TEXAS)
: ss.
COUNTY OF BEXAR)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, President of TENNECO OIL COMPANY, a Delaware corporation, on behalf of said corporation.

My commission expires:
_____

_____
Notary Public

STATE OF TEXAS)
: ss.
COUNTY OF EL PASO)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, President of ROBERT E. McKEE, INC., a Texas corporation, on behalf of said corporation.

My commission expires:
_____

_____
Notary Public

STATE OF NEW MEXICO)
: ss.
COUNTY OF CHAVES)

The foregoing instrument was acknowledged before me this _____ day of October, 1980, by _____, Partner, on behalf of FEATHERSTONE FARMS, LTD., a New Mexico limited partnership.

My commission expires:
_____

_____
Notary Public

EXHIBIT "A" TO COMMUNITIZATION AGREEMENT DATED OCTOBER 1, 1980, EMBRACING THE N/2 SECTION 35, TOWNSHIP 18 SOUTH, RANGE 29 EAST, N.M.P.M.

Operator of Communitized Area: Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Tract No. 1

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: NE/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

Tenneco Oil Company 100%

O.R.R.I. and Percentage:

Heirs and devisees of C. Melvin Neal, deceased 2.500000%

P.P.I. and Percentage:

*Robert E. McKee General Contractor, Inc.	4.218750%
†Robert J. Leonard	3.125000%
†Patrick J. Leonard	3.125000%
†Timothy T. Leonard	3.125000%

*Pursuant to Production Payment Agreement dated March 9, 1960, recorded Book 106, Page 399, from Leonard Oil Company to Robert E. McKee General Contractor, Inc., until $80,612.50 shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

†Pursuant to Assignment dated October 1, 1965, recorded Book 160, Page 67, from Leonard Oil Company to Tenneco Oil Company, until $3 million shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

Tract No. 2

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: NW/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

Tenneco Oil Company	100%

O.R.R.I. and Percentage:

Jimmie Marie Terry, Trustee of the Sandra Leigh Runyan Trust dated November 16, 1972	.666667%
Jimmie Marie Terry, Trustee of the Susan Lynn Perry Trust dated November 16, 1972	.666667%
Billie L. Kruse, Trustee of the Barbara Kruse Frankenfield Trust dated October 2, 1966	.666666%

P.P.I. and Percentage:

*Robert E. McKee General Contractor, Inc.	4.468750%
†Robert J. Leonard	3.125000%
†Patrick J. Leonard	3.125000%
†Timothy T. Leonard	3.125000%

*Pursuant to Production Payment Agreement dated March 9, 1960, recorded Book 106, Page 399, from Leonard Oil Company to Robert E. McKee General Contractor, Inc., until $88,612.50 shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

†Pursuant to Assignment dated October 1, 1965, recorded Book 160, Page 67, from Leonard Oil Company to Tenneco Oil Company, until $3 million shall have been paid, whereupon the PPI shall terminate and revert to Tenneco Oil Company.

Tract No. 3

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: SE/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

*Bassett-Birney Oil Corporation 100%

*Title to 1/2 disputed between Bassett-Birney Oil Corporation and Southland Royalty Company.

O.R.R.I. and Percentage:

Heirs and devisees of C. Melvin Neal, deceased 2.50000%

Tract No. 4

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: SW/4 NW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

*Bassett-Birney Oil Corporation 100%

*Title to 1/2 disputed between Bassett-Birney Oil Corporation and Southland Royalty Company.

O.R.R.I. and Percentage:

Jimmie Marie Terry, Trustee of the Sandra Leigh Runyan Trust dated November 16, 1972 .66667%
Jimmie Marie Terry, Trustee of the Susan Lynn Perry Trust dated November 16, 1972 .66667%
Billie L. Kruse, Trustee of the Barbara Kruse Frankenfield Trust dated October 2, 1966 .66666%

Tract No. 5

Lessor: United States

Lessees of Record: Bassett-Birney Oil Corporation and Robert E. McKee General Contractor, Inc.

Serial No. of Lease: LC 062029 (Consolidated)

Date of Lease: May 1, 1942

Description of Lands Committed: NW/4 SW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 40

Working Interest and Percentage:

*Bassett-Birney Oil Corporation 100%

*Title to 1/2 disputed by Bassett-Birney Oil Corporation and Southland Royalty Company.

O.P.R.I. and Percentage:

Neil B. Watson 5%

Tract No. 6

Lessor: United States

Lessee of Record: Featherstone Farms, Ltd.

Serial No. of Lease: NM 010907-A

Date of Lease: April 1, 1953

Description of Lands Committed: Lots 3 and 4 (S/2 SW/4), NE/4 SW/4 Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico

Number of Acres: 115.35

Working Interest and Percentage:

Before Payout:

Southland Royalty Company 100%

After Payout:

Southland Royalty Company 50%
Featherstone Farms, Ltd. 50%

O.R.R.I. and Percentage:

Before Payout:

Featherstone Farms, Ltd. 6.25%

RECAPITULATION

Tract Number	No. of Acres Committed	Percentage of Interest in Communitized Area
1	40.00	12.68432%
2	40.00	12.68432%
3	40.00	12.68432%
4	40.00	12.68432%
5	40.00	12.68432%
6	115.35	36.57840%
TOTAL	315.35	100.00000%

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BLDG.
SANTA FE, NEW MEXICO
11 December 1980

COMMISSION HEARING

IN THE MATTER OF:

Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico. CASE 7025

BEFORE: Oil Conservation Commission

TRANSCRIPT OF HEARING

A P P E A R A N C E S

For the Oil Conservation Commission: Ernest L. Padilla, Esq.
Legal Counsel to the Division
State Land Office Bldg.
Santa Fe, New Mexico 87501

MR. RAMEY: We'll call Case Number 7025.

MR. PADILLA: Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

MR. RAMEY: This case will be continued to a future Commission Hearing.

(Hearing concluded.)

C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY CERTIFY that the foregoing Transcript of Hearing before the Oil Conservation Division was reported by me; that the said transcript is a full, true, and correct record of the hearing, prepared by me to the best of my ability.

Sally W. Boyd C.S.R.

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BLDG.
SANTA FE, NEW MEXICO
11 December 1980

COMMISSION HEARING

IN THE MATTER OF:

Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

CASE 7025

BEFORE: Oil Conservation Commission

TRANSCRIPT OF HEARING

A P P E A R A N C E S

For the Oil Conservation Commission: Ernest L. Padilla, Esq.
Legal Counsel to the Division
State Land Office Bldg.
Santa Fe, New Mexico 87501

MR. RAMEY: We'll call Case Number 7025.

MR. PADILLA: Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

MR. RAMEY: This case will be continued to a future Commission Hearing.

(Hearing concluded.)

C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY CERTIFY that the foregoing Transcript of Hearing before the Oil Conservation Division was reported by me; that the said transcript is a full, true, and correct record of the hearing, prepared by me to the best of my ability.

Sally W. Boyd C.S.R.

Dockets Nos. 4-81 and 5-81 are tentatively set for January 28 and February 11, 1981. Applications for hearing must be filed at least 22 days in advance of hearing date.

DOCKET: EXAMINER HEARING - WEDNESDAY - JANUARY 14, 1981

9 A.M. - OIL CONSERVATION DIVISION CONFERENCE ROOM, STATE LAND OFFICE BUILDING, SANTA FE, NEW MEXICO

The following cases will be heard before Richard L. Stamets, Examiner, or Daniel S. Nutter, Alternate Examiner:

ALLOWABLE: (1) Consideration of the allowable production of gas for February, 1981, from fifteen prorated pools in Lea, Eddy, and Chaves Counties, New Mexico.

(2) Consideration of the allowable production of gas for February, 1981, from four prorated pools in San Juan, Rio Arriba, and Sandoval Counties, New Mexico.

CASE 7117: Application of Gulf Oil Corporation for a non-standard gas proration unit, unorthodox location, and simultaneous dedication, Lea County, New Mexico. Applicant, in the above-styled cause, seeks approval for the simultaneous dedication of a previously approved 320-acre non-standard proration unit comprising the E/2 of Section 25, Township 20 South, Range 36 East, Eumont Gas Pool, to its L. W. White (NCT-A)Wells No. 2 in Unit I and No. 7 at an unorthodox location 990 feet from the North line and 660 feet from the East line of said Section 25.

CASE 7118: Application of El Paso Exploration Company for downhole commingling, Rio Arriba County, New Mexico. Applicant, in the above-styled cause, seeks approval for the downhole commingling of South Blanco Tocito and Basin-Dakota production in the wellbore of its Jicarilla 152 W Well No. 3 in Unit D of Section 7, Township 26 North, Range 5 West.

CASE 7119: Application of Shell Oil Company for a unit agreement, Bernalillo and Sandoval Counties, New Mexico. Applicant, in the above-styled cause, seeks approval for the West Mesa Unit Area, comprising 26,722 acres, more or less, of State, Federal, and fee lands in Townships 10, 11, and 12 North, Ranges 1 and 2 East.

CASE 7120: Application of Dugan Production Corporation for downhole commingling, San Juan County, New Mexico. Applicant, in the above-styled cause, seeks approval for the downhole commingling of undesignated Gallup and Basin-Dakota production in the wellbore of its Merry May Well No. 1 in Unit I of Section 24, Township 24 North, Range 10 West.

CASE 7121: Application of Flag-Redfern Oil Co. for downhole commingling, San Juan County, New Mexico. Applicant, in the above-styled cause, seeks approval for the downhole commingling of Pinon-Fruitland and Fulcher Kutz-Pictured Cliffs production in the wellbores of its Aloha Wells Nos. 1 and 2 located in Units L and D, respectively, of Section 16, Township 28 North, Range 11 West.

CASE 7122: Application of Elk Oil Company for salt water disposal, Lea County, New Mexico. Applicant, in the above-styled cause, seeks authority to dispose of produced salt water into the Pennsylvanian formation in the interval from 10,445 feet to 10,516 feet in its C. S. State Well No. 2 in Unit K of Section 26, Township 14 South, Range 34 East, High Plains-Pennsylvanian Pool.

CASE 7123: Application of Yates Petroleum Corporation for an unorthodox gas well location, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks approval for the unorthodox location of its Federal "AB" Well No. 7, a Morrow test to be drilled 1980 feet from the North line and 660 feet from the West line of Section 9, Township 18 South, Range 25 East, the N/2 of said Section 9 to be dedicated to the well.

CASE 7124: Application of Caribou Four Corners, Inc. for two non-standard proration units, San Juan County, New Mexico. Applicant, in the above-styled cause, seeks approval for two non-standard oil proration units in Section 13, Township 29 North, Range 15 West, Cha Cha-Gallup Oil Pool, as follows: a 56.09-acre unit consisting of those fee lands comprising the NE/4 NW/4 and northernmost 16.09 acres of the SE/4 NW/4 of said Section 13, and a 66.33-acre unit consisting of those fee lands comprising the NW/4 NW/4 and northernmost 23.33 acres of the SW/4 NW/4 of said Section 13. In the alternative applicant seeks an order directing the escrowing of funds attributable to those lands in the E/2 NW/4 and W/2 NW/4, respectively, of said Section 13 which are not included in the above-described non-standard proration units.

CASE 7125: Application of Western Oil Producers Inc. for the amendment of Order No. R-5399, Lea County, New Mexico. Applicant, in the above-styled cause, seeks the amendment of Division Order No. R-5399 to include production from all of the Pennsylvanian formations in its Amoco State Well No. 1 at an unorthodox location in Unit M of Section 28, Township 16 South, Range 33 East.

CASE 7126: Application of Franks Petroleum, Inc. for an unorthodox gas well location, Lea County, New Mexico. Applicant, in the above-styled cause, seeks approval for an unorthodox location 1980 feet from the North line and 1315 feet from the West line, Section 3, Township 21 South, Range 32 East, Hat Mesa-Morrow Gas Pool, the N/2 of said Section 3 to be dedicated to the well.

CASE 7127: Application of Ellwade Corporation for amendment of Order No. R-6399, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks the amendment of Order No. R-6399 which approved a 129.52-acre non-standard gas proration unit comprising the W/2 of Section 33, Township 26 South, Range 30 East, for the Wolfcamp formation in the Ross Draw Area. Applicant seeks to have said order also apply to all formations of Pennsylvanian age.

CASE 6670: (Reopened and Readvertised)

In the matter of Case 6670 being reopened and pursuant to the provisions of Order No. R-6183 which order promulgated temporary special rules and regulations for the Red Hills-Devonian Gas Pool in Lea County, New Mexico, including a provision for 640-acre spacing units. Operators in said pool may appear and show cause why the pool should not be developed on 320-acre spacing units.

CASE 7128: Application of HNG Oil Company for pool creation, special pool rules, assignment of a discovery allowable, and dual completion, Lea County, New Mexico. Applicant, in the above-styled cause, seeks creation of a new Wolfcamp oil pool for its San Simon 6 State Comm. Well No. 1 located 1980 feet from the North line and 660 feet from the East line of Section 6, Township 22 South, Range 35 East, with special rules therefor, including provisions for 160-acre spacing. Applicant further seeks a discovery allowable for said well and approval for its dual completion to produce oil from the Wolfcamp and gas from an undesignated Morrow pool thru parallel strings of tubing.

CASE 7129: Application of Koch Exploration Company for compulsory pooling, San Juan County, New Mexico. Applicant, in the above-styled cause, seeks an order pooling all mineral interests in the Dakota formation underlying the N/2 of Section 28, Township 28 North, Range 8 West, to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said well and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the well, and a charge for risk involved in drilling said well.

CASE 7130: Application of Read & Stevens, Inc. for an unorthodox gas well location and two non-standard gas proration units, Chaves County, New Mexico. Applicant, in the above-styled cause, seeks approval of two 160-acre non-standard proration units in the Buffalo Valley-Pennsylvanian Gas Pool, the first being the SE/4 of Section 12, Township 15 South, Range 27 East, to be dedicated to its Trobough "A" State Com. Well No. 1 in Unit J, and the other being the NE/4 of said Section 12 to be dedicated to a well to be drilled at an unorthodox location 1315 feet from the North and East lines of the section.

CASE 7131: Application of Read & Stevens, Inc. for an unorthodox gas well location and two non-standard gas proration units, Chaves County, New Mexico. Applicant, in the above-styled cause, seeks approval of two 160-acre non-standard proration units in the Buffalo Valley-Pennsylvanian Gas Pool, the first being the SE/4 of Section 1, Township 15 South, Range 27 East, to be dedicated to its Trobough Com. Well No. 1 in Unit J, and the other being the NE/4 of said Section 1 to be dedicated to a well to be drilled at an unorthodox location 1315 feet from the North and East lines of the section.

CASE 7132: Application of Read & Stevens, Inc. for an unorthodox gas well location and two non-standard gas proration units, Chaves County, New Mexico. Applicant, in the above-styled cause, seeks approval of two 160-acre non-standard proration units in the Buffalo Valley-Pennsylvanian Gas Pool, the first being the SE/4 of Section 13, Township 15 South, Range 27 East, to be dedicated to its Rose Well No. 1 located in Unit J, and the other being the SW/4 of said Section 13 to be dedicated to a well to be drilled at an unorthodox location 1315 feet from the South and West lines of the section.

CASE 7133: Application of Read & Stevens, Inc. for an unorthodox gas well location and two non-standard gas proration units, Chaves County, New Mexico. Applicant, in the above-styled cause, seeks approval of two 160-acre non-standard proration units in the Buffalo Valley-Pennsylvanian Gas Pool, the first being the NW/4 of Section 12, Township 15 South, Range 27 East, to be dedicated to its Hurd Well No. 1 in Unit C, and the other being the SW/4 of said Section 12 to be dedicated to a well to be drilled at an unorthodox location 1315 feet from the South and West lines of the section.

CASE 7134: Application of Read & Stevens, Inc. for an unorthodox gas well location and two non-standard gas proration units, Chaves County, New Mexico. Applicant, in the above-styled cause, seeks approval of two 160-acre non-standard proration units in the Buffalo Valley-Pennsylvanian Gas Pool, the first being the NW/4 of Section 13, Township 15 South, Range 27 East, to be dedicated to its Langley "Com" Well No. 1 in Unit C, and the other being the NE/4 of said Section 12 to be dedicated to a well to be drilled at an unorthodox location 1315 feet from the North and East lines of the section.

CASE 7100: (Continued from the December 10, 1980, Examiner Hearing)

Application of Harvey E. Yates Company for downhole commingling, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks approval for the downhole commingling of Atoka and Morrow production in the wellbore of its Travis 24 State Com Well No. 1 in Unit H of Section 24, Township 18 South, Range 28 East.

CASE 7086: (Continued from the December 10, 1980, Examiner Hearing)

Application of Blackwood & Nichols Company, Ltd. for designation of a tight formation, San Juan and Rio Arriba Counties, New Mexico. Applicant, in the above-styled cause, seeks the designation of the Pictured Cliffs formation underlying portions of Townships 30 and 31 North, Ranges 6, 7, and 8 West, containing 33,500 acres, more or less, as a tight formation pursuant to Section 107 of the Natural Gas Policy Act and 18 CFR Section 271.701-705.

CASE 6940: (Continued from the December 30, 1980, Examiner Hearing)

Application of Adobe Oil Company for compulsory pooling, Lea County, New Mexico. Applicant in the above-styled cause, seeks an order pooling all mineral interests down through the Wolfcamp formation underlying the NW/4 SE/4 for oil and the SE/4 for gas, Section 23, Township 20 South, Range 38 East, to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said well and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the well, and a charge for risk involved in drilling said well.

CASE 7103: (Continued from the December 30, 1980, Examiner Hearing)

Application of E. L. Latham, Jr. for compulsory pooling, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks an order pooling all mineral interests in the Wolfcamp thru Pennsylvanian formations underlying the N/2 of Section 7, Township 22 South, Range 26 East, to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said well and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the well, and a charge for risk involved in drilling said well.

CASE 7114: (Continued from the December 30, 1980, Examiner Hearing)

Application of Yates Petroleum Corporation for an unorthodox gas well location, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks approval for the unorthodox location of its Rio Penasco "JX" Well No. 2, a Morrow test to be drilled 660 feet from the South and East lines of Section 35, Township 18 South, Range 25 East, the S/2 of said Section 35 to be dedicated to the well.

Docket No. 2-81

DOCKET: COMMISSION HEARING - MONDAY - JANUARY 19, 1981

OIL CONSERVATION COMMISSION - 9 A.M. - ROOM 205
STATE LAND OFFICE BUILDING, SANTA FE, NEW MEXICO

The following cases are continued from the December 11, 1980, Commission Hearing:

CASE 7025: (DE NOVO)

Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks an order pooling all mineral interests in the Pennsylvanian formation underlying the W/2 of Section 35, Township 18 South, Range 29 East, to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said well and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the well, and a charge for risk involved in drilling said well.

Upon application of Southland Royalty Company this case will be heard De Novo pursuant to the provisions of Rule 1220.

CASE 7008: (DE NOVO)

Application of Coronado Exploration Corp. for eight compulsory poolings, Chaves County, New Mexico. Applicant, in the above-styled cause, seeks an order pooling all mineral interests in the San Andres formation underlying eight 40-acre proration units, being the NE/4 NE/4 of Section 4 and the NW/4 NE/4 of Section 5, both in Township 12 South, Range 28 East, and the NW/4 SE/4 of Section 6, the NE/4 NW/4 of Section 23, the NE/4 SE/4 of Section 28, the SE/4 SE/4 of Section 29, the NE/4 NW/4 of Section 32, and the SE/4 NW/4 of Section 33, all in Township 11 South, Range 28 East, each to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said wells and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the wells, and a charge for risk involved in drilling said wells.

Upon application of Tenneco Oil Company this case will be heard De Novo pursuant to the provisions of Rule 1220.

CASE 6965: (DE NOVO)

Application of Supron Energy Corporation for a non-standard gas proration unit, Rio Arriba County, New Mexico. Applicant, in the above-styled cause, seeks approval of a 160-acre non-standard Mesaverde and Dakota gas proration unit comprising the SE/4 of Section 8, Township 25 North, Range 3 West, to be dedicated to a well to be drilled at a standard location thereon.

Upon application of Curtis J. Little and Beartooth Oil and Gas Company this case will be heard De Novo pursuant to the provisions of Rule 1220.

CASE 6896: (DE NOVO)

Application of John E. Schalk for a non-standard gas proration unit and an unorthodox gas well location, Rio Arriba County, New Mexico. Applicant, in the above-styled cause, seeks approval of a 160-acre non-standard Blanco Mesaverde gas proration unit comprising the NE/4 of Section 8, Township 25 North, Range 3 West, to be dedicated to his Gulf Well No. 2 to be drilled at an unorthodox location 1925 feet from the North line and 790 feet from the East line of said Section 8.

Upon application of Curtis J. Little and Beartooth Oil and Gas Company this case will be heard De Novo pursuant to the provisions of Rule 1220.

CASE 6996: Application of John E. Schalk for compulsory pooling, Rio Arriba County, New Mexico. Applicant, in the above-styled cause, seeks an order pooling all mineral interests in the Blanco Mesaverde Pool underlying the NE/4 of Section 8, Township 25 North, Range 3 West, to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said well and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the well, and a charge for risk involved in drilling said well.

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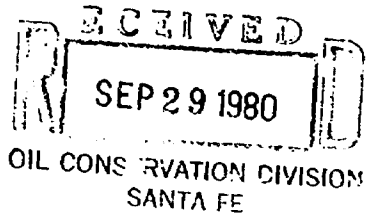
CAMPBELL AND BLACK, P.A.
LAWYERS

JACK M. CAMPBELL
BRUCE D. BLACK
MICHAEL B. CAMPBELL
WILLIAM F. CARR

POST OFFICE BOX 2208
JEFFERSON PLACE
SANTA FE, NEW MEXICO 87501
TELEPHONE (505) 988-4421

September 29, 1980



Mr. Joe D. Ramey
Director
Oil Conservation Division
New Mexico Department of
Energy & Minerals
Post Office Box 2088
Santa Fe, New Mexico 87501

Re: Case No. 7025: In the Matter of the
Application of Southland Royalty Company
for Compulsory Pooling, Eddy County, New Mexico

Dear Mr. Ramey:

Enclosed for filing in the above-referenced matter is a Response to Memorandum in Opposition to Application of Southland Royalty Company for Compulsory Pooling.

Very truly yours,

William F. Carr

WFC:lr

Enclosure

cc: Mr. Chad Dickerson
Mr. Richard W. Petrie
Mr. Don C. Plattsmier

RECEIVED
SEP 29 1980
OIL CONSERVATION DIVISION
SANTA FE

BEFORE THE

OIL CONSERVATION DIVISION

NEW MEXICO DEPARTMENT OF ENERGY AND MINERALS

IN THE MATTER OF THE APPLICATION OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

CASE 7025

RESPONSE TO MEMORANDUM IN OPPOSITION TO APPLICATION OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING

BACKGROUND.

On August 25, 1980, Southland Royalty Company filed applications seeking compulsory pooling of two 320 acre standard proration units in Section 35, Township 18 South, Range 29 East, Eddy County, New Mexico. A hearing was held before Examiner Richard Stamets on September 17, 1980, on the application of Southland Royalty Company in Case No. 7025 which sought an order pooling the W/2 of said Section 35. Southland Royalty Company appeared at the hearing and presented all evidence required to entitle it to an order pooling the subject acreage under Section 70-2-17, N.M.S.A., 1978 Compilation. At the time of the hearing, Bassett-Birney Oil Corporation, through its attorneys, offered a memorandum in opposition to Southland's application. Bassett-Birney Oil Corporation owns an interest in the proration unit which Southland is seeking to pool. A dispute exists as to exact breakdown of interest between Southland Royalty Company and Bassett-Birney Oil Corporation. This dispute is the subject of a case pending in the United States District Court for the District of New Mexico (Case No. CIV 80-614 HB).

THE PARTIES HAVE NOT AGREED
TO POOL THEIR INTERESTS.

The first basic question raised by the memorandum of Bassett-Birney Oil Corporation is whether or not the parties have agreed to voluntarily pool their interests with the drilling of a well in the proposed proration unit. Section 70-2-17, N.M.S.A., 1978 Compilation, provides in part as follows:

> C. When two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or individed interests in oil and gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, the owner or owners thereof may validly pool their interests and develop their land as a unit. Where, however, such owner or owners have not agreed to pool their interests, and where one such separate owner, or owners, who has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply, the Division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interests or both in the spacing or proration unit as a unit.

Bassett-Birney contends that they have "agreed" to pool their interests for the drilling of the well in the W/2 of said Section 35 and, therefore, the Commission lacks jurisdiction to enter an Order force pooling the lands involved. Southland Royalty Company does not dispute the fact that the Oil Conservation Division has no power to pool lands if all parties have voluntarily agreed but submits that there is a basic distinction between an expression of willingness to agree and an agreement which voluntarily pools lands for the drilling of a well. In voluntarily pooling lands, industry practice dictates, at a minimum, that the parties execute a Joint Operating Agreement and a Communitization Agreement. Both documents thoroughly describe the relationships of the parties, set out the prospective interests of the parties and provide for the drilling of wells and the division of the proceeds from each of the wells. Once these instruments are executed, they become the contractual

basis for the relationship between the parties. A willingness to participate in the drilling of a well absent the execution of these documents does not constitute an agreement to pool. This is particularly true in this case where Bassett-Birney's express agreement to pool was contained in a letter which states that it cannot execute a Joint Operating Agreement or approve an AFE.

Southland Royalty Company submits that Bassett-Birney's willingness to pool its interests in the W/2 of Section 35 absent the execution of the documents necessary to effect such agreement does not constitute an agreement to pool contemplated by Section 70-2-17, N.M.S.A., 1978 and that its mere statement of willingness to join does not create a bar to the Oil Conservation Division issuing an order under this section of statute pooling the W/2 of Section 35.

A COMPULSORY POOLING ORDER HAS NO EFFECT UPON UNDERLYING TITLES OF INTEREST OWNERS.

The second matter argued by Bassett-Birney in their memorandum in opposition to the application of Southland Royalty Company is that the Oil Conservation Division does not have authority to determine who is entitled to production under the terms of voluntary agreements. Certainly Southland Royalty Company does not take issue with this argument advanced by Bassett-Birney. Southland is merely seeking an order pooling the lands and interests in the W/2 of said Section 35. Both parties clearly recognize and accept the ultimate ability, capacity, power and certainty that the Court will identify the rightful owners of the disputed interest. Southland Royalty Company is not attempting to get the Oil Conservation Division to enter an order that would affect the action pending in the District Court or attempt to allocate production between the parties to this dispute.

CONCLUSION.

Southland Royalty Company has appeared before the Oil Conservation Division seeking an Order pooling the W/2 of Section 35 because it has been unable to obtain voluntary agreements from all interest owners in these lands to pool their interests and participate in the drilling of a well. Southland appeared before the Oil Conservation Division and presented testimony establishing all matters necessary to entitle it to an order pooling the W/2 of said Section 35. All Southland Royalty Company seeks is to drill a Pennsylvanian Gas Well at a legal location pursuant to Oil Conservation Division Rule 104 and to apportion costs and production, if any, in an equitable fashion among the interest owners as ultimately determined by a Court of competent jurisdiction.

Respectfully submitted,

CAMPBELL AND BLACK, P.A.

By _____
William F. Carr
Post Office Box 2208
Santa Fe, New Mexico 87501
Attorneys for Southland
Royalty Company

Certificate of Mailing

I hereby certify that a copy of the foregoing Response to Memorandum in Opposition to Application of Southland Royalty Company for Compulsory Pooling was mailed to Chad Dickerson, Attorney for Bassett-Birney Oil Company, this 29th day of September, 1980.

_____
William F. Carr

BEFORE THE OIL CONSERVATION COMMISSION
OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE HEARING
CALLED BY THE OIL CONSERVATION
COMMISSION OF NEW MEXICO FOR
THE PURPOSE OF CONSIDERING:

CASE NO. 7025 DE NOVO
Order No. R-6498-A

APPLICATION OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING EDDY COUNTY NEW MEXICO.

ORDER OF THE COMMISSION

BY THE COMMISSION:

This cause came on for hearing at 9 a.m. on January 19, 1981, at Santa Fe, New Mexico, before the Oil Conservation Commission of New Mexico, hereinafter referred to as the "Commission."

NOW, on this ___ th day of January, 1981, the Commission, a quorum being present, having considered the testimony presented and the exhibits received at said hearing, and being fully advised in the premises,

FINDS:

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

(2) That applicant, Southland Royalty Company, seeks an order pooling all mineral interests in the Pennsylvanian formation underlying the W/2 of Section 35, Township 18 South, Range 29 East, NMPM, Eddy County, New Mexico.

(3) That the matter came on for hearing at 9:00 a.m. on September 17, 1980, at Santa Fe, New Mexico, before Examiner Richard L. Stamets and, pursuant to this hearing, Order No. R-6498 was issued on October 21, 1980, which granted Southlands application and compulsorily pooled all mineral interests in the Pennsylvanian formation underlying the W/2 of Section 35, Township 18 South, Range 29 East, NMPM, Eddy County, New Mexico.

(4) That on November 6, 1980 application for Hearing De Novo was made by Southland Royalty Company and the matter was set for hearing before the Commission.

(5) That the matter came on for hearing de novo on January 19, 1981

Division

8(f) That the evidence adduced at said hearing indicates that ~~Commission~~ Order No. R-6498 entered October 21, 1980, should be affirmed.

IT IS THEREFORE ORDERED:

Division

(1) That ~~Commission~~ Order No. R-6498, entered October 21, 1980 is hereby affirmed.

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

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

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

I. R. TRUJILLO, Chairman

ALEX J. ARMIJO, Member

A. L. PORTER, Jr., Member & Secretary

SEAL

(6) That a well has been drilled to the Pennsylvanian formation upon said pooled unit and ~~dedicated~~ is presently being tested for completion.

(7) That the ~~well~~ log of ~~the~~ said well indicates that in all ~~reasonable~~ probability ~~that~~ the well will be a commercial ~~well~~ well.

dr/

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

BRUCE KING
GOVERNOR

LARRY KEHOE
SECRETARY

POST OFFICE BOX 2088
STATE LAND OFFICE BUILDING
SANTA FE, NEW MEXICO 87501
(505) 827-2434

October 21, 1990

Re: CASE NO. 7025
ORDER NO. R-6498

Mr. William F. Carr
Campbell and Black
Attorneys at Law
Post Office Box 2208
Santa Fe, New Mexico

Applicant:

Southland Royalty Company

Dear Sir:

Enclosed herewith are two copies of the above-referenced Division order recently entered in the subject case.

Yours very truly,

JOE D. RAMEY
Director

JDR/fd

Copy of order also sent to:

Hobbs OCD x
Artesia OCD x
Aztec OCD

Other Chad Dickerson

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

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

CASE NO. 7025
Order No. R-6498

APPLICATION OF SOUTHLAND ROYALTY
COMPANY FOR COMPULSORY POOLING,
EDDY COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 9 a.m on September 17, 1980, at Santa Fe, New Mexico, before Examiner Richard L. Stamets.

NOW, on this 21st day of October, 1980, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

FINDS:

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

(2) That the applicant, Southland Royalty Company, seeks an order pooling all mineral interests in the Pennsylvanian formation underlying the W/2 of Section 35, Township 18 South, Range 29 East, NMPM, Eddy County, New Mexico.

(3) That the applicant has the right to drill and proposes to drill a well at a standard location thereon.

(4) That the applicant and another interest owner in the proposed proration unit are involved in litigation to determine the true ownership of the S/2 NW/4 and NW/4 SW/4 of said Section 35.

(5) That said owners would, except for such litigation, agree to voluntarily pool their interests and pay their proportionate share for the drilling of the proposed well.

(6) That because of said litigation there are interest owners in the proposed proration unit who have not agreed to pool their interests.

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

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

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

(10) That any non-consenting working interest owner who does not pay his share of estimated well costs should have withheld from production his share of the reasonable well costs plus an additional 20 percent thereof as a reasonable charge for the risk involved in the drilling of the well.

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

(12) That following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs should pay to the operator any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(13) That $3000.00 per month while drilling and $300.00 per month while producing should be fixed as reasonable charges for supervision (combined fixed rates); that the operator should be authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator should be authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are reasonable, attributable to each non-consenting working interest.

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

(15) That upon the failure of the operator of said pooled unit to commence drilling of the well to which said unit is dedicated on or before January 15, 1981, the order pooling said unit should become null and void and of no effect whatsoever.

IT IS THEREFORE ORDERED:

(1) That all mineral interests, whatever they may be, in the Pennsylvanian formation underlying the W/2 of Section 35, Township 18 South, Range 29 East, NMPM, Eddy County, New Mexico, are hereby pooled to form a standard 320-acre gas spacing and proration unit to be dedicated to a well to be drilled at a standard location thereon.

PROVIDED HOWEVER, that the operator of said unit shall commence the drilling of said well on or before the 15th day of January, 1981, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test the Pennsylvanian formation;

PROVIDED FURTHER, that in the event said operator does not commence the drilling of said well on or before the 15th day of January, 1981, Order (1) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division for good cause shown.

PROVIDED FURTHER, that should said well not be drilled to completion, or abandonment, within 120 days after commencement thereof, said operator shall appear before the Division Director and show cause why Order (1) of this order should not be rescinded.

(2) That Southland Royalty Company is hereby designated the operator of the subject well and unit.

(3) That after the effective date of this order and within 90 days prior to commencing said well, the operator shall furnish the Division and each known working interest owner in the subject unit an itemized schedule of estimated well costs.

(4) That within 30 days from the date the schedule of estimated well costs is furnished to him, any non-consenting working interest owner shall have the right to pay his share

of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production, and that any such owner who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(5) That the operator shall furnish the Division and each known working interest owner an itemized schedule of actual well costs within 90 days following completion of the well; that if no objection to the actual well costs is received by the Division and the Division has not objected within 45 days following receipt of said schedule, the actual well costs shall be the reasonable well costs; provided however, that if there is an objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

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

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

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

(B) As a charge for the risk involved in the drilling of the well, 20 percent of the pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

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

(9) That $3000.00 per month while drilling and $300.00 per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rates); that the operator is hereby authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating such well, not in excess of what are reasonable, attributable to each non-consenting working interest.

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

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

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

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

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

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

JOE D. RAMEY
Director

SEAL
fd/

BEFORE THE OIL CONSERVATION DIVISION

OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE APPLICATION OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO	:	CASE NOS. ~~7024 and~~ 7025

MEMORANDUM IN OPPOSITION TO
APPLICATIONS OF SOUTHLAND ROYALTY
COMPANY FOR COMPULSORY POOLING

Section 70-2-17, N.M.S.A. 1978, provides in part as follows . . .

> C. When two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, the owner or owners thereof may validly pool their interests and develop their lands as a unit. Where, however, such owner or owners have not agreed to pool their interests, and where one such separate owner, or owners, who has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply, the division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interests or both in the spacing or proration unit as a unit.

As a matter of simple construction of the above statute, the division has authority to subject interests to compulsory pooling only when "such owner or owners have not agreed to pool their interests."

As expressly stated in the authorizing statute for this division, and as recognized by the Supreme Court of New Mexico in Sims v. Mechem, 72 N.M. 186, 382 P.2d 183, the authority of the division to pool arises only when such pooling has not been voluntarily agreed to by the parties. In this case, Bassett-Birney has agreed to pool its interests with the other leasehold owners in the spacing units.

The controversy between Southland and Bassett-Birney involves disputed title to interests in a Federal Oil and Gas Lease upon the lands affected by Southland's application herein, to which both Southland and Bassett-Birney claim title. As stated by Bassett-Birney in its Exhibit No. 1, "Bassett-Birney is willing to pool its interests" in the wells proposed to be drilled by Southland. Also, as made clear in such Exhibit, Bassett-Birney's objection to the operating agreements and AFE's furnished by Southland arises from the erroneous interests credited to Bassett-Birney by Southland in those instruments, and not with regard to any lack of agreement of Bassett-Birney to voluntarily pool its interests under the proposed wells. Bassett-Birney should not be required to assume the cost of a dry hole attributable to the disputed interests, in the face of Southland's denial of its title.

By its applications in these proceedings Southland attempts to accomplish by compulsory pooling what it can only accomplish by litigation. As reflected by Bassett-Birney Exhibit No. 2, the underlying title dispute between Southland and Bassett-Birney is presently the subject of litigation in the United States District Court for the District of New Mexico. In this suit, or in such other court to which this litigation may ultimately be transferred, the underlying title dispute between Southland and Bassett-Birney will ultimately be resolved.

As recognized in Williams and Meyers, Oil and Gas Law, §941.3, compulsory pooling statutes do not have any effect upon the underlying titles of the interest owners. In Monsanto Chemical Company v. Southern Natural Gas Company, 234 La. 939, 102 So.2d 223, 9 O&GR 1110, the court held that it was beyond the authority of the regulatory commission to determine who was entitled to production under the terms of voluntary agreements affecting the title to the premises, and further found that the only authority of the agency was to allocate to each tract a

pro rata share of the unit production. To the same effect is Arkansas-Louisana Gas Company v. Southwest Natural Production Company, 221 La. 608, 60 So.2d 9, 1 O&GR 1186, in which it was held that it was beyond the constitutional and legislative authority of the Commissioner of Conservation of the State of Louisiana to determine the title to the mineral ownership itself. In Texas it has also been held that orders of the Railroad Commission do not effect a transfer of title. Nale v. Carroll, 155 Tex. 555, 289 S.W.2d 743, 5 O&GR 1379, in which it was stated: "Rules and regulations of the Railroad Commission cannot effect a change or transfer of property rights. A Rule 37 Permit cannot be made the basis for a claim of title."

As stated above, only the courts have the power to determine the title to this disputed interest in real estate. The courts also will determine the rights of Southland and Bassett-Birney once the title dispute has been resolved, with regard to such questions as drainage caused during the pendency of the dispute, for any decrease in the speculative value of the land by reason of the drilling of a dry hole and other such measures. Williams and Meyers, supra, §231.4.

As shown by its Exhibits, Bassett-Birney is willing to pool its interests and to participate in the wells proposed by Southland, but is not willing to execute AFE's and operating agreements not recognizing the leasehold interests claimed by Bassett-Birney. For these reasons, the policies behind enactment of compulsory pooling statutes in virtually all of the oil producing states, that being the prevention of waste and the furtherance of spacing rules regulating the size of the drilling units, have no application to the dispute between Southland and Bassett-Birney. Further, the fact that the prevailing party in the litigation will be made whole for any damages suffered by it as a result of the title dispute assures that no waste can be prevented by the applications of Southland in these proceedings. Southland is free to drill its proposed wells, and

Bassett-Birney has elected to participate therein to the full extent of its interests. The title to any production resulting will also be determined in the litigation.

For the reasons stated above, the division has no authority to subject the interests of Bassett-Birney to compulsory pooling under these circumstances, and the applications of Southland should therefore be denied.

BASSETT-BIRNEY OIL CORPORATION

By: Chad Dickerson
Chad Dickerson

LOSEE, CARSON & DICKERSON, P.A.
P. O. Drawer 239
Artesia, New Mexico 88210

Attorneys for Bassett-Birney Oil Corporation

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BLDG.
SANTA FE, NEW MEXICO
17 September 1980

EXAMINER HEARING

IN THE MATTER OF:

Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

CASE 7025

BEFORE: Richard L. Stamets

TRANSCRIPT OF HEARING

A P P E A R A N C E S

For the Oil Conservation Division: Ernest L. Padilla, Esq.
Legal Counsel to the Division
State Land Office Bldg.
Santa Fe, New Mexico 87501

For the Applicant: William F. Carr, Esq.
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A P P E A R A N C E S CONT'D

For Bassett-Birney: Chad Dickerson, Esq.
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MR. STAMETS: We'll call next Case 7025.

MR. PADILLA: Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

MR. CARR: Mr. Examiner, I'm William F. Carr, Campbell & Black, P. A., Santa Fe, appearing on behalf of the applicant. I have one witness.

MR. STAMETS: Call for other appearances in this case.

MR. DICKERSON: Mr. Examiner, my name is Chad Dickerson, Losee, Carson, & Dickerson, P. A., Artesia, New Mexico. We also have one witness, on behalf of Bassett-Birney Oil Corporation.

MR. STAMETS: I'd like to have all witnesses stand and be sworn at this time, please.

(Witnesses sworn.)

MR. STAMETS: You may proceed, Mr. Carr.

DON W. DAVIS

being called as a witness and having been duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

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BY MR. CARR:

Q. Will you state your name and place of residence?

A. Don W. Davis, Midland, Texas.

Q. Mr. Davis, by whom are you employed and in what capacity?

A. Southland Royalty Company as a petroleum landman.

Q. Have you previously testified before this Commission and had your credentials accepted and made a matter of record?

A. No, sir, I have not.

Q. Will you briefly summarize your educational background and your work experience?

A. I graduated from Texas Christian University in 1978 with a Bachelor's in management.

Upon graduation I moved to Houston, Texas; worked as a petroleum landman for Texaco, Incorporated, for eight months. Following that I moved to Midland, Texas, and have now been employed by Southland Royalty Company as a petroleum landman for one year and three months.

Q. Are you familiar with the application that has been filed in this case?

A. Yes, I am.

Q. Are you familiar with the area which is

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the general subject of the application?

A. Yes, sir, I am.

MR. CARR: Are the witness' qualifications as a petroleum landman acceptable?

MR. STAMETS: Yes.

Q. Mr. Davis, will you briefly state what Southland Royalty Company seeks with this application?

A. Southland Royalty Company is seeking an order to force pool the west half of Section 35, Township 18 South, Range 29 East, Eddy County, New Mexico, for the drilling of one Morrow test well.

We are also seeking a risk factor in this case and requesting that SRC be designated as operator of the well.

Q. Will you now refer to what has been marked for identification as Southland Exhibit Number One and explain to the Examiner what it is and what it shows?

A. This is a plat showing all of Section 35 plus some of the surrounding sections. It also shows in the west half of Section 35 the proposed proration unit and the location of the SRC Empire Federal 35 Com No. 1 Well.

Q. Is this a standard proration unit?

A. Yes, sir, it is.

Q. And is the well proposed to be drilled at an orthodox location?

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A. No, sir.

Q. It is not?

A. Excuse me, sir, I thought you said unorthodox.

Q. No, at an orthodox location.

A. Yes, sir, it is an orthodox location.

Q. Does this exhibit also show other Pennsylvanian completions in the area?

A. Yes, sir, it does.

Q. Will you please refer to each of the tracts in the west half Section 35 and explain the status of them vis-a-vis this application?

A. Yes, sir. Beginning at the top, working down, the top 80-acre tracts, which includes the north half of the northwest quarter of Section 35, is owned by Tenneco 100 percent, and they have agreed to join in the drilling of the subject well.

The acreage shaded in yellow currently 50 percent of it has been in support to SRC for the drilling of this well through a farm-in from Robert E. McKee Company, the other 50 percent, owned by Bassett-Birney, they have refused to join in the well.

The acreage shaded in green with the title Featherstone Farms has been farmed-in to Southland Royalty Company for the drilling of the subject well.

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Q. Mr. Davis, is there a dispute as to the ownership of any of the acreage involved in this application?

A. Yes, there is, sir, the acreage shaded in yellow is currently under ownership dispute.

Q. And are any efforts underway to resolve this dispute?

A. Yes, sir. At this time there is a case on the docket for the United States District Court to settle the ownership dispute.

Q. Could Southland Royalty Company wait for resolution of the ownership question before proceeding with development of the acreage involved?

A. No, sir, we cannot.

Q. And why not?

A. From our support agreements, our farm-in agreements, which is the acreage shaded in yellow and green, SRC must commence a well by November 5th, 1980, or lose the support we have under the well.

Q. Is the only interest that Southland is seeking to pool by this application the interest of Bassett-Birney?

A. Yes, sir.

Q. And has -- has Southland Royalty Company given notice to Bassett-Birney of this application?

A. Yes, sir, we have.

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Q. Has a copy of the letter giving them notice of the hearing been marked Exhibit Two in this case?

A. Yes, sir, it is.

Q. Mr. Davis, according to Southland Royalty Company's title data, what percentage of the working interest does Southland represent here today?

A. According to SRC's title data under this well we currently represent 80 percent of the well.

Q. And what percentage of this interest is in dispute?

A. 19 percent.

Q. So what interest do you represent, even if Bassett-Birney should be successful in the District -- U. S. District Court proceeding concerning title?

A. Approximately 62 percent.

Q. Does Southland propose to drill a well on the proration unit in the near future?

A. Yes, sir.

Q. And how soon do you plan to spud the well?

A. We hope to be able to spud 35 No. 1 Well within thirty days.

Q. Will you now refer to what has been marked for identification as Applicant's Exhibit Number Three and review this data for Mr. Stamets? You might first just ident-

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ify what it is.

A. Okay, there are the relevant correspondence and documents concerning our attempts to drill this well.

First, by letter dated February 26th, 1980, SRC requested a farm-in from Bassett-Birney concerning their interest in all of Sections 33, 34, and 35 in Township 18 South, Range 29 East, Eddy County.

We offered a 1/16th override with a 50 percent backin in payout. We also in this letter offered for them to join in a well which would be proposed later.

By letter dated March 24th, 1980, to Bassett-Birney Oil Corporation SRC proposed our 35 No. 1 Well, once again requesting a farm-out or joinder in the 35 No. 1 Well, and also enclosed an AFE for the well.

By letter dated March 24th, 1980, SRC requested from Tenneco Oil Exploration and Production a farm-out or joinder in the 35 No. 1 Well; also supplied an AFE at that time.

Q. Mr. Davis, was the proposal made to Bassett-Birney identical to that made to Tenneco Oil?

A. Yes, sir, it was.

By letter dated June 19th, 1980, SRC responded to a request by Tenneco in which they wanted to form a working interest unit. We said we had tried to form that unit; were unsuccessful in trying to form the working interest

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unit.

By letter dated July 8th, 1980, to Bassett-Birney Oil Corporation, SRC informed Bassett-Birney of the location change for the 35 No. 1 Well; also submitted an AFE and an operating agreement for the well, which is attached.

Q. I'd like you to direct your attention to the AFE and briefly review the costs that are reflected therein.

A. Yes, sir. We propose that a dry hole in this area, dry hole well, would cost us $488,000 total cost; a completed well, $767,010, approximations.

Q. Are the costs reflected on the AFE in line with what other operators in the area are estimating the costs of drilling and completing similar wells?

A. Yes, sir, they are.

Q. Okay, will you proceed now to review this exhibit?

A. The next correspondence is dated July 15th, 1980, a letter sent to Tenneco Oil Exploration. We informed Tenneco of our unsuccessful attempts to form the working interest unit, a location change for our well, and also submitted a new AFE and joint operating agreement.

Next is the designation of operator for the 35 No. 1 Well executed by Featherstone Farms, dated 7-23-80, date of execution.

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Next a letter dated July 25th, 1980, SRC references early proposals for the 35 No. 1 Well and also reference my attempt to form the working interest unit; also was another well proposed at a later date.

By letter dated July 29th, 1980, to Flag-Redfern Oil Company, SRC once again makes reference to our unsuccessful attempts to form a working interest unit in Section 35.

Q. Does Flag-Redfern have any interest in the west half of Section 35?

A. No, sir, they do not.

Q. Their interests are confined to the east half of the section?

A. Yes, sir.

By letter dated September 4th, 1980, from Bassett-Birney Oil Corporation to SRC, in this letter you'll note at the bottom, last paragraph, Bassett-Birney is willing to pool its interest in the west half of Section 35 and the east half of Section 35 for the drilling of the 35 Com No. 1 Well and 35-A Com No. 1, which at this hearing we are only interested in the 35 Com No. 1.

Q. Mr. Davis, doesn't this letter also contain references to the title dispute and indicate that because of that they are unable to execute certain documents?

A. Yes, sir, that is correct.

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Next document is a letter dated September 15th, 1980, from Southland Royalty Company pertaining to the disputed interest in which we propose an escrow arrangement which would allow us to continue drilling the well and put the disputed acreage in escrow.

Q. Has this escrow arrangement been accepted or rejected to your knowledge?

A. No, sir, it has not been accepted to the best of my knowledge.

Q. It has not been accepted?

A. No, sir.

Q. Okay. In your opinion, Mr. Davis, has Southland Royalty Company made a good faith effort to obtain voluntary pooling of the west half of Section 35?

A. Yes, sir.

Q. Are you prepared to make a recommendation to the Examiner concerning charges for overhead and administrative costs while drilling and producing this well?

A. Yes, sir, I am.

Q. And what are those figures?

A. Charges are $3000 for a drilling well per month; $300 for a producing well per month.

Q. And do you recommend that these figures be incorporated into any order which results from this hearing?

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A. Yes, sir, I do.

Q. Are these figures in line with what is being charged by other operators in the area?

A. Yes, sir, they are.

Q. Have you been involved in the drilling of other Pennsylvanian wells in this area?

A. Yes, sir, I have.

Q. What is your experience concerning the risk involved in drilling wells to the Pennsylvanian formation?

A. Well, we are giving this well a 62 percent success factor. Wells, we feel that the -- or management feels that Morrow wells in the area are very, very risky.

Q. And what success factor was that you presented?

A. 62 percent success factor for this well.

Q. Do you consider this well to be a high risk venture?

A. Yes, sir, I do.

Q. Are you prepared to make a recommendation to the Examiner as to a risk factor that should be assessed against those who do not voluntarily participate in the drilling of the well?

A. Yes, sir, I am.

Q. And what is that?

A. 200 percent.

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Q. Does Southland Royalty Company request to be named operator of this well?

A. Yes, sir, we do.

Q. I believe you've indicated that you plan to spud the well in the immediate future.

A. Yes, sir, within thirty days we will.

Q. Do you request that the order resulting from this hearing be expedited?

A. Yes, sir, I do.

Q. In your opinion will granting this application be in the interest of conservation, the prevention of waste, and the protection of correlative rights?

A. Yes, sir.

Q. Were Exhibits One through Three prepared under your supervision and direction?

A. Yes, sir, they were.

MR. CARR: At this time, Mr. Examiner, we would offer into evidence Southland Royalty Company Exhibits One through Three.

MR. STAMETS: These exhibits will be admitted.

MR. DICKERSON: Mr. Examiner, we would -- before you admit those, Bassett-Birney would object to the admission of the letter containing -- I think it's part of Exhibit Number Three -- dated September 15th, 1980, containing

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a proposed escrow agreement, on the grounds of irrelevancy to this proceeding.

MR. STAMETS: Mr. Carr, do you have any response to this?

MR. CARR: The only reason that is included, Mr. Examiner, is to indicate that Southland has made a good faith effort to obtain voluntary joinder and when there have been problems they've made efforts to deal with those. They've made good faith efforts to deal with those. We think it's appropriate and should be included in the record.

MR. DICKERSON: Mr. Examiner, we'd only say it is part -- or it is my understanding that it was part of a settlement negotiation scheme between Southland and Bassett-Birney in attempt to reach some resolution of the problem between the parties, which pend not only in this Division but also in the Federal District Court of New Mexico, and that the -- to the extent my understanding was correct, it was a settlement proposal and was rejected by Bassett-Birney by telephone yesterday; that that exhibit should not be admitted. It is irrelevant to -- to the matters in issue before this Division.

The specific legal point, Mr. Examiner, would go to the admission of settlement offers made between parties for the purpose of accommodating each other in disputes of various types, and the admissibility of that type

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of instruments in administrative or judicial proceedings.

MR. CARR: If that's the case, Mr. Examiner, any letter or correspondence in which operators are trying to reach some agreement whereby they might voluntarily pool, might also not be proper, if that rule were to apply.

I think it's important as you look at that to note that it has been rejected and so that the contents of it, I think, are not of significance.

MR. DICKERSON: Mr. Examiner, I might say that the reason that the rules of evidence, in my opinion, exclude offers of this type from admissibility under most circumstances, is that it is the policy of the tribunals deciding disputes between the parties, to enable the parties to, when possible, reach accommodations between themselves in settlement of the dispute, but when those attempts are not successful the details of the attempts should not be admitted for the reason that they contain matters which are not otherwise admissible.

MR. CARR: Mr. Examiner, maybe I can --

MR. STAMETS: Mr. Carr, did I -- I'm sorry --

MR. CARR: If I might ask Mr. Davis an additional question or two, I would be willing to withdraw this.

MR. STAMETS: That certainly might simplify.

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MR. CARR: Might simplify and facilitate proceedings.

MR. STAMETS: Yes.

Q. Mr. Davis, would Southland Royalty Company have any objection to an order resulting from this hearing providing that disputed sums be placed in escrow?

A. No, sir, we would not have any objection to that.

MR. CARR: I would withdraw the last letter in Exhibit Three.

MR. STAMETS: We will accept your exhibits, then, with the letter of September 15th, 1980, from Mr. Losee being withdrawn.

MR. CARR: And I have nothing further of Mr. Davis on direct.

MR. STAMETS: Relative to that last question, Mr. Carr and Mr. Davis, are we talking about the standard provisions in a Division order which provide for the escrowing of funds which may not otherwise be payable to persons for any reasons?

MR. CARR: Mr. Stamets, that is not provided for in the joint operating agreement involved in this case.

MR. STAMETS: I'm talking about, Bill, the provisions of our orders which say that any funds which

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may not be paid out are to be escrowed. Or are we talking about some different type of escrow account here?

Let's go off the record a second.

(Thereupon a discussion was had off the record.)

MR. STAMETS: Okay, we can go back on the record.

Are there any other questions of Mr. Davis?

MR. DICKERSON: Yes, sir, I have a few questions.

CROSS EXAMINATION

BY MR. DICKERSON:

Q. Mr. Davis, what is the significance of the red circle in the east half of Section 34 shown on your plat as Exhibit Number One?

A. In the east half of 34?

Q. Yes.

A. It is a well we have also proposed to drill.

Q. Have you proposed to drill that well?

A. Did you say 35 or 34?

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Q. 34?

A. Oh, yes, sir, it is a well that has been drilled.

Q. Whose well is that?

A. SRC is the operator of that well.

Q. And is Bassett-Birney involved in that acreage with you, also?

A. Yes, sir, they are.

Q. To enlighten the Examiner a little bit, would you explain the significance of that well in the east half of Section 34 with regard to its effect on this litigation concerning this title dispute which you referred to between Southland and Bassett-Birney?

MR. CARR: I'm going to object to this. We are not here today to litigate the title dispute and I don't think that it's appropriate to -- for the Commission to receive testimony as to a matter which is pending in the District Court.

MR. DICKERSON: Mr. Examiner, I would agree 100 percent that we are not here to litigate the title dispute and the purpose of this question is only for informational purposes so that the Examiner will have the opportunity to have an over-view of the entire situation; how the circumstance arose, and with that knowledge of the over-view to apply it to the issues in dispute here today concerning forced

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pooling of Bassett-Birney.

MR. CARR: Mr. Examiner, I would submit that we're here seeking a pooling order under a very specific section of the statute, which provides when you're unable to obtain a voluntary agreement to pool acreage, and you have an operator who has the right to drill a well and is prepared to drill a well, that you can come in and after giving notice, get an order whereby the acreage shall be pooled and you can go forward with his plans to develop the acreage.

MR. STAMETS: Mr. Dickerson, I believe you'll be able to develop this information -- I would assume you'll be able to develop this information with your witness and it certainly would seem like a more appropriate time to do it in light of Mr. Carr's objection here, and I would sustain that objection.

MR. DICKERSON: Could I say, Mr. Examiner, and without any way trying to be argumentative, but to try to make myself a little clearer, that this is cross examination. This witness is the party who brought the subject of the litigation up and when it's brought up, in our opinion, it is relevant and is necessary to a clear understanding of the issues here for the Examiner to know a little bit more about the litigation at this point.

MR. STAMETS: Is there any reason that that can't be discussed specifically relating to the 320-acre

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tract that is the subject of this case?

MR. DICKERSON: It deals, Mr. Examiner, with the time frame at which the problem became known to the parties, and I don't intend to use a lot of time or anything in this line of inquiry; about a one paragraph reply is all that's requested.

If you prefer, what I was attempting to do is bring it out and save the necessity of calling Mr. McCaw for this purpose in the interest of time. I can do it and establish it that way, but I'm attempting to do exactly the same thing in this way.

MR. STAMETS: I would prefer that you develop this with your own witness.

MR. DICKERSON: Okay.

MR. STAMETS: Mr. Dickerson.

Q. What -- do you have any knowledge as to the nature of this well in the east half of Section 34, Mr. Davis, as to whether -- what its productivity is?

A. In the -- I'm not a geologist, I'm a landman. I've done land work. I know we have made a commercial completion in there. As far as the geology of the well, I do not know.

Q. All right. In your capacity as a landman you know, generally, the area in dispute here and the relationship between the interest of Southland and Bassett-Birney,

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do you not?

A. I know there is a dispute over acreage.

Q. That involves not only the acreage in Section 34 but also acreage in Section 35 and other acreage in that area.

A. Yes, sir, that is true.

Q. Mr. Davis, in your operating agreement that you referred to as part of Exhibit Number Three, I believe it was, would you look at Exhibit Number A to that operating agreement?

Now I believe that you testified that the amount in dispute was between Bassett-Birney and Southland approximately 19 percent, is that correct?

A. Yes, sir.

Q. So that if, to clarify for the Examiner the meaning of Exhibit A to the operating agreement, if Bassett-Birney prevails in this litigation that you referred to, their interest would be doubled over that shown, is that correct?

A. Yes, sir, that is correct.

Q. And --

A. If they prevail.

Q. Right, and if Southland should prevail, then the interest of Southland, both before payout and after payout, shown on Exhibit A would be decreased by that amount,

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is that correct?

A. That is correct, if they win.

Q. Now your AFE and operating agreement, or I should say -- right, AFE and operating agreement, are prepared, are they not, on the assumption that Southland is going to prevail in the title litigation.

A. There is no assumption made there. The operating agreement we prepared is from title we had prepared by attorneys. I made no assumptions concerning any lawsuit when I prepared this agreement.

Q. Well, you're assuming, aren't you, Mr. Davis, that those opinions are correct?

A. Yes, sir.

Q. So it's based on some assumption and that assumption is that the opinions on which you based --

A. It's based on a title opinion, yes, sir.

Q. Right, so to go back to my original question, you are ultimately assuming that Southland is going to prevail in the litigation, aren't you?

A. I am presuming the title opinion prepared for us is correct.

Q. And your AFE presumes that the title opinion is correct and therefor the interest set forth for Bassett-Birney to agree to is based on your opinion, is that correct?

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A. Yes, sir, that is correct.

MR. STAMETS: While we're on that point, I'd like a little clarification there.

Presuming now that Bassett-Birney prevail in this particular case, then their share of the well would be increased and their share of the costs would be increased, as well?

MR. DICKERSON: I might clarify this off the record.

(Thereupon a discussion was had off the record.)

MR. STAMETS: Let's go back on the record. Mr. Dickerson, do you have some additional questions?

MR. DICKERSON: Yes, Mr. Examiner.

Q. Mr. Davis, I'm handing you what is marked Bassett-Birney Exhibit Number One and I believe that's one of the instruments that is part of your Exhibit Number Three, but for clarification and further future reference, would you describe to the Examiner what that is?

A. This is a letter mailed from Bassett-Birney to Southland Royalty Company in which they reject to sign. They will not sign either our AFE or operating agreement, for two wells proposed to them, due to, and I'll read it, "Since Southland has instituted, among other parties, Bassett-Birney Oil Corporation, in the United States District Court

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for the District of New Mexico, Case Number, contesting our title for the working interest underlying the proposals, and also due to their opinion as to what their interest under the operating agreement and AFE should be".

Q. Does it say anything else?

A. Do you want to read the whole letter?

Q. I was just really getting at your understanding of the -- you testified that Bassett-Birney had not agreed to pool their interest, I believe, did you not?

A. No, I testified that there is a sentence, and I read the sentence straight from the letter, where it says Bassett-Birney is willing to pool its interests in the west half of Section 35, east half of Section 35. My attorney clarified that by also saying is there a paragraph in here that also states due to the dispute that they would not sign it, and I said yes to that.

Q. That they would not sign the AFE and operating agreement in the form it was submitted?

A. Yes, sir, that is correct, due to the title dispute and due to our instigating a lawsuit.

Q. Mr. Davis, if you were recommending to your management as to whether or not Southland should sign an operating agreement and an AFE in which it admitted it had an interest, but which credited with another interest other than the one you thought it had, would you recommend

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that the instruments be executed?

A. I'm not sure whether I can answer that because I'm not in that situation.

Q. I know it's a hypothetical question, but if you were in that situation would you recommend, if you were --

A. If I was in the situation where I owned more than someone said I owned, I would clarify what I did own and then go on with the drilling or whatever situation it involved.

Q. All right, and isn't that exactly what that letter, Exhibit Number One, says?

A. Well, I've already said what the letter said. I said that they -- well, I don't need to reiterate what I just said.

Q. But, I'm just confirming my understanding of what I thought you said, they should have clarified the interest that they did claim, and so my question is, didn't Exhibit Number One of Bassett-Birney do precisely that?

A. Yes, but I did not say clarify the interest they claim. I said clarify the interest they own, and that is something that's in dispute at this time.

Q. Right.

Mr. Davis, what's the nature of -- you testified that Southland, because of offset -- or support

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for its well in Section 35, must commence a well by November 5th of this year. What's the nature of that obligation?

A. Under our farm-out agreements, which we have from Robert E. McKee Company and Featherstone Farms, if we do not commence a well on at least a portion or where their interest in a well on a portion, commence the well, then all rights outside any acreage we have earned from production, will expire.

Q. Do you -- are you familiar with the terms of those farm-out letters?

A. Yes, sir.

Q. You're testifying concerning those letters, would you produce a copy?

A. Of which, the farm-out agreement?

Q. The farm-out agreement from Featherstone Farms?

A. We did not submit that farm-out agreement as an exhibit so I do not have it with me.

Q. I understand, well, but you're testifying to it.

A. Yes.

Q. And you testified that it obligates you to commence a well by November 5th?

A. Yes, sir. That's from memory.

Q. Are you certain of that date? Do you have

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any way to confirm the date that --

A. I am certain of the date but I have no instrument here which will confirm that date.

Q. Would Southland have any objection to furnishing a copy of that farm-out letter to Bassett-Birney?

MR. CARR: Mr. Examiner, I'm going to object to this entire line of questioning. I don't think it's relevant to anything here except the request that the order be expedited. It isn't relevant to any issue that's before the Commission at this time.

MR. DICKERSON: Mr. Examiner, it's testified to by Southland, not Bassett-Birney. I think on cross examination we're entitled to inquire into it, but we do so only for the purposes of this proceeding, and it's necessary for us to properly present the issues that this Division has to decide to know the basis of the testimony which Southland offers in support of its application.

MR. STAMETS: In view of the fact that the November 5th date doesn't really make any difference as to whether or not the interest owners have or have not agreed, I don't believe that we require that information to render a decision on compulsory pooling in this case, and because of that I would support Mr. Carr's -- or sustain Mr. Carr's objection.

Q. Mr. Davis, in your testimony concerning

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the risk factor which you recommended to the Commission be imposed in the drilling of the well on the west half of Section 35, did you take into account the offsetting commercial well that you testified to in the east half of Section 34?

A. Sir, management made the decisions as to risk factor. I am a landman. I have no knowledge of --

MR. DICKERSON: Mr. Examiner, I'm objecting that his answer is not responsive. If the witness would like me to repeat the question, I'll be happy to, but he's not answering the question I put to him.

MR. CARR: Well, will you restate the question, please?

Q. You testified, did you not, Mr. Davis, as to -- on your -- in your capacity as a landman, disclaiming expertise as a geologist or engineer or anything else, but you testified, did you not as a landman, as to a proposed risk factor to be imposed in the drilling of this well?

A. Yes.

Q. So you must have thought -- I assume, you correct me if I'm wrong, that you thought of certain things in making that recommendation, is that correct?

A. Yes, sir. That people, we did think of those things.

Q. So that is correct?

A. Yes, sir.

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Q. And so did you or did you not take into account the offsetting well in Section 34 in making that recommendation?

A. Yes, sir, the decision to make that recommendation, it was taken into account.

Q. Thank you. Did I understand you correctly, Mr. Davis, to testify that, and I'll try to quote but you correct it if I'm inexact, that Bassett-Birney had refused to join in the drilling of this well on Section 35?

A. They refused to sign the AFE and operating agreement for the well.

Q. They didn't refuse to join or participate in the drilling of the well?

A. By not signing the AFE and operating agreement, yes, I would say they refused to join in the well.

Q. You've been -- is it your opinion -- do you have -- in your capacity as a landman, Mr. Davis, is it part of your responsibilities and duties to draft contracts, operating agreements, and things of that nature?

A. Yes, sir.

Q. So is it your understanding that you're free to draft an operating agreement, as a hypothetical example, in any form, shape, or fashion that you desire and you simply mail it out to anybody and they can either take it or leave it and that's the way it is?

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A. No, sir, that is not correct. There are certain guidelines we need to follow when we draw our operating agreements, which are decided upon on our upper level management and interests are sitting there bearing our title.

Q. Right, but wasn't it made clear to you, and I'm talking with you personally if you read the letter addressed to you marked Bassett-Birney Exhibit Number One, wasn't it made clear to you that Bassett-Birney's objection to the operating agreement and the AFE was to the extent of the interest credited to Bassett-Birney?

In other words, they didn't quibble over supervision costs, did they?

A. No, sir.

Q. Is there any argument over that?

A. No, sir.

Q. And any argument over any other provisions of the operating agreement, the nonconsent penalties, the operator's lien, or anything, except the title dispute?

A. No, sir.

Q. So the title dispute is really the only --

A. Except for drilling these wells down here on the acreage under dispute, Bassett-Birney requested that they not pay any title costs, so we assumed 100 percent of their title costs.

Q. So --

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A. In good faith.

Q. I'll make a statement and you disagree with it if it's not correct.

The only dispute, to your knowledge, between Southland and Bassett-Birney in this acreage with which we're concerned in this proceeding, evolves directly out of this title dispute?

A. That is true, as of my knowledge.

MR. DICKERSON: That's all I have, Mr. Examiner.

MR. STAMETS: Any other questions of the witness? He may be excused.

MR. CARR: I'd like to ask him just one question on redirect.

MR. STAMETS: Okay.

REDIRECT EXAMINATION

BY MR. CARP:

Q. Mr. Davis, you testified that -- let me just ask you to refer again to Exhibit A to the operating agreement, and my question is, if Southland Royalty Company should ultimately prevail in any litigation, is that exhibit correct?

A. Yes, sir, that exhibit is correct.

Q. Okay. Thank you.

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MR. STAMETS: The witness may be excused.

MR. CARR: I'm going to ask if we could take about a five minute recess?

MR. STAMETS: You certainly may, Mr. Carr.

(Thereupon a recess was taken.)

MR. STAMETS: The hearing will come to order. Mr. Carr?

MR. CARR: Mr. Stamets, at this time I'll call Mr. Richard Petrie. He has not been sworn.

MR. STAMETS: I'd like to have him stand and be sworn, please.

(Mr. Petrie sworn.)

RICHARD W. PETRIE

being called as a witness and having been duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. CARR:

Q Will you state your name and place of residence?

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A. Richard W. Petrie, Midland, Texas.

Q. By whom are you employed and in what capacity?

A. Southland Royalty Company as District Landman.

Q. Have you previously testified before the Commission and had your credentials accepted and made a matter of record?

A. I have.

Q. Are you familiar with the application in this case?

A. Yes, I am.

MR. CARR: Are the witness' qualifications acceptable?

MR. STAMETS: They are.

Q. Mr. Petrie, I believe you've heard testimony presented here today concerning the status of the effort to obtain voluntary commitment of all the acreage in the west half of Section 35 for the drilling of a Morrow test.

A. Yes.

Q. Have all the interests voluntarily joined or voluntarily pooled their acreage?

A. No, sir, they have not.

Q. And what interest is outstanding?

A. The interest owned by Bassett-Birney.

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Q. And what act on the part of Basset-Birney would it take to commit that -- their acreage in this proposed proration unit to the well you propose to drill?

A. Their signature on a joint operating agreement and an AFE, which would evidence their acceptance of our estimated costs of drilling and equipping the well as proposed.

Q. And they have not done that?

A. They have not.

Q. I believe you also heard testimony concerning the position of Southland Royalty in regard to agreement any order entered here should contain a provision to escrow funds in dispute?

A. Yes.

Q. Is that the position of Southland Royalty?

A. It was an attempt on our part to accommodate all parties concerned in this well. I believe, though, that if we must rely on a compulsory pooling order from this body that we will have no choice but to withdraw the escrow agreement offered.

Q. Do you have anything further to add to your testimony?

A. No, I do not.

MR. CARR: I have nothing further of this witness on direct.

MR. DICKERSON: One or two questions.

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CROSS EXAMINATION

BY MR. DICKERSON:

Q. Mr. Petrie, would you refer to Exhibit Number One of Bassett-Birney, please?

A. Yes.

Q. Do I understand you to testify that Bassett-Birney had not agreed to pool its interest in the west half of Section 35?

A. Yes, sir, that's what you heard.

Q. Would you read the last full sentence on the first page of that letter?

A. That's correct.

Q. What does it say?

A. It says that Bassett-Birney is willing to pool its interest in the west half of Section 35 and in the east half of Section 35 for the drilling of the 35 Com No. 1 Well and the 35-A Com No. 1 Well.

Q. So it says Bassett-Birney is willing, not that it's not willing, it is willing to pool its interest.

A. I believe, and correct me if I'm wrong, that that's an indication of willingness and is not an act.

Q. It is not the pooling itself, and I'll agree with you.

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A. That's correct, yes, sir.

Q. What does Southland Royalty Company usually use to effect the pooling of interests under a well?

A. I believe industry-wide there are basically at least two documents that are used, and in most cases three documents, the first of all being a joint operating agreement; the second being an AFE; and lastly, a communitization agreement, if there is more than one ownership.

Q. But your testimony is that the custom is that the parties execute AFE's, operating agreements, and communitization agreements?

A. That's correct.

Q. But don't parties only usually execute AFE's and operating agreements when they agree with what those AFE's and operating agreements credit to them as an interest?

A. That's correct, but I believe, if I may, the actions of an acceptance of those instruments is sufficient notice to the operator that he is undertaking in the absence of signed or acknowledged AFE and joint operating agreement, he is undertaking the costs, the total costs of the project, if those are not accepted by the other working interest owners.

Q. Hypothetically, Mr. Petric, let me pose one final question to you.

A. Uh-huh.

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Q. Just assume that the tables are reversed and Bassett-Birney is the proposed operator of this well.

A. Uh-huh.

Q. Southland stands in the shoes of Bassett-Birney, and Bassett-Birney sends you the identical operating agreement, crediting Southland Royalty Company not with the interest you think you've got, but with the interest that Bassett-Birney thinks you've got, would you recommend to your superiors that you or someone on their behalf execute that thing?

A. I -- am I restricted to a yes or no answer?

Q. Well, I think it can be answered by a yes or no.

A. Okay, I'd rather not. In the first place, given that hypothetical fact situation, I'd refuse to recommend that we sign a joint operating agreement covering that well. I would accept an escrow arrangement as proposed.

Q. That --

MR. STAMETS: Let's hold it for a minute here and go off the record.

(There followed discussion off the record.)

MR. STAMETS: Back on the record. Are there any other questions of Mr. Petrie?

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MR. CARR: I have one question of Mr. Petrie.

REDIRECT EXAMINATION

BY MR. CARR:

Q. The last question, I believe, from Mr. Dickerson was if the situation was exactly the reverse, could you recommend to Southland Royalty Company that they execute an AFE and an operating agreement. Would you restate your answer to that question?

A. I said that in the situation he described I would be unable to recommend that we sign a joint operating agreement.

Q. In your opinion would you then have agreed to voluntarily commit your acreage?

A. No, sir.

MR. CARR: I have no further questions of Mr. Petrie.

RECROSS EXAMINATION

BY MR. DICKERSON:

Q. Mr. Petrie, I'll hand you what is marked Bassett-Birney Exhibit Number Two and ask you to describe what it is very briefly, please.

A. This appears to be a Complaint in the

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United States District Court for the District of New Mexico, filed on July the 23rd of 1980 by Southland Royalty Company as plaintiff versus Robert E. McKee, Inc., Bassett-Birney Oil Corporation, and the United States Department of the Interior, Bureau of Land Management, as defendants.

Q And that's the Complaint evidencing the dispute which you heard testimony concerning today between Southland and Bassett-Birney?

A That's correct.

MR. DICKERSON: No further questions.

MR. STAMETS: Any other questions of the witness?

MR. CARR: I have no questions.

MR. STAMETS: He may be -- well, before we excuse him, let's just ask him this question.

CROSS EXAMINATION

BY MR. STAMETS:

Q Mr. Petrie, do you think it would be appropriate that the Division recognize in any order resulting from this hearing the disputed acreage?

A I don't think this is the proper forum to address the title dispute; however, it's my opinion that in the event the -- an order is entered by the -- by the Division that it would still be effective as to the mineral

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interest within that proration unit.

Q. That will be all, Mr. Petrie, and you may be excused.

MR. STAMETS: If either of the attorneys in this case have anything that they would like to submit, assuming that we can't get voluntary agreement subsequent to the date of hearing, if either of the attorneys in the case have anything they would like to submit relative to the question on the disputed acreage and the -- how that share of the well cost is to be handled and the application of a risk factor to that share of the well cost, the Examiner would certainly be most appreciative of that.

The Examiner will keep the record in this case open until the close of business on September 30th for notice that communitization agreement has been -- voluntary agreement has been reached and that the pooling order is no longer needed, or for the submittal of the other data that I requested in this case, and I would request that if you do submit additional data, that you provide a copy of it to opposing counsel and do that in sufficient time that they would have a chance to make any kind of response that would be appropriate.

Anything further in this case?

MR. DICKERSON: Mr. Examiner, I have just a couple of comments.

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At this time Bassett-Birney Oil Corporation would move that this Division issue an order dismissing Application for Compulsory Pooling of Southland Royalty Company in this case and in support of this motion we submit the memorandum which has been exhibited to the Division and handed to opposing counsel.

And in very brief statement of the substance of that memorandum, we point out that it is Bassett-Birney's position that the statutory authority under which the New Mexico Oil Conservation Division can act limits its authority to subject interest to compulsory pooling when, quote, the parties have not agreed to pool their interest, unquote.

Undisputed evidence in this proceeding shows that in this case Bassett-Birney, the party seeking to be force pooled, has agreed to pool its interest. The Division has no authority to issue a compulsory pooling order under these circumstances.

Given the fact of the litigation pending between these parties in the courts, which will ultimately determine the title to this disputed interest, it's Bassett-Birney's further position that the attempt of Southland Royalty Company to subject its interest to compulsory pooling is made solely for the purpose of changing the risk burden of a dry hole as to the disputed interest from Southland to

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Bassett-Birney, which the terms of a compulsory pooling order would do, and that that is not one of the functions of this Division.

MR. STAMETS: Mr. Dickerson, your request for dismissal in this case will be considered in the thirteen days that the record remains open in this case and it will be addressed in an order which subsequently derives herefrom, unless the parties voluntarily agree and a dismissal results from such voluntary agreement.

MR. DICKERSON: Thank you.

MR. CARR: I have a brief statement.

MR. STAMETS: Mr. Carr.

MR. CARR: Mr. Examiner, Southland Royalty Company will attempt to resolve this matter and therefor be able to request that the case be dismissed.

If they're unable to reach an agreement we think it's important in considering this case to remember that Southland Royalty Company is merely seeking an order pooling certain interest in a standard proration unit.

I think one thing is clear, that whatever the semantics involved in this are, there has not been a voluntary agreement to pool those interests and develop this tract by the drilling of a well.

Southland has a right to drill on this unit. They plan to drill on this unit. They plan to do it

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in the very near future, and we submit that if we're unable to reach an agreement, we have presented everything necessary to entitle us to an order under the pooling statute.

I think it's important in considering this to also remember that the statute talks about pooling any part of such lands or interests, and we're asking that all the lands in the west half of this section be pooled. Now, I think it's worthwhile to take the next two weeks to attempt to resolve this, but if we're unable to do so, we stand behind our request that an order be entered, and an order be entered in an expeditious fashion because of the time frame we find ourselves operating under with the farm-out agreements.

And if anybody doesn't like the order that they get, there are ways that those orders can be appealed.

But we want this clearly understood that although we're willing to make the effort again to try to resolve this matter without the aid of the Commission, if we can't, we have no choice but to ask for the order and ask for it promptly so we can proceed to meet our obligations under our other agreements.

MR. STAMETS: If there is nothing further, the hearing is adjourned.

(Hearing concluded.)

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C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY CERTIFY that the foregoing Transcript of Hearing before the Oil Conservation Division was reported by me; that the said transcript is a full, true, and correct record of the hearing, prepared by me to the best of my ability.

_____

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. _____, heard by me on _____ 19____.

_____, Examiner
Oil Conservation Division

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BLDG.
SANTA FE, NEW MEXICO
17 September 1980

EXAMINER HEARING

IN THE MATTER OF:

Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

CASE 7025

BEFORE: Richard L. Stamets

TRANSCRIPT OF HEARING

A P P E A R A N C E S

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A P P E A R A N C E S CONT'D

For Bassett-Birney:

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MR. STAMETS: We'll call next Case 7025.

MR. PADILLA: Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico.

MR. CARR: Mr. Examiner, I'm William F. Carr, Campbell & Black, P. A., Santa Fe, appearing on behalf of the applicant. I have one witness.

MR. STAMETS: Call for other appearances in this case.

MR. DICKERSON: Mr. Examiner, my name is Chad Dickerson, Losee, Carson, & Dickerson, P. A., Artesia, New Mexico. We also have one witness, on behalf of Bassett-Birney Oil Corporation.

MR. STAMETS: I'd like to have all witnesses stand and be sworn at this time, please.

(Witnesses sworn.)

MR. STAMETS: You may proceed, Mr. Carr.

DON W. DAVIS

being called as a witness and having been duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

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BY MR. CARR:

Q. Will you state your name and place of residence?

A. Don W. Davis, Midland, Texas.

Q. Mr. Davis, by whom are you employed and in what capacity?

A. Southland Royalty Company as a petroleum landman.

Q. Have you previously testified before this Commission and had your credentials accepted and made a matter of record?

A. No, sir, I have not.

Q. Will you briefly summarize your educational background and your work experience?

A. I graduated from Texas Christian University in 1978 with a Bachelor's in management.

Upon graduation I moved to Houston, Texas; worked as a petroleum landman for Texaco, Incorporated, for eight months. Following that I moved to Midland, Texas, and have now been employed by Southland Royalty Company as a petroleum landman for one year and three months.

Q. Are you familiar with the application that has been filed in this case?

A. Yes, I am.

Q. Are you familiar with the area which is

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the general subject of the application?

A. Yes, sir, I am.

MR. CARR: Are the witness' qualifications as a petroleum landman acceptable?

MR. STAMETS: Yes.

Q. Mr. Davis, will you briefly state what Southland Royalty Company seeks with this application?

A. Southland Royalty Company is seeking an order to force pool the west half of Section 35, Township 18 South, Range 29 East, Eddy County, New Mexico, for the drilling of one Morrow test well.

We are also seeking a risk factor in this case and requesting that SRC be designated as operator of the well.

Q. Will you now refer to what has been marked for identification as Southland Exhibit Number One and explain to the Examiner what it is and what it shows?

A. This is a plat showing all of Section 35 plus some of the surrounding sections. It also shows in the west half of Section 35 the proposed proration unit and the location of the SRC Empire Federal 35 Com No. 1 Well.

Q. Is this a standard proration unit?

A. Yes, sir, it is.

Q. And is the well proposed to be drilled at an orthodox location?

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A. No, sir.

Q. It is not?

A. Excuse me, sir, I thought you said unorthodox.

Q. No, at an orthodox location.

A. Yes, sir, it is an orthodox location.

Q. Does this exhibit also show other Pennsylvanian completions in the area?

A. Yes, sir, it does.

Q. Will you please refer to each of the tracts in the west half Section 35 and explain the status of them vis-a-vis this application?

A. Yes, sir. Beginning at the top, working down, the top 80-acre tracts, which includes the north half of the northwest quarter of Section 35, is owned by Tenneco 100 percent, and they have agreed to join in the drilling of the subject well.

The acreage shaded in yellow currently 50 percent of it has been in support to SRC for the drilling of this well through a farm-in from Robert E. McKee Company; the other 50 percent, owned by Bassett-Birney, they have refused to join in the well.

The acreage shaded in green with the title Featherstone Farms has been farmed-in to Southland Royalty Company for the drilling of the subject well.

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Q. Mr. Davis, is there a dispute as to the ownership of any of the acreage involved in this application?

A. Yes, there is, sir, the acreage shaded in yellow is currently under ownership dispute.

Q. And are any efforts underway to resolve this dispute?

A. Yes, sir. At this time there is a case on the docket for the United States District Court to settle the ownership dispute.

Q. Could Southland Royalty Company wait for resolution of the ownership question before proceeding with development of the acreage involved?

A. No, sir, we cannot.

Q. And why not?

A. From our support agreements, our farm-in agreements, which is the acreage shaded in yellow and green, SRC must commence a well by November 5th, 1980, or lose the support we have under the well.

Q. Is the only interest that Southland is seeking to pool by this application the interest of Bassett-Birney?

A. Yes, sir.

Q. And has -- has Southland Royalty Company given notice to Bassett-Birney of this application?

A. Yes, sir, we have.

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Q. Has a copy of the letter giving them notice of the hearing been marked Exhibit Two in this case?

A. Yes, sir, it is.

Q. Mr. Davis, according to Southland Royalty Company's title data, what percentage of the working interest does Southland represent here today?

A. According to SRC's title data under this well we currently represent 80 percent of the well.

Q. And what percentage of this interest is in dispute?

A. 19 percent.

Q. So what interest do you represent, even if Bassett-Birney should be successful in the District -- U. S. District Court proceeding concerning title?

A. Approximately 62 percent.

Q. Does Southland propose to drill a well on the proration unit in the near future?

A. Yes, sir.

Q. And how soon do you plan to spud the well?

A. We hope to be able to spud 35 No. 1 Well within thirty days.

Q. Will you now refer to what has been marked for identification as Applicant's Exhibit Number Three and review this data for Mr. Stamets? You might first just ident-

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ify what it is.

A. Okay, there are the relevant correspondence and documents concerning our attempts to drill this well.

First, by letter dated February 26th, 1980, SRC requested a farm-in from Bassett-Birney concerning their interest in all of Sections 33, 34, and 35 in Township 18 South, Range 29 East, Eddy County.

We offered a 1/16th override with a 50 percent backin ~~in~~ at payout. We also in this letter offered for them to join in a well which would be proposed later.

By letter dated March 24th, 1980, to Bassett-Birney Oil Corporation SRC proposed our 35 No. 1 Well, once again requesting a farm-out or joinder in the 35 No. 1 Well, and also enclosed an AFE for the well.

By letter dated March 24th, 1980, SRC requested from Tenneco Oil Exploration and Production a farm-out or joinder in the 35 No. 1 Well; also supplied an AFE at that time.

Q. Mr. Davis, was the proposal made to Bassett-Birney identical to that made to Tenneco Oil?

A. Yes, sir, it was.

By letter dated June 19th, 1980, SRC responded to a request by Tenneco in which they wanted to form a working interest unit. We said we had tried to form that unit; were unsuccessful in trying to form the working interest

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unit.

By letter dated July 8th, 1980, to Bassett-Birney Oil Corporation, SRC informed Bassett-Birney of the location change for the 35 No. 1 Well; also submitted an AFE and an operating agreement for the well, which is attached.

Q. I'd like you to direct your attention to the AFE and briefly review the costs that are reflected therein.

A. Yes, sir. We propose that a dry hole in this area, dry hole well, would cost us $488,000 total cost; a completed well, $767,010, approximations.

Q. Are the costs reflected on the AFE in line with what other operators in the area are estimating the costs of drilling and completing similar wells?

A. Yes, sir, they are.

Q. Okay, will you proceed now to review this exhibit?

A. The next correspondence is dated July 15th, 1980, a letter sent to Tenneco Oil Exploration. We informed Tenneco of our unsuccessful attempts to form the working interest unit, a location change for our well, and also submitted a new AFE and joint operating agreement.

Next is the designation of operator for the 35 No. 1 Well executed by Featherstone Farms, dated 7-23-80, date of execution.

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Next a letter dated July 25th, 1980, SRC references early proposals for the 35 No. 1 Well and also reference my attempt to form the working interest unit; also was another well proposed at a later date.

By letter dated July 29th, 1980, to Flag-Redfern Oil Company, SRC once again makes reference to our unsuccessful attempts to form a working interest unit in Section 35.

Q. Does Flag-Redfern have any interest in the west half of Section 35?

A. No, sir, they do not.

Q. Their interests are confined to the east half of the section?

A. Yes, sir.

By letter dated September 4th, 1980, from Bassett-Birney Oil Corporation to SRC, in this letter you'll note at the bottom, last paragraph, Bassett-Birney is willing to pool its interest in the west half of Section 35 and the east half of Section 35 for the drilling of the 35 Com No. 1 Well and 35-A Com No. 1, which at this hearing we are only interested in the 35 Com No. 1.

Q. Mr. Davis, doesn't this letter also contain references to the title dispute and indicate that because of that they are unable to execute certain documents?

A. Yes, sir, that is correct.

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Next document is a letter dated September 15th, 1980, from Southland Royalty Company pertaining to the disputed interest in which we propose an escrow arrangement which would allow us to continue drilling the well and put the disputed acreage in escrow.

Q. Has this escrow arrangement been accepted or rejected to your knowledge?

A. No, sir, it has not been accepted to the best of my knowledge.

Q. It has not been accepted?

A. No, sir.

Q. Okay. In your opinion, Mr. Davis, has Southland Royalty Company made a good faith effort to obtain voluntary pooling of the west half of Section 35?

A. Yes, sir.

Q. Are you prepared to make a recommendation to the Examiner concerning charges for overhead and administrative costs while drilling and producing this well?

A. Yes, sir, I am.

Q. And what are those figures?

A. Charges are $3000 for a drilling well per month; $300 for a producing well per month.

Q. And do you recommend that these figures be incorporated into any order which results from this hearing?

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A. Yes, sir, I do.

Q. Are these figures in line with what is being charged by other operators in the area?

A. Yes, sir, they are.

Q. Have you been involved in the drilling of other Pennsylvanian wells in this area?

A. Yes, sir, I have.

Q. What is your experience concerning the risk involved in drilling wells to the Pennsylvanian formation?

A. Well, we are giving this well a 62 percent success factor. Wells, we feel that the -- or management feels that Morrow wells in the area are very, very risky.

Q. And what success factor was that you presented?

A. 62 percent success factor for this well.

Q. Do you consider this well to be a high risk venture?

A. Yes, sir, I do.

Q. Are you prepared to make a recommendation to the Examiner as to a risk factor that should be assessed against those who do not voluntarily participate in the drilling of the well?

A. Yes, sir, I am.

Q. And what is that?

A. 200 percent.

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Q. Does Southland Royalty Company request to be named operator of this well?

A. Yes, sir, we do.

Q. I believe you've indicated that you plan to spud the well in the immediate future.

A. Yes, sir, within thirty days we will.

Q. Do you request that the order resulting from this hearing be expedited?

A. Yes, sir, I do.

Q. In your opinion will granting this application be in the interest of conservation, the prevention of waste, and the protection of correlative rights?

A. Yes, sir.

Q. Were Exhibits One through Three prepared under your supervision and direction?

A. Yes, sir, they were.

MR. CARR: At this time, Mr. Examiner, we would offer into evidence Southland Royalty Company Exhibits One through Three.

MR. STAMETS: These exhibits will be admitted.

MR. DICKERSON: Mr. Examiner, we would -- before you admit those, Bassett-Birney would object to the admission of the letter containing -- I think it's part of Exhibit Number Three -- dated September 15th, 1980, containing

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a proposed escrow agreement, on the grounds of irrelevancy to this proceeding.

MR. STAMETS: Mr. Carr, do you have any response to this?

MR. CARR: The only reason that is included, Mr. Examiner, is to indicate that Southland has made a good faith effort to obtain voluntary joinder and when there have been problems they've made efforts to deal with those. They've made good faith efforts to deal with those. We think it's appropriate and should be included in the record.

MR. DICKERSON: Mr. Examiner, we'd only say it is part -- or it is my understanding that it was part of a settlement negotiation scheme between Southland and Bassett-Birney in attempt to reach some resolution of the problem between the parties, which pend not only in this Division but also in the Federal District Court of New Mexico, and that the -- to the extent my understanding was correct, it was a settlement proposal and was rejected by Bassett-Birney by telephone yesterday; that that exhibit should not be admitted. It is irrelevant to -- to the matters in issue before this Division.

The specific legal point, Mr. Examiner, would go to the admission of settlement offers made between parties for the purpose of accommodating each other in disputes of various types, and the admissibility of that type

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of instruments in administrative or judicial proceedings.

MR. CARR: If that's the case, Mr. Examiner, any letter or correspondence in which operators are trying to reach some agreement whereby they might voluntarily pool, might also not be proper, if that rule were to apply.

I think it's important as you look at that to note that it has been rejected and so that the contents of it, I think, are not of significance.

MR. DICKERSON: Mr. Examiner, I might say that the reason that the rules of evidence, in my opinion, exclude offers of this type from admissibility under most circumstances, is that it is the policy of the tribunals deciding disputes between the parties, to enable the parties to, when possible, reach accommodations between themselves in settlement of the dispute, but when those attempts are not successful the details of the attempts should not be admitted for the reason that they contain matters which are not otherwise admissible.

MR. CARR: Mr. Examiner, maybe I can --

MR. STAMETS: Mr. Carr, did I -- I'm sorry --

MR. CARR: If I might ask Mr. Davis an additional question or two, I would be willing to withdraw this.

MR. STAMETS: That certainly might simplify.

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MR. CARR: Might simplify and facilitate proceedings.

MR. STAMETS: Yes.

Q. Mr. Davis, would Southland Royalty Company have any objection to an order resulting from this hearing providing that disputed sums be placed in escrow?

A. No, sir, we would not have any objection to that.

MR. CARR: I would withdraw the last letter in Exhibit Three.

MR. STAMETS: We will accept your exhibits, then, with the letter of September 15th, 1980, from Mr. Losee being withdrawn.

MR. CARR: And I have nothing further of Mr. Davis on direct.

MR. STAMETS: Relative to that last question,Mr. Carr and Mr. Davis, are we talking about the standard provisions in a Division order which provide for the escrowing of funds which may not otherwise be payable to persons for any reasons?

MR. CARR: Mr. Stamets, that is not provided for in the joint operating agreement involved in this case.

MR. STAMETS: I'm talking about, Bill, the provisions of our orders which say that any funds which

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may not be paid out are to be escrowed. Or are we talking about some different type of escrow account here?

Let's go off the record a second.

(Thereupon a discussion was had off the record.)

MR. STAMETS: Okay, we can go back on the record.

Are there any other questions of Mr. Davis?

MR. DICKERSON: Yes, sir, I have a few questions.

CROSS EXAMINATION

BY MR. DICKERSON:

Q. Mr. Davis, what is the significance of the red circle in the east half of Section 34 shown on your plat as Exhibit Number One?

A. In the east half of 34?

Q. Yes.

A. It is a well we have also proposed to drill.

Q. Have you proposed to drill that well?

A. Did you say 35 or 34?

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Q. 34?

A. Oh, yes, sir, it is a well that has been drilled.

Q. Whose well is that?

A. SRC is the operator of that well.

Q. And is Bassett-Birney involved in that acreage with you, also?

A. Yes, sir, they are.

Q. To enlighten the Examiner a little bit, would you explain the significance of that well in the east half of Section 34 with regard to its effect on this litigation concerning this title dispute which you referred to between Southland and Bassett-Birney?

MR. CARR: I'm going to object to this. We are not here today to litigate the title dispute and I don't think that it's appropriate to -- for the Commission to receive testimony as to a matter which is pending in the District Court.

MR. DICKERSON: Mr. Examiner, I would agree 100 percent that we are not here to litigate the title dispute and the purpose of this question is only for informational purposes so that the Examiner will have the opportunity to have an over-view of the entire situation; how the circumstance arose, and with that knowledge of the over-view to apply it to the issues in dispute here today concerning forced

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pooling of Bassett-Birney.

MR. CARR: Mr. Examiner, I would submit that we're here seeking a pooling order under a very specific section of the statute, which provides when you're unable to obtain a voluntary agreement to pool acreage, and you have an operator who has the right to drill a well and is prepared to drill a well, that you can come in and after giving notice, get an order whereby the acreage shall be pooled and you can go forward with his plans to develop the acreage.

MR. STAMETS: Mr. Dickerson, I believe you'll be able to develop this information -- I would assume you'll be able to develop this information with your witness and it certainly would seem like a more appropriate time to do it in light of Mr. Carr's objection here, and I would sustain that objection.

MR. DICKERSON: Could I say, Mr. Examiner, and without any way trying to be argumentative, but to try to make myself a little clearer, that this is cross examination. This witness is the party who brought the subject of the litigation up and when it's brought up, in our opinion, it is relevant and is necessary to a clear understanding of the issues here for the Examiner to know a little bit more about the litigation at this point.

MR. STAMETS: Is there any reason that that can't be discussed specifically relating to the 320-acre

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tract that is the subject of this case?

MR. DICKERSON: It deals, Mr. Examiner, with the time frame at which the problem became known to the parties, and I don't intend to use a lot of time or anything in this line of inquiry; about a one paragraph reply is all that's requested.

If you prefer, what I was attempting to do is bring it out and save the necessity of calling Mr. McCaw for this purpose in the interest of time. I can do it and establish it that way, but I'm attempting to do exactly the same thing in this way.

MR. STAMETS: I would prefer that you develop this with your own witness.

MR. DICKERSON: Okay.

MR. STAMETS: Mr. Dickerson.

Q. What -- do you have any knowledge as to the nature of this well in the east half of Section 34, Mr. Davis, as to whether -- what its productivity is?

A. In the -- I'm not a geologist, I'm a landman. I've done land work. I know we have made a commercial completion in there. As far as the geology of the well, I do not know.

Q. All right. In your capacity as a landman you know, generally, the area in dispute here and the relationship between the interest of Southland and Bassett-Birney,

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do you not?

A. I know there is a dispute over acreage.

Q. That involves not only the acreage in Section 34 but also acreage in Section 35 and other acreage in that area.

A. Yes, sir, that is true.

Q. Mr. Davis, in your operating agreement that you referred to as part of Exhibit Number Three, I believe it was, would you look at Exhibit Number A to that operating agreement?

Now I believe that you testified that the amount in dispute was between Bassett-Birney and Southland approximately 19 percent, is that correct?

A. Yes, sir.

Q. So that if, to clarify for the Examiner the meaning of Exhibit A to the operating agreement, if Bassett-Birney prevails in this litigation that you referred to, their interest would be doubled over that shown, is that correct?

A. Yes, sir, that is correct.

Q. And --

A. If they prevail.

Q. Right, and if Southland should prevail, then the interest of Southland, both before payout and after payout, shown on Exhibit A would be decreased by that amount,

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is that correct?

A. That is correct, if they win.

Q. Now your AFE and operating agreement, or I should say -- right, AFE and operating agreement, are prepared, are they not, on the assumption that Southland is going to prevail in the title litigation.

A. There is no assumption made there. The operating agreement we prepared is from title we had prepared by attorneys. I made no assumptions concerning any lawsuit when I prepared this agreement.

Q. Well, you're assuming, aren't you, Mr. Davis, that those opinions are correct?

A. Yes, sir.

Q. So it's based on some assumption and that assumption is that the opinions on which you based --

A. It's based on a title opinion, yes, sir.

Q. Right, so to go back to my original question, you are ultimately assuming that Southland is going to prevail in the litigation, aren't you?

A. I am presuming the title opinion prepared for us is correct.

Q. And your AFE presumes that the title opinion is correct and therefor the interest set forth for Bassett-Birney to agree to is based on your opinion, is that correct?

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A. Yes, sir, that is correct.

MR. STAMETS: While we're on that point, I'd like a little clarification there.

Presuming now that Bassett-Birney prevail in this particular case, then their share of the well would be increased and their share of the costs would be increased, as well?

MR. DICKERSON: I might clarify this off the record.

(Thereupon a discussion was had off the record.)

MR. STAMETS: Let's go back on the record. Mr. Dickerson, do you have some additional questions?

MR. DICKERSON: Yes, Mr. Examiner.

Q. Mr. Davis, I'm handing you what is marked Bassett-Birney Exhibit Number One and I believe that's one of the instruments that is part of your Exhibit Number Three, but for clarification and further future reference, would you describe to the Examiner what that is?

A. This is a letter mailed from Bassett-Birney to Southland Royalty Company in which they reject to sign. They will not sign either our AFE or operating agreement, for two wells proposed to them, due to, and I'll read it, "Since Southland has instituted a suit against among other parties, Bassett-Birney Oil Corporation, in the United States District Court

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for the District of New Mexico, Case Number, contesting our title for the working interest underlying the proposals, and also due to their opinion as to what their interest under the operating agreement and AFE should be".

Q. Does it say anything else?

A. Do you want to read the whole letter?

Q. I was just really getting at your understanding of the -- you testified that Bassett-Birney had not agreed to pool their interest, I believe, did you not?

A. No, I testified that there is a sentence, and I read the sentence straight from the letter, where it says Bassett-Birney is willing to pool its interests in the west half of Section 35, east half of Section 35. My attorney clarified that by also saying is there a paragraph in here that also states due to the dispute that they would not sign it, and I said yes to that.

Q. That they would not sign the AFE and operating agreement in the form it was submitted?

A. Yes, sir, that is correct, due to the title dispute and due to our instigating a lawsuit.

Q. Mr. Davis, if you were recommending to your management as to whether or not Southland should sign an operating agreement and an AFE in which it admitted it had an interest, but which credited with another interest other than the one you thought it had, would you recommend

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that the instruments be executed?

A. I'm not sure whether I can answer that because I'm not in that situation.

Q. I know it's a hypothetical question, but if you were in that situation would you recommend, if you were --

A. If I was in the situation where I owned more than someone said I owned, I would clarify what I did own and then go on with the drilling or whatever situation it involved.

Q. All right, and isn't that exactly what that letter, Exhibit Number One, says?

A. Well, I've already said what the letter said. I said that they -- well, I don't need to reiterate what I just said.

Q. But, I'm just confirming my understanding of what I thought you said, they should have clarified the interest that they did claim, and so my question is, didn't Exhibit Number One of Bassett-Birney do precisely that?

A. Yes, but I did not say clarify the interest they claim. I said clarify the interest they own, and that is something that's in dispute at this time.

Q. Right.

Mr. Davis, what's the nature of -- you testified that Southland, because of offset -- or support

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for its well in Section 35, must commence a well by November 5th of this year. What's the nature of that obligation?

A. Under our farm-out agreements, which we have from Robert E. McKee Company and Featherstone Farms, if we do not commence a well on at least a portion or where their interest in a well on a portion, commence the well, then all rights outside any acreage we have earned from production, will expire.

Q. Do you -- are you familiar with the terms of those farm-out letters?

A. Yes, sir.

Q. You're testifying concerning those letters, would you produce a copy?

A. Of which, the farm-out agreement?

Q. The farm-out agreement from Featherstone Farms?

A. We did not submit that farm-out agreement as an exhibit so I do not have it with me.

Q. I understand, well, but you're testifying to it.

A. Yes.

Q. And you testified that it obligates you to commence a well by November 5th?

A. Yes, sir. That's from memory.

Q. Are you certain of that date? Do you have

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any way to confirm the date that --

A. I am certain of the date but I have no instrument here which will confirm that date.

Q. Would Southland have any objection to furnishing a copy of that farm-out letter to Bassett-Birney?

MR. CARR: Mr. Examiner, I'm going to object to this entire line of questioning. I don't think it's relevant to anything here except the request that the order be expedited. It isn't relevant to any issue that's before the Commission at this time.

MR. DICKERSON: Mr. Examiner, it's testified to by Southland, not Bassett-Birney. I think on cross examination we're entitled to inquire into it, but we do so only for the purposes of this proceeding, and it's necessary for us to properly present the issues that this Division has to decide to know the basis of the testimony which Southland offers in support of its application.

MR. STAMETS: In view of the fact that the November 5th date doesn't really make any difference as to whether or not the interest owners have or have not agreed, I don't believe that we require that information to render a decision on compulsory pooling in this case, and because of that I would support Mr. Carr's -- or sustain Mr. Carr's objection.

Q. Mr. Davis, in your testimony concerning

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the risk factor which you recommended to the Commission be imposed in the drilling of the well on the west half of Section 35, did you take into account the offsetting commercial well that you testified to in the east half of Section 34?

A. Sir, management made the decisions as to risk factor. I am a landman. I have no knowledge of --

MR. DICKERSON: Mr. Examiner, I'm objecting that his answer is not responsive. If the witness would like me to repeat the question, I'll be happy to, but he's not answering the question I put to him.

MR. CARR: Well, will you restate the question, please?

Q. You testified, did you not, Mr. Davis, as to -- on your -- in your capacity as a landman, disclaiming expertise as a geologist or engineer or anything else, but you testified, did you not as a landman, as to a proposed risk factor to be imposed in the drilling of this well?

A. Yes.

Q. So you must have thought -- I assume, you correct me if I'm wrong, that you thought of certain things in making that recommendation, is that correct?

A. Yes, sir. That people, we did think of those things.

Q. So that is correct?

A. Yes, sir.

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Q. And so did you or did you not take into account the offsetting well in Section 34 in making that recommendation?

A. Yes, sir, the decision to make that recommendation, it was taken into account.

Q. Thank you. Did I understand you correctly, Mr. Davis, to testify that, and I'll try to quote but you correct it if I'm inexact, that Bassett-Birney had refused to join in the drilling of this well on Section 35?

A. They refused to sign the AFE and operating agreement for the well.

Q. They didn't refuse to join or participate in the drilling of the well?

A. By not signing the AFE and operating agreement, yes, I would say they refused to join in the well.

Q. You've been -- is it your opinion -- do you have -- in your capacity as a landman, Mr. Davis, is it part of your responsibilities and duties to draft contracts, operating agreements, and things of that nature?

A. Yes, sir.

Q. So is it your understanding that you're free to draft an operating agreement, as a hypothetical example, in any form, shape, or fashion that you desire and you simply mail it out to anybody and they can either take it or leave it and that's the way it is?

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A. No, sir, that is not correct. There are certain guidelines we need to follow when we draw our operating agreements, which are decided upon on our upper level management and interests are sitting there bearing our title.

Q. Right, but wasn't it made clear to you, and I'm talking with you personally if you read the letter addressed to you marked Bassett-Birney Exhibit Number One, wasn't it made clear to you that Bassett-Birney's objection to the operating agreement and the AFE was to the extent of the interest credited to Bassett-Birney?

In other words, they didn't quibble over supervision costs, did they?

A. No, sir.

Q. Is there any argument over that?

A. No, sir.

Q. And any argument over any other provisions of the operating agreement, the nonconsent penalties, the operator's lien, or anything, except the title dispute?

A. No, sir.

Q. So the title dispute is really the only --

A. Except for drilling these wells down here on the acreage under dispute, Bassett-Birney requested that they not pay any title costs, so we assumed 100 percent of their title costs.

Q. So --

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A. In good faith.

Q. I'll make a statement and you disagree with it if it's not correct.

The only dispute, to your knowledge, between Southland and Bassett-Birney in this acreage with which we're concerned in this proceeding, evolves directly out of this title dispute?

A. That is true, as of my knowledge.

MR. DICKERSON: That's all I have, Mr. Examiner.

MR. STAMETS: Any other questions of the witness? He may be excused.

MR. CARR: I'd like to ask him just one question on redirect.

MR. STAMETS: Okay.

REDIRECT EXAMINATION

BY MR. CARR:

Q. Mr. Davis, you testified that -- let me just ask you to refer again to Exhibit A to the operating agreement, and my question is, if Southland Royalty Company should ultimately prevail in any litigation, is that exhibit correct?

A. Yes, sir, that exhibit is correct.

Q. Okay. Thank you.

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MR. STAMETS: The witness may be excused.

MR. CARR: I'm going to ask if we could take about a five minute recess?

MR. STAMETS: You certainly may, Mr. Carr.

(Thereupon a recess was taken.)

MR. STAMETS: The hearing will come to order. Mr. Carr?

MR. CARR: Mr. Stamets, at this time I'll call Mr. Richard Petrie. He has not been sworn.

MR. STAMETS: I'd like to have him stand and be sworn, please.

(Mr. Petrie sworn.)

RICHARD W. PETRIE

being called as a witness and having been duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. CARR:

Q Will you state your name and place of residence?

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Rt. 1 Box 193-B
Santa Fe, New Mexico 87501
Phone (505) 455-7409

A. Richard W. Petrie, Midland, Texas.

Q. By whom are you employed and in what capacity?

A. Southland Royalty Company as District Landman.

Q. Have you previously testified before the Commission and had your credentials accepted and made a matter of record?

A. I have.

Q. Are you familiar with the application in this case?

A. Yes, I am.

MR. CARR: Are the witness' qualifications acceptable?

MR. STAMETS: They are.

Q. Mr. Petrie, I believe you've heard testimony presented here today concerning the status of the effort to obtain voluntary commitment of all the acreage in the west half of Section 35 for the drilling of a Morrow test.

A. Yes.

Q. Have all the interests voluntarily joined or voluntarily pooled their acreage?

A. No, sir, they have not.

Q. And what interest is outstanding?

A. The interest owned by Bassett-Birney.

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Q. And what act on the part of Basset-Birney would it take to commit that -- their acreage in this proposed proration unit to the well you propose to drill?

A. Their signature on a joint operating agreement and an AFE, which would evidence their acceptance of our estimated costs of drilling and equipping the well as proposed.

Q. And they have not done that?

A. They have not.

Q. I believe you also heard testimony concerning the position of Southland Royalty in regard to agreement any order entered here should contain a provision to escrow funds in dispute?

A. Yes.

Q. Is that the position of Southland Royalty?

A. It was an attempt on our part to accommodate all parties concerned in this well. I believe, though, that if we must rely on a compulsory pooling order from this body that we will have no choice but to withdraw the escrow agreement offered.

Q. Do you have anything further to add to your testimony?

A. No, I do not.

MR. CARR: I have nothing further of this witness on direct.

MR. DICKERSON: One or two questions.

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CROSS EXAMINATION

BY MR. DICKERSON:

Q. Mr. Petrie, would you refer to Exhibit Number One of Bassett-Birney, please?

A. Yes.

Q. Do I understand you to testify that Bassett-Birney had not agreed to pool its interest in the west half of Section 35?

A. Yes, sir, that's what you heard.

Q. Would you read the last full sentence on the first page of that letter?

A. That's correct.

Q. What does it say?

A. It says that Bassett-Birney is willing to pool its interest in the west half of Section 35 and in the east half of Section 35 for the drilling of the 35 Com No. 1 Well and the 35-A Com No. 1 Well.

Q. So it says Bassett-Birney is willing, not that it's not willing, it is willing to pool its interest.

A. I believe, and correct me if I'm wrong, that that's an indication of willingness and is not an act.

Q. It is not the pooling itself, and I'll agree with you.

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A. That's correct, yes, sir.

Q. What does Southland Royalty Company usually use to effect the pooling of interests under a well?

A. I believe industry-wide there are basically at least two documents that are used, and in most cases three documents, the first of all being a joint operating agreement; the second being an AFE; and lastly, a communitization agreement, if there is more than one ownership.

Q. But your testimony is that the custom is that the parties execute AFE's, operating agreements, and communitization agreements?

A. That's correct.

Q. But don't parties only usually execute AFE's and operating agreements when they agree with what those AFE's and operating agreements credit to them as an interest?

A. That's correct, but I believe, if I may, the actions of an acceptance of those instruments is sufficient notice to the operator that he is undertaking in the absence of signed or acknowledged AFE and joint operating agreement, he is undertaking the costs, the total costs of the project, if those are not accepted by the other working interest owners.

Q. Hypothetically, Mr. Petrie, let me pose one final question to you.

A. Uh-huh.

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Q. Just assume that the tables are reversed and Bassett-Birney is the proposed operator of this well.

A. Uh-huh.

Q. Southland stands in the shoes of Bassett-Birney, and Bassett-Birney sends you the identical operating agreement, crediting Southland Royalty Company not with the interest you think you've got, but with the interest that Bassett-Birney thinks you've got, would you recommend to your superiors that you or someone on their behalf execute that thing?

A. I -- am I restricted to a yew or no answer?

Q. Well, I think it can be answered by a yes or no.

A. Okay, I'd rather not. In the first place, given that hypothetical fact situation, I'd refuse to recommend that we sign a joint operating agreement covering that well. I would accept an escrow arrangement as proposed.

Q. That --

MR. STAMETS: Let's hold it for a minute here and go off the record.

(There followed discussion off the record.)

MR. STAMETS: Back on the record. Are there any other questions of Mr. Petrie?

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MR. CARR: I have one question of Mr. Petrie.

REDIRECT EXAMINATION

BY MR. CARR:

Q. The last question, I believe, from Mr. Dickerson was if the situation was exactly the reverse, could you recommend to Southland Royalty Company that they execute an AFE and an operating agreement. Would you restate your answer to that question?

A. I said that in the situation he described I would be unable to recommend that we sign a joint operating agreement.

Q. In your opinion would you then have agreed to voluntarily commit your acreage?

A. No, sir.

MR. CARR: I have no further questions of Mr. Petrie.

RECROSS EXAMINATION

BY MR. DICKERSON:

Q. Mr. Petrie, I'll hand you what is marked Bassett-Birney Exhibit Number Two and ask you to describe what it is very briefly, please.

A. This appears to be a Complaint in the

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United States District Court for the District of New Mexico, filed on July the 23rd of 1980 by Southland Royalty Company as plaintiff versus Robert E. McKee, Inc., Bassett-Birney Oil Corporation, and the United States Department of the Interior, Bureau of Land Management, as defendants.

Q. And that's the Complaint evidencing the dispute which you heard testimony concerning today between Southland and Bassett-Birney?

A. That's correct.

MR. DICKERSON: No further questions.

MR. STAMETS: Any other questions of the witness?

MR. CARR: I have no questions.

MR. STAMETS: He may be -- well, before we excuse him, let's just ask him this question.

CROSS EXAMINATION

BY MR. STAMETS:

Q. Mr. Petrie, do you think it would be appropriate that the Division recognize in any order resulting from this hearing the disputed acreage?

A. I don't think this is the proper forum to address the title dispute; however, it's my opinion that in the event the -- an order is entered by the -- by the Division that it would still be effective as to the mineral

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interest within that proration unit.

Q That will be all, Mr. Petrie, and you may be excused.

MR. STAMETS: If either of the attorneys in this case have anything that they would like to submit, assuming that we can't get voluntary agreement subsequent to the date of hearing, if either of the attorneys in the case have anything they would like to submit relative to the question on the disputed acreage and the -- how that share of the well cost is to be handled and the application of a risk factor to that share of the well cost, the Examiner would certainly be most appreciative of that.

The Examiner will keep the record in this case open until the close of business on September 30th for notice that communitization agreement has been -- voluntary agreement has been reached and that the pooling order is no longer needed, or for the submittal of the other data that I requested in this case, and I would request that if you do submit additional data, that you provide a copy of it to opposing counsel and do that in sufficient time that they would have a chance to make any kind of response that would be appropriate.

Anything further in this case?

MR. DICKERSON: Mr. Examiner, I have just a couple of comments.

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At this time Bassett-Birney Oil Corporation would move that this Division issue an order dismissing Application for Compulsory Pooling of Southland Royalty Company in this case and in support of this motion we submit the memorandum which has been exhibited to the Division and handed to opposing counsel.

And in very brief statement of the substance of that memorandum, we point out that it is Bassett-Birney's position that the statutory authority under which the New Mexico Oil Conservation Division can act limits its authority to subject interest to compulsory pooling when, quote, the parties have not agreed to pool their interest, unquote.

Undisputed evidence in this proceeding shows that in this case Bassett-Birney, the party seeking to be force pooled, has agreed to pool its interest. The Division has no authority to issue a compulsory pooling order under these circumstances.

Given the fact of the litigation pending between these parties in the courts, which will ultimately determine the title to this disputed interest, it's Bassett-Birney's further position that the attempt of Southland Royalty Company to subject its interest to compulsory pooling is made solely for the purpose of changing the risk burden of a dry hole as to the disputed interest from Southland to

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Bassett-Birney, which the terms of a compulsory pooling order would do, and that that is not one of the functions of this Division.

MR. STAMETS: Mr. Dickerson, your request for dismissal in this case will be considered in the thirteen days that the record remains open in this case and it will be addressed in an order which subsequently derives herefrom, unless the parties voluntarily agree and a dismissal results from such voluntary agreement.

MR. DICKERSON: Thank you.

MR. CARR: I have a brief statement.

MR. STAMETS: Mr. Carr.

MR. CARR: Mr. Examiner, Southland Royalty Company will attempt to resolve this matter and therefor be able to request that the case be dismissed.

If they're unable to reach an agreement we think it's important in considering this case to remember that Southland Royalty Company is merely seeking an order pooling certain interest in a standard proration unit.

I think one thing is clear, that whatever the semantics involved in this are, there has not been a voluntary agreement to pool those interests and develop this tract by the drilling of a well.

Southland has a right to drill on this unit. They plan to drill on this unit. They plan to do it

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in the very near future, and we submit that if we're unable to reach an agreement, we have presented everything necessary to entitle us to an order under the pooling statute.

I think it's important in considering this to also remember that the statute talks about pooling any part of such lands or interests, and we're asking that all the lands in the west half of this section be pooled. Now, I think it's worthwhile to take the next two weeks to attempt to resolve this, but if we're unable to do so, we stand behind our request that an order be entered, and an order be entered in an expeditious fashion because of the time frame we find ourselves operating under with the farm-out agreements.

And if anybody doesn't like the order that they get, there are ways that those orders can be appealed.

But we want this clearly understood that although we're willing to make the effort again to try to resolve this matter without the aid of the Commission, if we can't, we have no choice but to ask for the order and ask for it promptly so we can proceed to meet our obligations under our other agreements.

MR. STAMETS: If there is nothing further, the hearing is adjourned.

(Hearing concluded.)

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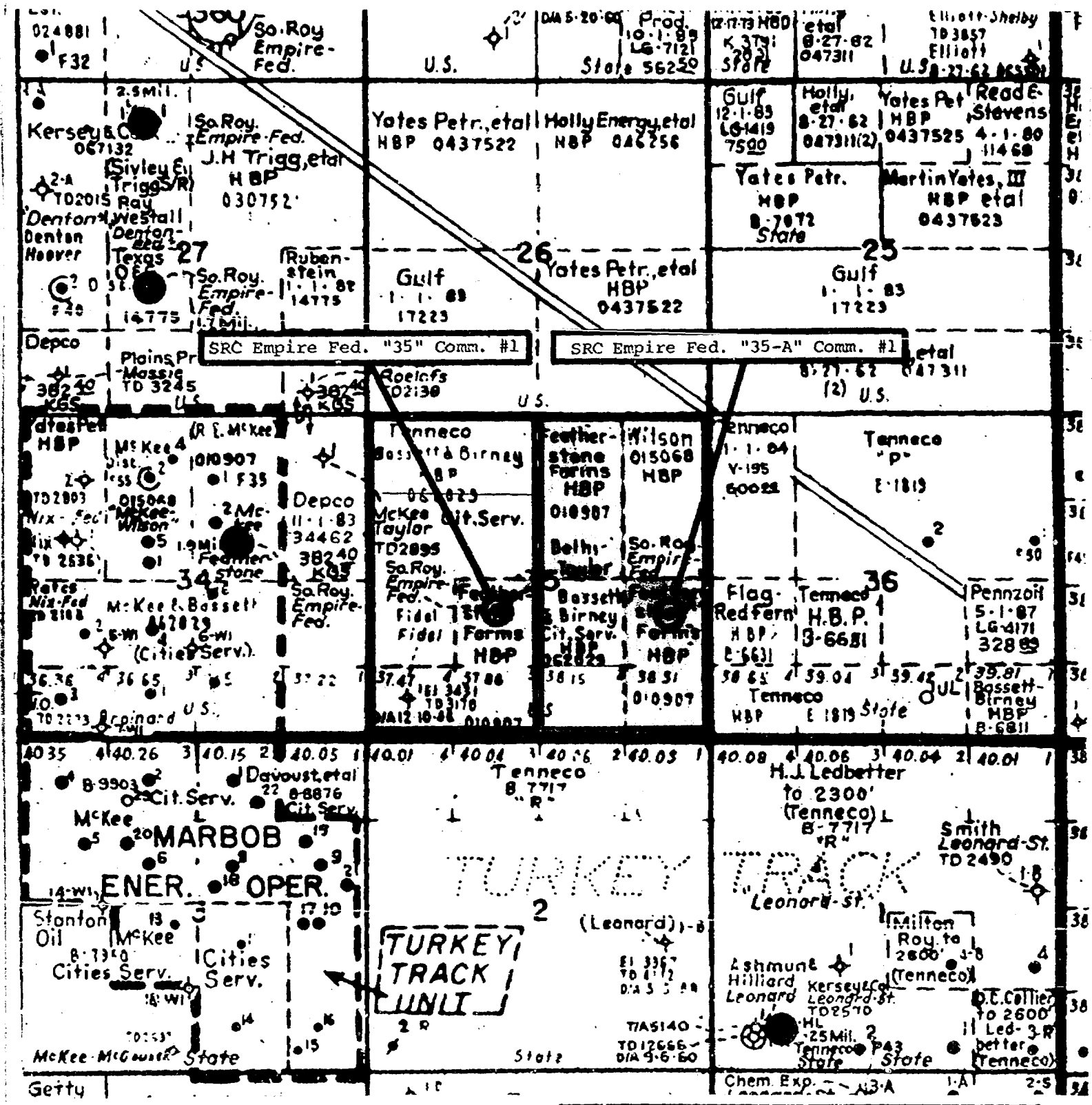
C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY CERTIFY that the foregoing Transcript of Hearing before the Oil Conservation Division was reported by me; that the said transcript is a full, true, and correct record of the hearing, prepared by me to the best of my ability.

Sally W. Boyd C.S.R.

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 7025, heard by me on 9-17, 1980.

Richard L. Stamets, Examiner
Oil Conservation Division



REMARKS

FARMIN SUPPORT, OWNED 100% BY SRC
(Obligation date for well: 11-05-80

FARMIN SUPPORT, OWNED 50% BY SRC
(Obligation date for well: 11-05-80

DEDICATED PRORATION UNIT TO WELL

MORROW OR ATOKA PRODUCER

Southland Royalty Company
SOUTHWESTERN DISTRICT
MIDLAND TEXAS

EMPIRE (SOUTH) PROSPECT
EDDY COUNTY, NEW MEXICO

September 8, 1980

Flag-Redfern Oil Company
1200 Wall Towers West
Midland, Texas 79701

Re: New Mexico Oil Conservation Division
Case 7024

Gentlemen:

Enclosed is a copy of the docket for the September 17, 1980 Oil Conservation Division Examiner Hearing.

You may have an interest that will be affected by the above-referenced case.

Very truly yours,

William F. Carr

WFC:lr

Enclosure

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

BEFORE EXAMINER STAMETS
OIL CONSERVATION DIVISION
SRC EXHIBIT NO. 2
CASE NO. 7024
Submitted by DON DAVIS
Hearing Date 9/17/80

P11

RECEIPT FOR CERTIFIED MAIL
NO INSURANCE COVERAGE PROVIDED—
NOT FOR INTERNATIONAL MAIL
(See Reverse)

SENT TO Flag Redfern Oil Co.
STREET AND NO.
P.O., STATE AND ZIP CODE

POSTAGE $
CERTIFIED FEE
SPECIAL DELIVERY
RESTRICTED DELIVERY
CONSULT POSTMASTER FOR FEES
OPTIONAL SERVICES
RETURN RECEIPT SERVICE
SHOW TO WHOM AND DATE DELIVERED
SHOW TO WHOM, DATE AND ADDRESS OF DELIVERY
RESTRICTED DELIVERY
TOTAL POSTAGE AND FEES $
POSTMARK OR DATE
9/8/80

Southland Royalty - Case 7024

PS Form 3811, Jan. 1979

SENDER: Complete items 1, 2, and 3.
Add your address in the "RETURN TO" space on reverse.

1. The following service is requested (check one.)
- ☒ Show to whom and date delivered.....¢
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- ☐ RESTRICTED DELIVERY
  Show to whom and date delivered.....¢
- ☐ RESTRICTED DELIVERY.
  Show to whom, date, and address of delivery.$____

(CONSULT POSTMASTER FOR FEES)

2. ARTICLE ADDRESSED TO:
Flag-Redfern Oil Company
1200 Wall Towers West
Midland, Texas 79701

3. ARTICLE DESCRIPTION:

REGISTERED NO.	CERTIFIED NO.	INSURED NO.
	7144036	

(Always obtain signature of addressee or agent)

I have received the article described above.
SIGNATURE ☐Addressee ☐Authorized agent

4. DATE OF DELIVERY — POSTMARK

5. ADDRESS (Complete only if requested)

6. UNABLE TO DELIVER BECAUSE: — CLERK'S INITIALS

RETURN RECEIPT, REGISTERED, INSURED AND CERTIFIED MAIL

☆GPO 1979-300-459

September 8, 1980

Tenneco Oil Exploration and
Production Company
6800 Park Ten Boulevard
Suite 200 North
San Antonio, Texas 78213

Re: New Mexico Oil Conservation Division
Case 7024

Gentlemen:

Enclosed is a copy of the docket for the September 17, 1980 Oil Conservation Division Examiner Hearing.

You may have an interest that will be affected by the above-referenced case.

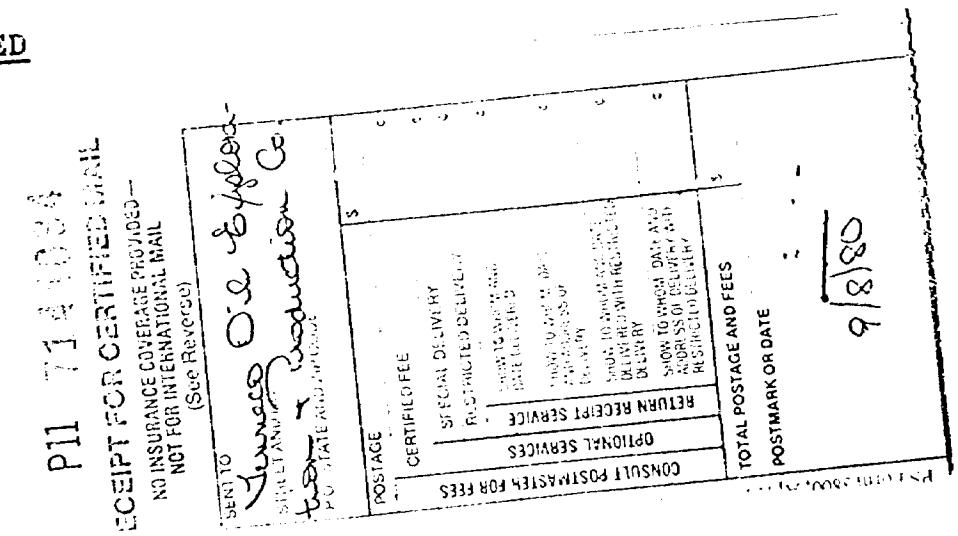
Very truly yours,

William F. Carr

WFC:lr

Enclosure

CERTIFIED MAIL
RETURN RECEIPT REQUESTED



Southland Royalty - Case 7024

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1. The following service is requested (check one.)
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- [ ] RESTRICTED DELIVERY
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- [ ] RESTRICTED DELIVERY.
  Show to whom, date, and address of delivery.$____

(CONSULT POSTMASTER FOR FEES)

2. ARTICLE ADDRESSED TO:
Tenneco Oil Exploration Co.
6800 Park Ten Blvd., St. 200
San Anotnio, TX 78213

3. ARTICLE DESCRIPTION:

REGISTERED NO.	CERTIFIED NO.	INSURED NO.
	7144034	

(Always obtain signature of addressee or agent)

I have received the article described above.
SIGNATURE ☐ Addressee ☐ Authorized agent

4. Estelle Eggman

DATE OF DELIVERY: SEP 12 1980

POSTMARK: SEP 12 1980

5. ADDRESS (Complete only if requested)

6. UNABLE TO DELIVER BECAUSE:

CLERK'S INITIALS

☆GPO : 1979-300 459

RETURN RECEIPT, REGISTERED, INSURED AND CERTIFIED MAIL

September 8, 1980

Bassett-Birney Oil Corporation
202 South 4th Street
Artesia, New Mexico 88210

Re: New Mexico Oil Conservation Division
Case 7024

Gentlemen:

Enclosed is a copy of the docket for the September 17, 1980 Oil Conservation Division Examiner Hearing.

You may have an interest that will be affected by the above-referenced case.

Very truly yours,

William F. Carr

WFC:lr

Enclosure

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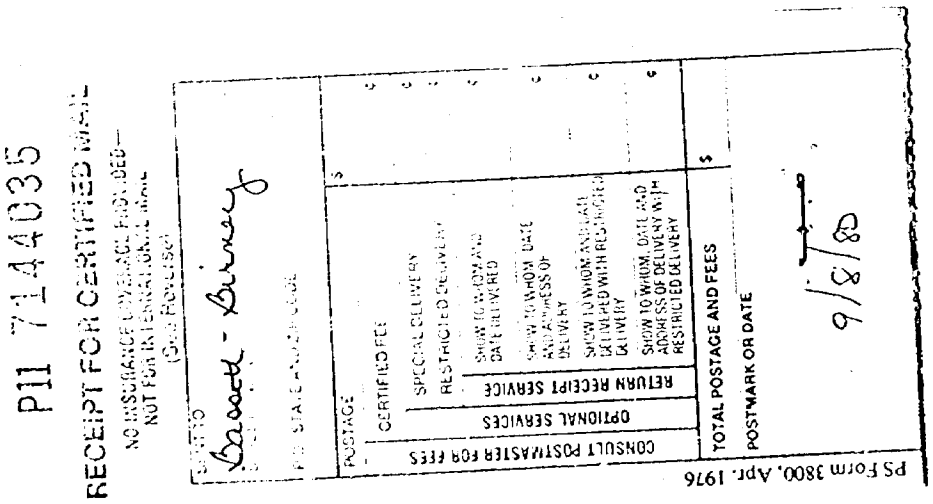
RETURN RECEIPT REQUESTED



Southland Royalty - Case 7024

PS Form 3811, Jan. 1979

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- ☐ RESTRICTED DELIVERY
  Show to whom and date delivered.....¢
- ☐ RESTRICTED DELIVERY.
  Show to whom, date, and address of delivery.$

(CONSULT POSTMASTER FOR FEES)

2. ARTICLE ADDRESSED TO:

Bassett-Birney Oil Corp.
202 South 4th Street
Artesia, NM 88210

3. ARTICLE DESCRIPTION:

REGISTERED NO.	CERTIFIED NO.	INSURED NO.
	7144035	

(Always obtain signature of addressee or agent)

I have received the article described above.

SIGNATURE ☐ Addressee ☒ Authorized agent

4. DATE OF DELIVERY

POSTMARK: ARTESIA, N.M. SEP 19 1980

5. ADDRESS (Complete only if requested)

6. UNABLE TO DELIVER BECAUSE:

CLERK'S INITIALS

☆GPO : 1978-300-459

RETURN RECEIPT, REGISTERED, INSURED AND CERTIFIED MAIL

Southland Royalty Company

February 26, 1980

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: Farmout Request
Portions of Sections 33, 34 & 35
T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

Gentlemen:

Reference is made to your leasehold located in the above subject tracts. Southland Royalty Company is presently attempting to secure support from the leasehold owners under these sections for the drilling of several Morrow wells.

A check of the records indicates that Bassett & Birney Oil Corporation owns a 50% working interest in a lease covering the deep rights in the following tracts of land:

Section	W.I.	Gross Acres	Net Acres
Section 33: N½SE¼, SE¼SW¼	50%	120	60
Section 34: Lots 1, 2, 4 & NW¼SW¼	50%	160	80
Section 35: Lot 2, NW¼ NW¼SW¼, NW¼SE¼	50%	280	140
Totals		560	280

Southland requests your support for the project by granting of a Farmout of your acreage under the following general terms:

1. Bassett-Birney deliver its leasehold interest in the E½ of Section 34 to Southland Royalty Company for the drilling of a Morrow well. Southland Royalty Company will have a period of ninety (90) days in which to commence drilling this well. Upon obtaining production from this well, Southland Royalty Company will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled. The remainder of Bassett-Birney's leasehold in Sections 33, 34 and 35,

1100 WALL TOWERS WEST (915) 682-8641 MIDLAND, TEXAS 79701

BEFORE EXAMINER STAMETS
OIL CONSERVATION DIVISION
SDC EXHIBIT NO. 3
CASE NO. 7025
Submitted by DON DAVIS
Hearing Date 9/17/80

out side the drilled proration unit will fall under a 120-day continuous development program.

2. Under the terms of this Agreement, Bassett & Birney will retain a 1/16th of 8/8ths ORRI convertible to a 50% working interest at payout on the initial well.

Upon receiving approval for this proposal, Southland will be happy to prepare a Farmout Agreement containing the above provisions. If instead, you choose to join in this well, an AFE and Joint Operating Agreement will be forwarded to you at once.

If there are any questions concerning the above, please do not hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am

Southland Royalty Company

March 24, 1980

Tenneco Oil Exploration & Production
6800 Park Ten Blvd. - Suite 200 North
San Antonio, Texas 78213

Attention: Michael M. Hinze

Re: SRC-Empire Federal Comm "35" #1
1980' FNL & 1980' FWL Section 35,
T-18-S, R-29-E,
Eddy County, New Mexico
Empire, South Prospect #1873
F/O 382, F/O 399

Gentlemen:

Reference is made to the proposed well to be drilled in Section 35, Township 18 South, Range 29 East. Southland Royalty Company is at this time preparing to drill a Morrow well in the W½ of Section 35, and by this letter, request your support for the well.

A check of the records indicates that Tenneco Oil Exploration & Production owns a 100% working interest in a lease covering the deep rights in the N½ of the NW¼ of Section 35. Southland requests a farmout of your acreage under the following general terms:

1. Tenneco deliver its leasehold interest in the W½ of Section 35 for the drilling of the SRC-Empire Federal "35" #1 well. Southland will have a ninety (90) day period in which to commence the drilling of this well. Upon obtaining production from this well, Southland will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled.

2. Under the terms of this Agreement, Tenneco will retain a 1/16th of 8/8ths overriding royalty interest convertible to a 50% working interest at payout, proportionately reduced.

Upon receiving approval for this proposal, Southland Royalty Company will be more than happy to prepare a Farmout Agreement containing the above provisions. If instead, Tenneco chooses to join in this well, upon approval,

please execute the three (3) enclosed AFEs, returning two (2) originals to Southland Royalty Company's Midland Office, while retain one (1) original for your files. At such time as we have received the signed AFEs, a Joint Operating Agreement and Communitization Agreement will be forwarded for your approval.

If there are any questions concerning the above, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am
Enclosures

Southland Royalty Company

March 24, 1980

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: SRC-Empire Federal Comm. "35" #1
1,980' FN&WL Section 35,
T-18-S, R-29-E,
Eddy County, New Mexico
Empire, South Prospect #1873
F/O 382, F/O 399

Gentlemen:

Reference is made to the proposed well and to a Farmout request mailed to Bassett & Birney Oil Corporation dated February 26, 1980. In this letter, Southland Royalty Company requested a farmout of your acreage in Sections 33, 34 and 35.

Southland Royalty Company is now prepared to drill a Morrow well in the W½ of Section 35, and by this letter, request your support for the well.

A check of the records indicates that Bassett & Birney Oil Corporation owns a 50% working interest in a lease covering the deep rights in the S½ of the NW¼ and the NW¼ of the SW¼ of Section 35. Southland requests a farmout of your acreage under the following general terms:

1. Bassett & Birney deliver its leasehold interest in the W½ of Section 35 for the drilling of the SRC Empire Federal Comm. "35" #1 well. Southland will have a ninety (90) day period in which to commence the drilling of this well. Upon obtaining production from this well, Southland will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below total depth drilled.

2. Under the terms of this Agreement, Bassett & Birney will retain a 1/16th of 8/8ths overriding royalty interest convertible to a 50% working interest at payout, proportionately reduced.

Upon receiving approval for this proposal, Southland Royalty Company will be happy to prepare a Farmout Agreement containing the above provisions.

If instead, Bassett & Birney Oil Corporation chooses to join in this well, upon approval, please execute the three (3) enclosed AFEs, returning two (2) originals to Southland Royalty Company's Midland office, while retaining one (1) original for your files. At such time as we have received the signed AFEs, a Joint Operating Agreement and Communitization Agreement will be forwarded for your approval.

If there are any questions regarding the above, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 WALL TOWERS WEST MIDLAND, TEXAS 79701

COMPANY NO ___

AFE NUMBER ___

ADD A CHANGE ___ DELETE ___ PROPERTY NUMBER ___

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "35" No. 1

ORIGINAL 0 SUPPLEMENTAL ___ PRODUCER ___ DRY HOLE ___ SRC OPERATOR ___ MANUAL ___

AUTHORITY IS REQUESTED TO:

WILDCAT ___ DEV. X Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980 FNL 1980 FWL Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249		
	01 Conductor or Drive Pipe	$ -	$ -
350	02 Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	03 8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	04 4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	05 4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	06 4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	07 4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	08	-	-
11,450'	09 Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	10 Wellhead & Safety Equipment	26,000	2,000
	11 Packer & Special Equipment	4,500	-
	12 Artificial Lift	-	-
	13 Tank Battery and process equip.	36,000	-
	14 Other Equipment	7,530	3,040
	15 TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16 Bassett & Birney . 19026479	$ 43,534	$ 8,467
	INTANGIBLE - 248		
	17 Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	18 Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	19 Rig Moving Costs	-	-
	20 Completion Rig 10 Days @ $ 1200 /day	12,000	-
	21 Roustabout & Miscellaneous Labor	4,000	2,000
	22 Auto, Trucking, Barge, Tug	4,500	2,000
	23 Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	24 Mud, Oil, Water, Chemicals	45,000	40,000
	25 Drill Stem Tests	5,000	5,000
	26 Electric Logs & Bond Logs	35,000	35,000
	27 Cement, Centralizer, Scratchers, Service	45.000	40,000
	28 Bits, Fuel	20,000	20,000
	29 Rental Equipment & tubular inspection	25,000	12,000
	30 Core & Analyses	-	-
	31 Bottle Tests & Sidewall Cores	-	-
	32 Perforate	10,000	-
	33 Acid & Frack Variable	25,000	-
	34 Geological & Engineering	5,000	2,500
	35 Mud Logger	20,000	20,000
	36 Cost of Control Insurance (SRC Only) .468	5,400	5,400
	37 Miscellaneous & Unforseen	24,800	10,100
	38 District & Overhead Expense	3,000	2,000
	39 TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40 Bassett & Birney . 19026479	$ 102,400	$ 92,849
	41 GRAND TOTAL COSTS	$ 767,010	$ 488,000
	42 Bassett & Birney . 19026479	$ 145,935	$ 85,239

AUTHORIZATION REQUESTED

D M Harbin

AUTHORIZATION APPROVED

COMPANY: _____

BY: _____

DATE: _____

Southland Royalty Company

June 19, 1980

Tenneco Oil Exploration and Production
6800 Park Ten Blvd., Suite 200 North
San Antonio, Texas 78213

Attn: Mr. Steve D. King,
Landman

RE: Proposed SRC Empire Fed. Comm.
"35" #1 Well
W/2 Section 35, T18S, R29E
Eddy County, New Mexico
Empire, South #1873
F/O 382, 399 J/O 500342

Gentlemen:

Reference is made to your response of June 4, 1980, to Southland Royalty Company's proposal for the drilling of the SRC Empire Federal Comm. "35" #1 well. Although Southland Royalty Company would look favorably toward the formation of a one section working interest unit encompassing all of section 35, T18S, R29E, and would agree to offer Tenneco any farmin acreage received in support of the "35" #1 well; Southland Royalty Company, at this time, does not feel that any acreage received in support of our initial test well should be offered to partners in the "35" well.

Southland Royalty Company acquired farmin support in Sections 33, 34 and 35, in October of 1979, some nine months ago, in support of our proposed SRC Empire Federal Comm. #1 test well. This well, which was drilled and completed in the S/2 of Section 27, was not offsetting any Morrow production, and was quite risky. Had SRC not received the farmin support we did, this initial well, which has prompted the current development and activity in this immediate area, would not have been drilled. Also, although SRC is aware of Tenneco's geological expertise in this area, Southland Royalty Company has also been successful in the drilling of numerous Morrow wells in the area.

I look forward to hearing from you concerning the formation of a unit. If there are any questions concerning this matter, please feel free to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd

1100 WALL TOWERS WEST (915) 682-8641 MIDLAND, TEXAS 79701

Southland Royalty Company

July 8, 1980

Bassett-Birney Oil Corporation
207 South Fourth Street
Artesia, New Mexico 88210

Attn: Mr. Jack McCaw

Empire, S.

RE: SRC-Empire Fed. Comm. "35" #1
1980' FSL & 1980' FWL, Sec. 35
T18S, R29E, Eddy Co, New Mexico
F/O 382 and 399 500340 J/O

Gentlemen:

Reference is made to my letters of February 26th, 1980 and March 24, 1980, concerning the above proposed well. In the letter of March 24th, 1980, Southland proposed the drilling of the subject well at a location of 1980' FNL and 1980' FWL of Sec. 35. Southland has now moved the location of this well to 1980' FSL and 1980' FWL, and once again requests your support for the subject well.

Enclosed, please find three original AFE's,along with a Joint Operating Agreement which contains three sets of signature pages for the 35 #1 well. At such time as these instruments meet with your approval, please have the appropriate company officer execute all AFE's and signature pages, returning two executed originals of each to our Midland Office for further handling. If instead, you choose to Farmout your interest under this well, Southland will be happy to prepare a Farmout Agreement which will contain the provisions mentioned in my prior two letters.

If you have any questions concerning this matter, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd
Encl.

1100 WALL TOWERS WEST (915) 682-8641 MIDLAND, TEXAS 79701

Southland Royalty Company
5100 WALL TOWERS WEST MIDLAND TEXAS 79701

AUTHORIZATION FOR EXPENDITURE

COMPANY NO 01

AFE NUMBER 022E

ADD A CHANGE DELETE PROPERTY NUMBER 0-5 0 0 3 1 0-

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "35" No. 1

ORIGINAL 0 SUPPLEMENTAL PRODUCER DRY HOLE SRC OPERATOR U MANUAL

AUTHORITY IS REQUESTED TO:

WILDCAT DEV. ~~X~~ D

Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980 FSL 1980 FWL Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE			ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
		TANGIBLE - 249		
	01 01	Conductor or Drive Pipe	$ -	$ -
350	01 02	Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	03	8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	04	4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	05	4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	06	4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	07	4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	08		-	-
11,450'	02 09	Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	03 10	Wellhead & Safety Equipment	26,000	2,000
	04 11	Packer & Special Equipment	4,500	-
	04 12	Artificial Lift	-	-
	05 13	Tank Battery and process equip.	36,000	-
	10 14	Other Equipment	7,530	3,040
	15	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16	Bassett-Birney .19026479	$ 43,534	$ 8,467
		INTANGIBLE - 248		
	01 17	Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	01 18	Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	01 19	Rig Moving Costs	-	-
	01 20	Completion Rig 10 Days @ $ 1200 /day	12,000	-
	02 21	Roustabout & Miscellaneous Labor	4,000	2,000
	03 22	Auto, Trucking, Barge, Tug	4,500	2,000
	04 23	Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	05 24	Mud, Oil, Water, Chemicals	45,000	40,000
	06 25	Drill Stem Tests	5,000	5,000
	06 26	Electric Logs & Bond Logs	35,000	35,000
	07 27	Cement, Centralizer, Scratchers, Service	45,000	40,000
	08 28	Bits, Fuel	20,000	20,000
	21 29	Rental Equipment & tubular inspection	25,000	12,000
	01 30	Core & Analyses	-	-
	05 31	Bottle Tests & Sidewall Cores	-	-
	01 32	Perforate	10,000	-
	99 33	Acid & Frack Variable	25,000	-
	01 34	Geological & Engineering	5,000	2,500
	09 35	Mud Logger	20,000	20,000
	10 36	Cost of Control Insurance (SRC Only) .468	5,400	5,400
	10 37	Miscellaneous & Unforseen	24,800	10,100
	11&12 38	District & Overhead Expense	3,000	2,000
	39	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40	Bassett-Birney .19026479	$ 102,400	$ 84,382
	41	GRAND TOTAL COSTS	$ 767,010	$ 488,000
	42	Bassett-Birney .19026479	$ 145,934	$ 92,849

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: _____

BY: _____

DATE: _____

SRC - Empire Federal
"35" Comm. #1 500340

Empire, South Prospect
500340 J/O
F/O 382; F/O 399

A.A.P.L. FORM 610 - 1977

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

July 8, 19 80,

OPERATOR SOUTHLAND ROYALTY COMPANY

CONTRACT AREA W/2 Section 35, T18S, R29E

COUNTY ~~OR PARISH~~ OF Eddy STATE OF New Mexico

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xc: Meta Hilbers 7-2-80

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between SOUTHLAND ROYALTY COMPANY, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators",

WITNESSETH:

WHEREAS, the parties to this agreement are owners of oil and gas leases and/or oil and gas interests in the land identified in Exhibit "A", and the parties hereto have reached an agreement to explore and develop these leases and or oil and gas interests for the production of oil and gas to the extent and as hereinafter provided;

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.
DEFINITIONS

As used in this agreement, the following words and terms shall have the meanings here ascribed to them:

A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.

B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.

D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".

E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.

F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.

G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.

H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II.
EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

[X] A. Exhibit "A", shall include the following information:
- (1) Identification of lands subject to agreement,
- (2) Restrictions, if any, as to depths or formations,
- (3) Percentages or fractional interests of parties to this agreement,
- (4) Oil and gas leases and/or oil and gas interests subject to this agreement,
- (5) Addresses of parties for notice purposes.

[X] B. Exhibit "B", Form of Lease.

[X] C. Exhibit "C", Accounting Procedure.

[X] D. Exhibit "D", Insurance.

[X] E. Exhibit "E", Gas Balancing Agreement.

[X] F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.

If any provision of any exhibit, except Exhibit "E", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

ARTICLE III.
INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an unleased oil and gas interest in the Contract Area, that interest shall be treated for the purpose of this agreement and during the term hereof as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B". As to such interest, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the lessee interest.

B. Interest of Parties in Costs and Production:

Exhibit "A" lists all of the parties and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and material acquired in operations on the Contract Area shall be owned by the parties as their interests are shown in Exhibit "A". All production of oil and gas from the Contract Area, subject to the payment of lessor's royalties ~~which will be borne by the Joint Account~~, shall also be owned by the parties in the same manner during the term hereof; provided, however, this shall not be deemed an assignment or cross-assignment of interests covered hereby.

ARTICLE IV.
TITLES

A. Title Examination:

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including Federal Lease Status Reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

~~[ ] Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be a part of the administrative overhead as provided in Exhibit "C," and shall not be a direct charge, whether performed by Operator's staff attorneys or by outside attorneys~~.

[X] Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Exhibit "A".* Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection with leases or oil and gas interests contributed by such party. The Operator shall be responsible for the preparation and recording of Pooling Designations or Declarations as well as the conduct of hearings before Governmental Agencies for the securing of spacing or pooling orders. This shall not prevent any party from appearing on its own behalf at any such hearing.

No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to participate in the drilling of the well.

B. Loss of Title:

1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A", this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests, and

(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development

*except when such costs are incurred in connection with an operation conducted under Article VI B.2 in which event such costs are to be borne by the drilling parties in the proportions elected by such parties.

or operating costs which it may have theretofore paid, but there shall be no monetary liability on its part to the other parties hereto for drilling, development, operating or other similar costs by reason of such title failure; and

(b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract Area by the amount of the interest lost; and

(c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract Area is increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such interests (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well; and

(d) Should any person not a party to this agreement, who is determined to be the owner of any interest in the title which has failed, pay in any manner any part of the cost of operation, development, or equipment, such amount shall be paid to the party or parties who bore the costs which are so refunded; and

(e) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be borne by the party or parties whose title failed in the same proportions in which they shared in such prior production; and

(f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in connection therewith.

2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, is not paid or is erroneously paid, and as a result a lease or interest therein terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new lease covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties shall be revised on an acreage basis, effective as of the date of termination of the lease involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the lease or interest which has terminated. In the event the party who failed to make the required payment shall not have been fully reimbursed, at the time of the loss, from the proceeds of the sale of oil and gas attributable to the lost interest, calculated on an acreage basis, for the development and operating costs theretofore paid on account of such interest, it shall be reimbursed for unrecovered actual costs theretofore paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost interest, on an acreage basis, up to the amount of unrecovered costs;

(b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an acreage basis, of that portion of oil and gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such lease termination, would be attributable to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said portion of the oil and gas to be contributed by the other parties in proportion to their respective interests; and

(c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall not be considered failure of title but shall be joint losses and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of the Contract Area.

ARTICLE V.
OPERATOR

A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:

SOUTHLAND ROYALTY COMPANY shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operator, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the Parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed, shall be determined by Operator, and all such employees shall be the employees of Operator.

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the 8th day of October, 19 80 Operator shall commence the drilling of a well for oil and gas at the following location:

1980' FSL & 1980' FWL, Section 35, T18S, R29E, Eddy County, New Mexico

and shall thereafter continue the drilling of the well with due diligence to

11,600' or a depth sufficient to test the Morrow formation

unless granite or other practically impenetrable substance or condition in the hole which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E.1. hereof.

B. Subsequent Operations:

1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday or legal holidays. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or response given by telephone shall be promptly confirmed in writing.

2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, within sixty (60) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period where the drilling rig is on location, as the case may be) actually commence work on the proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest of the parties approving such operation, and (b) its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A", or (b) carry its proportionate part of Non-Consenting Parties' interest.* The proposing party, at its election, may withdraw such proposal if there is insufficient participation, and shall promptly notify all parties of such decision. *and failure so to advise the proposing party shall constitute an election under (b).

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a producer of oil and or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk, and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or market value thereof if such share is not sold (after deducting production taxes, royalty, overriding royalty and other interests existing on the effective date hereof, payable out of or measured by the production from such well accruing with respect to such interest until it reverts) shall equal the total of the following:

(a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping) plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to each Non-Consenting Party had it participated in the well from the beginning of the operation; and

(b) 300% of that portion of the costs and expenses of drilling, reworking, deepening, or plugging back, testing and completing, after deducting any cash contributions received under Article VIII.C., and

300 % of that portion of the cost of newly acquired equipment in the well (to and including the well-head connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's election, shall be sold to its purchaser, if available, under the terms of its existing gas sales contract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from such sale direct to the Consenting Parties until the amounts provided for in this Article are recovered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not contracted for sale of its gas at the time such gas is available for delivery, or has not made the election as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-Consenting Party's share of gas as hereinabove provided during the recoupment period.

During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production.

In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.

Within sixty (60) days after the completion of any operation under this Article, the party conducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas produced during any month, Consenting Parties shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs of the work done and of the equipment purchased, in determining when the interest of such Non-Consenting Party shall revert to it as above provided; and if there is a credit balance, it shall be paid to such Non-Consenting party.

If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent of all parties, no wells shall be completed in or produced from a source of supply from which a well located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such source of supply.

The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b) to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article VI.A.

C. Right to Take Production in Kind:

Each party shall have the right to take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating oil for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any

party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment direct from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate commerce, of any other party's share of gas production without first giving such other party thirty (30) days prior written notice of such intended sale.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any Gas Balancing Agreement between the parties hereto, whether such Agreement is attached as Exhibit "E", or is a separate Agreement.

D. Access to Contract Area and Information:

Each party shall have access to the Contract Area at all reasonable times, at its sole risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the information.

E. Abandonment of Wells:

1. Abandonment of Dry Holes: Except for any well drilled pursuant to Article VI.B.2., any well which has been drilled under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling of such well. Any party who objects to the plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well which has been drilled or reworked pursuant to Article VI.B.2. hereof for which the Consenting Parties have not been fully reimbursed as therein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of such well, all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one year and so long thereafter as oil and or gas is produced from the interval or inter-

vals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentages of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interest in the remaining portion of the Contract Area.

Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned well.

ARTICLE VII.
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.

B. Liens and Payment Defaults:

Each Non-Operator grants to Operator a lien upon ~~its oil and gas rights in the Contract Area, and~~ a security interest in its share of oil and or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon at the rate provided in the Accounting Procedure attached hereto as Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the State, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's share of oil and or gas until the amount owed by such Non-Operator, plus interest has been paid. Each purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.

If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.

C. Payments and Accounting:

Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in the Accounting Procedure attached hereto as Exhibit "C". Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Limitation of Expenditures:

1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this Agreement, it being understood that the consent to the drilling or deepening shall include:

~~☐ Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and equipping of the well, including necessary tankage and or surface facilities.~~

☒ Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its authorized depth, and all tests have been completed, Operator shall give immediate notice to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion attempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, including necessary tankage and or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less than all parties.

2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agreement, it being understood that the consent to the reworking or plugging back of a well shall include consent to all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage and or surface facilities.

3. Other Operations: Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Twenty-Five Thousand and no/100--- Dollars ($ 25,000.00) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares "Authority for Expenditures" for its own use, Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project costing in excess of Twenty-Five Thousand and no/100-------- Dollars ($ 25,000.00).

E. Royalties, Overriding Royalties and Other Payments:

Each party shall pay or deliver, or cause to be paid or delivered, all royalties to the extent of one-fourth (1/4) due on its share of production and shall hold the other parties free from any liability therefor. If the interest of any party in any oil and gas lease covered by this agreement is subject to any royalty, overriding royalty, production payment, or other charge over and above the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account for or cause to be accounted for, such interest to the owners thereof.

No party shall ever be responsible, on any price basis higher than the price received by such party, to any other party's lessor or royalty owner; and if any such other party's lessor or royalty owner should demand and receive settlements on a higher price basis, the party contributing such lease shall bear the royalty burden insofar as such higher price is concerned.

F. Rentals, Shut-in Well Payments and Minimum Royalties:

Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.2.

Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sunday and holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments

of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

G. Taxes:

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. Operator shall bill other parties for their proportionate share of all tax payments in the manner provided in Exhibit "C".

If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final determination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint account, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as provided in Exhibit "C".

Each party shall pay or cause to be paid all production, severance, gathering and other taxes imposed upon or with respect to the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.

H. Insurance:

At all times while operations are conducted hereunder, Operator shall comply with the Workmen's Compensation Law of the State where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be an amount equivalent to the premium which would have been paid had such insurance been obtained. Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the Workmen's Compensation Law of the State where the operations are being conducted and to maintain such other insurance as Operator may require.

In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's fully owned automotive equipment.

ARTICLE VIII.
ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

A. Surrender of Leases:

The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole or in part unless all parties consent thereto.

However, should any party desire to surrender its interest in any lease or in any portion thereof, and other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not desiring to surrender it. If the interest of the assigning party includes an oil and gas interest, the assigning party shall execute and deliver to the party or parties not desiring to surrender an oil and gas lease covering such oil and gas interest for a term of one year and so long thereafter as oil and/or gas is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B". Upon such assignment, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the acreage assigned and the operation of any well thereon, and the assigning party shall have no further interest in the lease assigned and its equipment and production other than the royalties retained in any lease made under the terms of this Article. The parties assignee shall pay to the party assignor the reasonable salvage value of the latter's interest in any wells and equipment on the assigned acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. If the assignment is in favor of more than one party, the assigned interest shall

be shared by the parties assignee in the proportions that the interest of each bears to the interest of all parties assignee.

Any assignment or surrender made under this provision shall not reduce or change the assignor's or surrendering parties' interest, as it was immediately before the assignment, in the balance of the Contract Area; and the acreage assigned or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this agreement.

B. Renewal or Extension of Leases:

If any party secures a renewal of any oil and gas lease subject to this Agreement, all other parties shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area.

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this agreement.

The provisions in this Article shall apply also and in like manner to extensions of oil and gas leases.

C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash toward the drilling of a well or any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. If all parties hereto are Drilling Parties and accept such tender, such acreage shall become a part of the Contract Area and be governed by the provisions of this agreement. If less than all parties hereto are Drilling Parties and accept such tender, such acreage shall not become a part of the Contract Area. Each party shall promptly notify all other parties of all acreage or money contributions it may obtain in support of any well or any other operation on the Contract Area.

If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Subsequently Created Interest:

Notwithstanding the provisions of Article VIII.E. and VIII.G., if any party hereto shall, subsequent to execution of this agreement, create an overriding royalty, production payment, or net proceeds interest, which such interests are hereinafter referred to as "subsequently created interest", such subsequently created interest shall be specifically made subject to all of the terms and provisions of this agreement, as follows:

1. If non-consent operations are conducted pursuant to any provision of this agreement, and the party conducting such operations becomes entitled to receive the production attributable to the interest out of which the subsequently created interest is derived, such party shall receive same free and clear of such subsequently created interest. The party creating same shall bear and pay all such subsequently created interests and shall indemnify and hold the other parties hereto free and harmless from any and all liability resulting therefrom.

2. If the owner of the interest from which the subsequently created interest is derived (1) fails to pay, when due, its share of expenses chargeable hereunder, or (2) elects to abandon a well under provisions of Article VI.E. hereof, or (3) elects to surrender a lease under provisions of Article VIII.A. hereof, the subsequently created interest shall be chargeable with the pro rata portion of all expenses hereunder in the same manner as if such interest were a working interest. For purposes of collecting such chargeable expenses, the party or parties who receive assignments as a result of (2) or (3) above shall have the right to enforce all provisions of Article VII.B. hereof against such subsequently created interest.

E. Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or

2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the right of the other parties.

If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such party's interests within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds hereof.

F. Waiver of Right to Partition:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

~~**G. Preferential Right to Purchase:**~~

~~Should any party desire to sell all or any part of its interests under this agreement, or its rights and~~ interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent ~~company, or to any company in which any one party owns a majority of the stock~~.

ARTICLE IX.
INTERNAL REVENUE CODE ELECTION

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No

such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from Operations hereunder can be adequately determined without the computation of partnership taxable income.

ARTICLE X.
CLAIMS AND LAWSUITS

Operator may settle any single damage claim or suit arising from operations hereunder if the expenditure does not exceed Five Thousand and no/100---------- Dollars ($ 5,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, the party shall immediately notify Operator, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

ARTICLE XI.
FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure. The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

ARTICLE XII.
NOTICES

All notices authorized or required between the parties, and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by United States mail or Western Union telegram, postage or charges prepaid, or by teletype, and addressed to the party to whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed, and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid, or when sent by teletype. Each party shall have the right to change its address at any time, and from time to time, by giving written notice hereof to all other parties.

ARTICLE XIII.
TERM OF AGREEMENT

This agreement shall remain in full force and effect as to the oil and gas leases and or oil and gas interests subjected hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any lease, or oil and gas interest contributed by any other party beyond the term of this agreement.

~~[ ] Option No. 1: So long as any of the oil and gas leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise, and/or so long as oil and/or gas production continues from any lease or oil and gas interest.~~

[X] Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of 90 days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling or reworking a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and or gas from the Contract Area, this agreement shall terminate unless drilling or reworking operations are commenced within 60 days from the date of abandonment of said well.

It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

ARTICLE XIV.
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the conservation laws of the state in which the committed acreage is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and orders.

B. Governing Law:

The essential validity of this agreement and all matters pertaining thereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state where most of the land in the Contract Area is located shall govern.

ARTICLE XV.
OTHER PROVISIONS

SALE OF ROYALTY GAS

It is recognized by the parties hereto that in addition to each party's share of working interest production, such party shall have the right, subject to existing contracts, to market the royalty gas attributable to each lease which it contributes to the unit area and to receive payments due for such royalty gas produced from or allocated to such lease or leases. It is agreed that, regardless of whether each party markets or contracts for its share of gas, including the royalty gas under the leases which it contributed to the Unit, such party agrees to pay or cause to be paid to the royalty owners under its lease or leases the proceeds attributable to their respective royalty interest and to hold all other parties hereto harmless for its failure to do so.

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of _____ day of _____, 19____.

OPERATOR

SOUTHLAND ROYALTY COMPANY

_____ By: C. E. Mear

DD Rwp Kellt

NON-OPERATORS

TENNECO OIL EXPLORATION & PRODUCTION

_____ By: _____

BASSETT-BIRNEY OIL CORPORATION

_____ By: _____

FEATHERSTONE FARMS, LTD.

_____ BY: _____

ROBERT E. McKEE COMPANY

_____ BY: _____

CORPORATION ACKNOWLEDGMENT

THE STATE OF Texas

COUNTY OF Midland

BEFORE ME, the undersigned authority, on this day personally appeared C. E. Mear, known to me to be the person whose name is subscribed to the foregoing instrument, as Attorney-in-Fact of Southland Royalty Company, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the 18th day of July A.D. 1980.

My Commission Expires:
Oct. 31, 1980

Notary Public in and for Midland County, Texas

CORPORATION ACKNOWLEDGMENT

THE STATE OF

COUNTY OF

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing instrument, as _____ of _____, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the _____ day of _____ A.D. 19____.

My Commission Expires:

Notary Public in and for _____ County,

CORPORATION ACKNOWLEDGMENT

THE STATE OF

COUNTY OF

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing instrument, as _____ of _____, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the _____ day of _____ A.D. 19____.

My Commission Expires:

Notary Public in and for _____ County,

W/2 Section 35, T18S, R29E
Eddy County, New Mexico

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of _____ day of _____, 19____.

OPERATOR

SOUTHLAND ROYALTY COMPANY

By: C. E. Mear

DD Rwp Kill

NON-OPERATORS

TENNECO OIL COMPANY

ATTEST:

D. L. Motloch, Asst. Secretary

By: D.S. Taylor

D.S.TAYLOR, Vice-President
BASSETT-BIRNEY OIL CORPORATION

SDK
mmm
4HM

By: _____

FEATHERSTONE FARMS, LTD.

BY: _____

ROBERT E. McKEE COMPANY

BY: _____

CORPORATION ACKNOWLEDGMENT

THE STATE OF Texas

COUNTY OF Midland

BEFORE ME, the undersigned authority, on this day personally appeared C. E. Mear, known to me to be the person whose name is subscribed to the foregoing instrument, as Attorney-in-Fact of Southland Royalty Company, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the 18th day of July A.D. 1980.

My Commission Expires:
Oct. 31, 1980

Linda Harrell
Notary Public in and for Midland County, Texas

CORPORATION ACKNOWLEDGMENT

THE STATE OF Texas

COUNTY OF Bexar

BEFORE ME, the undersigned authority, on this day personally appeared C. S. Taylor, known to me to be the person whose name is subscribed to the foregoing instrument, as Vice President of Tennessee Oil Company, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the 15 day of August A.D. 19 80.

My Commission Expires:
CAROLYN WRIGHT
Notary Public, Bexar County, Texas
My Commission Expires 9-15-80

Carolyn Wright
Notary Public in and for Bexar County,

CORPORATION ACKNOWLEDGMENT

THE STATE OF

COUNTY OF

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing instrument, as _____ of _____, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the _____ day of _____ A.D. 19____.

My Commission Expires:

_____
Notary Public in and for _____ County,

EXHIBIT "A"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration and Production and Bassett-Birney Oil Corporation, Non-Operators.

LANDS SUBJECT TO AGREEMENT:

W/2 of Section 35, T18S, R29E, Eddy County, New Mexico, below the base of the San Andres formation.;

NE/4SW/4, of Section 35, T18S, R29E, Eddy County, New Mexico, insofar as it covers the depths from the surface of the earth to the base of the San Andres formation.

ADDRESSES AND INTERESTS OF PARTIES:

	WI (BPO)	WI (APO)
Southland Royalty Company 1100 Wall Towers West Midland, Texas 79701	.55604883	.27802442
Tenneco Oil Exploration & Production 6800 Park Ten Blvd., Suite 200 North San Antonio, Texas 78213	.25368638	.25368638
Bassett-Birney Oil Corporation 202 South Fourth Street Artesia, New Mexico 88210	.19026479	.19026479
Robert E. McKee Co. P. O. Box 20562 El Paso, Texas 79998	-0-	.09513239
Featherstone Farms, Ltd. 1717 W. Second Street Roswell, New Mexico 88201	-0-	.18289202
	1.000000	1.00000000

EXHIBIT "B"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

OIL AND GAS LEASE

THIS AGREEMENT made this_____day of_____19___, between_____

_____

as Lessor, and_____ as Lessee, WITNESSETH:

1. Lessor in consideration of Ten and No/100 Dollars ($10.00) in hand paid of the royalties herein provided, and of the agreements of Lessor herein contained, hereby grants, leases and lets exclusively unto Lessee for the purpose of investigating, exploring, producing, drilling and mining for and producing oil and gas, laying pipe lines, building roads, tanks, power stations, telephone lines and other structures thereon to produce, care, take care of, treat, transport, and own said products, the following

described land in_____County, Texas, to-wit:

and containing_____acres, more or less. In the event a resurvey of said lands shall reveal the existance of excess and/or vacant lands lying adjacent to the lands above described and the Lessor, his heirs, or assigns, shall by virtue of its ownership of the lands above described, have preference right to acquire said excess and/or vacant lands, then in that event this lease shall cover and include all such excess and/or vacant lands which the Lessor, its successors or assigns, shall have the preference right to acquire by virtue of its ownership of the lands above described as and when acquired by the Lessor; and the Lessee shall pay the Lessor for such excess and/or vacant lands at the same rate per acre as the cash consideration paid for the acreage hereinabove mentioned.

2. Subject to the other provisions herein contained, this lease shall be for a term of_____ _____from this date (called "primary term") and as long thereafter as oil or gas is produced from said land hereunde..

3. The royalties to be paid Lessor are: (a) on oil one-fourth (1/4) of that produced and saved from said land, the same to be delivered at the wells or to the credit of Lessor into the pipe line to which the wells may be connected; Lessee may from time to time purchase any royalty oil in its possession, paying the market price therefor prevailing for the field where produced on the date of purchase; and (b) on gas, including cashinghead gas or other gaseous substance, produced from said land and sold or used off the premises or in the manufacture of gasoline or other products therefrom, the market value at the well of one-fourth (1/4) of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-fourth (1/4) of the amount realized from such sale; where gas from a well producing gas only is not sold or used, Lessee may pay as annual royalty, commencing ninety (90) days after such well is first shut in, the sum of_____ per well per year, and upon such payment it will be considered that gas is being produced within the meaning of Paragraph 2 hereof; provided, however, that such shut in payments shall not continue this lease in force for any consecutive period of more than_____ years. Lessee shall have free use of oil, gas and water from said land, except water from Lessor's wells, for all operations hereunder, and the royalty on oil, gas or water shall be computed after deducting any so used.

4. If prior to discovery of oil or gas on said land, Lessee should drill a dry hole or holes thereon, or if after discovery of oil or gas, the production thereof should cease from any cause, this lease shall not terminate if Lessee commences additional drilling or re-working operations within sixty (60) days thereafter. If at the expiration of the primary term, oil or gas is not being produced on said land, but Lessee is then engaged in drilling or re-working operations thereon, the lease shall remain in force so long as operations on said well or for drilling or re-working of any additional well are prosecuted with no cessation of more than sixty (60) consecutive days and if they result in the production of oil or gas so long thereafter as oil or gas is produced from said land. In the event a well or wells producing oil or gas in paying quantities should be brought in on adajacent land and draining the leased premises, Lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.

5. Lessee shall have the right at any time until six months after the expiration of this lease to remove all property and fixtures placed by Lessee on said land, including the right to draw and remove all casing. When required by Lessor, Lessee will bury all pipe lines below ordinary plow depth, and no well shall be drilled within two hundred (200) feet of any residence or barn now on said land without Lessor's consent.

6. The rights of either party hereunder may be assigned in whole or in part and the provisions hereof shall extend to the heirs, successors and assigns, but no change or division in ownership of the land, or royalties, however accomplished, shall operate to enlarge the obligations or diminish the rights of Lessor. No sale or enlargement by either party shall be binding on the other party hereto until such party shall have been furnished with a certified copy of recorded instrument evidencing same. If six or more parties become entitled to royalty hereunder, Lessee may withold payment thereof unless and until furnished with a recordable instrument executed by all such parties designating an agent to receive payment for all.

7. Lessor herein makes no warranty of title, either express or implied. Lessor hereby agrees that Lessee at its option may discharge any tax, mortgage or other lien upon said land and in the event Lessee does so, it shall be subrogated to such lien with the right to enforce same and apply royalties accruing hereunder toward satisfying same. It is agreed that if Lessor owns an interest in said land less than the entire fee simple, then the royalties to be paid Lessor shall be reduced proportionately.

8. If any operations permitted or required hereunder or the performance by Lessee of any covenant, agreement or requirement hereof is delayed or interrupted directly or indirectly by any past or future acts, orders, regulations, or requirements of the Government of the United States or of any state or other governmental body, or any agent, officer, representative or authority of any of them, the period of such Delay or interruption shall not be counted against the Lessee, and the primary term of this lease shall automatically be extended after the expiration of the primary term set forth in Section 2 above so long as the cause or causes for such delay or interruption continue and for a period of six (6) months thereafter; and such extended term shall constitute and shall be considered for the purposes of this lease as a part of the primary term hereof. The Lessee shall not be liable to Lessor in damages for failure to perform any operation permitted or required hereunder or to comply with any covenant, agreement or requirement hereof during the time Lessee is relieved from the obligations to comply with such covenants, agreements, or requirements.

IN WITNESS WHEREOF, this instrument is executed on the date first above written.

_____

601. BOX 800 TULSA OK 74101

COPAS — 1974
Recommended by the Council of Petroleum Accountants Societies of North America

COPAS

EXHIBIT "C"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

ACCOUNTING PROCEDURE
JOINT OPERATIONS

I. GENERAL PROVISIONS

1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

2. Statement and Billings

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

3. Advances and Payments by Non-Operators

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

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

4. Adjustments

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

5. Audits

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

6. Approval by Non-Operators

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

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. Rentals and Royalties

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

2. Labor

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

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

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

B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II. Such costs under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 2A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.

C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II.

D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II.

3. Employee Benefits

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

4. Material

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

5. Transportation

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

A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by the Parties.

B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.

C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking cost of $200 or less excluding accessorial charges.

6. Services

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

7. Equipment and Facilities Furnished by Operator

A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on investment not to exceed eight per cent (8%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.

B.. In lieu of charges in Paragraph 7A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

8. Damages and Losses to Joint Property

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

9. Legal Expense

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

10. Taxes

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

11. Insurance

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

12. Other Expenditures

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

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

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

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

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

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

A. Overhead - Fixed Rate Basis

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

Drilling Well Rate $ 3,000.00
Producing Well Rate $ 300.00

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

(a) Drilling Well Rate

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

[2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days

[3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

[1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.

[2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.

[3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.

[4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.

[5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

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

~~B. Overhead - Percentage Basis~~

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

(a) Development

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

(b) Operating

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

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

2. Overhead - Major Construction

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess of $ 25,000.00 :

A. 5.0 % of total costs if such costs are more than $ 25,000.00 but less than $ 100,000.00 ; plus
B. 2.0 % of total costs in excess of $ 100,000.00 but less than $1,000,000; plus
C. 2.0 % of total costs in excess of $1,000,000.

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

3. Amendment of Rates

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

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

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

1. Purchases

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

2. Transfers and Dispositions

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

A. New Material (Condition A)

(1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.

(2) Line Pipe

(a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.

(b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.

(3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

B. Good Used Material (Condition B)

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

(1) Material moved to the Joint Property

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

(2) Material moved from the Joint Property

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

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

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

C. Other Used Material (Condition C and D)

(1) Condition C

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

(2) Condition D

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

D. Obsolete Material

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

E. Pricing Conditions

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

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

3. Premium Prices

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

4. Warranty of Material Furnished by Operator

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

V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

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

3. Special Inventories

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

4. Expense of Conducting Periodic Inventories

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

EXHIBIT "D"

INSURANCE

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

(a) Operator shall at all times during the terms of this Agreement carry insurance to protect the parties hereto as follows:

(1) Workmen's compensation and occupational disease insurance as required by the laws of the state or states in which operations will be conducted and employer's liability insurance with a limit of not less than $100,000.

(2) Comprehensive general public liability insurance, excluding products liability insurance, with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident and $100,000 aggregate limit applicable to all loss of or damage to property during the policy period.

(3) Automotive public liability insurance covering all automotive equipment used in performance of work under this Agreement with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident.

(b) Operator shall require all contractors performing work under this Agreement to carry the following insurance:

(1) Workmen's compensation and occupational disease insurance as required by the laws of the state or states in which operations will be conducted and employers' liability insurance with a limit of not less than $100,000.

(2) Comprehensive general liability insurance with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident and $100,000 aggregate limit applicable to all loss of or damage to property during the policy period.

(3) Automotive public liability insurance covering all automotive equipment used in performance of work under this Agreement with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident.

EXHIBIT "E"

GAS BALANCING AGREEMENT

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

The parties to the Operating Agreement to which this agreement is attached, own working interest in the gas rights underlying the Unit Area covered by such Operating Agreement in accordance with the percentages of participation as set forth in Exhibit "A" to said Agreement.

In accordance with the terms of the Operating Agreement, each party thereto has the right to take in kind its share of gas produced from the Unit Area and market or otherwise dispose of same. In the event any party hereto is not at any time taking or marketing its share of gas, or has contracted to sell its share of gas produced from the Unit Area to a purchaser which does not at any time take the full share of gas attributable to the interest of such party, the terms of this agreement shall automatically become operative.

During the period when any party hereto is not marketing or otherwise disposing of its share of gas produced from any proration unit within the Unit Area, the other parties hereto shall be entitled to produce, in addition to their own share of production, that portion of such other party's share of production which said party is unable to market or otherwise dispose of and shall be entitled to take such gas production and deliver same to its or their purchaser(s). All parties hereto shall share in and own the liquid hydrocarbons recovered from such gas by lease equipment in accordance with their respective interests, and subject to the aforesaid Operating Agreement, but the party or parties taking such gas shall own all of such gas delivered to its or their purchaser(s).

An account shall be established for each party not marketing or otherwise disposing of its share of the gas produced, which account shall be credited with an amount of gas equal to such party's full share of the gas produced, less its share of gas used in lease operations, vented or lost, and less that portion marketed or otherwise disposed of by such party. The Operator will maintain a current over and under account of the gas balance between the parties and will furnish all parties hereto monthly statements showing the total quantity of gas produced, the amount used in lease operations, vented or lost, the total quantity of liquid hydrocarbons recovered therefrom, and the monthly and cumulative over and under account of each party.

Each party hereto will make settlement with the royalty owners to whom it is accountable, just as if such party were marketing or otherwise disposing of its share, and its share only, of such gas production. Each party hereto agrees to hold each other harmless from any and all claims for royalty payments asserted by royalty owners to whom each party is accountable. The term "royalty owner" shall include owners of royalty, overriding royalties, production payments and similar interests.

After notice to the Operator, any party at any time may begin marketing or otherwise disposing of its share of the gas produced from a proration unit with respect to which it has an under account balance. In addition to such share, said party, until it has balanced the gas account as to its interest, shall be entitled to take a share of gas determined by multiplying thirty-three and one-third percent (33 1/3%) of the interest in the current gas production of the party or parties having an over account balance by a fraction, the numerator of which is the interest in the proration unit of such party with the under account balance and the denominator of which is the total percentage interest in such proration unit of all parties having an under account balance and who are currently marketing or otherwise disposing of a portion of their under account balance in addition to their share of gas.

Each party marketing or otherwise disposing of gas shall pay the production taxes due on such gas.

Nothing herein shall be construed to deny any party the right, from time to time, to produce and deliver to its purchaser its full share of the allowable gas production to meet the deliverability tests required by its purchaser.

Should production of gas from a proration unit be permanently discontinued before the gas account is balanced, settelement will be made between those parties credited with under account and over account balances. In making such settlement, the party or parties credited with an under account balance will be paid by the party or parties credited with an over account balance a sum of money equal to that received attributable to such over account, less applicable taxes theretofore paid. For gas sold or delivered into intrastate commerce said sum shall be computed at the price received for sale of the gas. For gas sold or delivered into interstate commerce said sum shall be computed at the rate collected, not subject to possible refund, as provided by the Federal Energy Regulatory Commission, plus any additional collected amount which is ultimately not required to be refunded, such additional collected amount to be accounted for at such time as final determination is made with respect thereto.

Nothing herein shall change or affect each party's obligation to pay its proportionate share of all costs and liabilities incurred, as provided in the aforesaid Operating Agreement.

This agreement shall constitute a separate agreement as to each proration unit within the Unit Area. It shall inure to the benefit of and be binding upon the parties hereto, their successors, legal representatives and assigns. It shall become effective in accordance with its terms and shall remain in force and effect as long as the Operating Agreement to which it is attached remains in effect.

EXHIBIT "F"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

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 origin 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 relevent 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 non-discrimination 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 orders 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 (EE01) 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.

Southland Royalty Company

July 15, 1980

Tenneco Oil Exploration
and Production
6800 Park Ten Boulevard
Suite 200 North
San Antonio, Texas 78213

Attention: Mr. Steve King

RE: SRC Empire Federal Comm "35" #1
1980' FSL & 1980' FWL - Sec. 35,
T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873
F/O 382 and F/O 399 J/O 500340

Dear Steve:

Reference is made to our telephone conversation of even date concerning our original proposal to drill a Morrow test in the W/2 of Section 35, and our most recent attempts to form a one section working interest unit encompassing all of section 35. Due to the conflict concerning R. E. McKee's interest in section 35, Bassett-Birney Corporation has refused to join in a working interest unit.

Therefore, Southland Royalty Company,once again proposes its original well to be drilled in the W/2 of Section 35. Although this well is to be drilled in a W/2 proration unit as was our first proposal, there has been a footage location change. The subject well has been moved to 1980' FSL and 1980' FWL of Section 35.

Enclosed, please find three original AFE's, along with a Joint Operating Agreement which contains three sets of signature pages for the subject well. At such time as this well is approved by Tenneco, please have the appropriate company officer execute all AFE's and signature pages, returning two executed originals of each to our Midland Office for further handling.

As we discussed in our telephone conversation, Southland Royalty Company is also preparing to propose a Morrow test to be drilled in the E/2 of Section 35. The location of 660' FSL and 1980' FEL of Section 35 was wrong, and our proposed location for this well will be 1980' FSL and 660' FEL of Section 35, T18S, R29E. As we hope to spud these wells in the very near future, I anxiously await your reply.

If you have any questions, or if I can be of any assistance concerning this matter, please do not hesitate to give me a call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 WALL TOWERS WEST MIDLAND, TEXAS 79701

COMPANY NO ___

AFE NUMBER ___

PROPERTY NUMBER ___

ADD A CHANGE ___ DELETE ___

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "35" No. 1

ORIGINAL 0 SUPPLEMENTAL ___ PRODUCER ___ DRY HOLE ___ SRC OPERATOR ___ MANUAL ___

AUTHORITY IS REQUESTED TO: Drill and complete to TD of 11,450' as gas well in

WILDCAT ___ DEV. X

Morrow formation complete w/tank battery.

LOCATION: 1980 FNL 1980 FWL Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249	$ -	$ -
350	Conductor or Drive Pipe	5,860	5,860
3200'	Casing 11/3/4" 42# H-40 ST&C @ $16.75	33,600	33,600
1870'	8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	14,620	-
5470'	4 1/2" 13.5 #N-80 LT&C @ $7.82	36,760	-
3020'	4 1/2" 11.6# N-80 LT&C @ $6.72	15,250	-
1090'	4 1/2" 11.6# K-55 ST&C @ $5.05	7,810	-
11,450'	4 1/2" 11.6# N-80 Butt. @ $7.17	-	-
11,450'		40,880	-
	Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	26,000	2,000
	Wellhead & Safety Equipment	4,500	-
	Packer & Special Equipment	-	-
	Artificial Lift	36,000	-
	Tank Battery and process equip.	7,530	3,040
	Other Equipment		
	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
		$ 58,046	$ 11,289
	Tenneco .25368638		
		$ 170,000	$170,000
	INTANGIBLE - 248		
10,000	Drilling ft. @ $ 17.00 /ft.	67,500	67,500
15	Rig, Day Work Days @ $ 4500 /day	-	-
	Rig Moving Costs	12,000	-
10	Completion Rig Days @ $ 1200 /day	4,000	2,000
	Roustabout & Miscellaneous Labor	4,500	2,000
	Auto, Trucking, Barge, Tug	12,000	10,000
	Roads, Canals, Location, Damages, Cleanup	45,000	40,000
	Mud, Oil, Water, Chemicals	5,000	5,000
	Drill Stem Tests	35,000	35,000
	Electric Logs & Bond Logs	45,000	40,000
	Cement, Centralizer, Scratchers, Service	20,000	20,000
	Bits, Fuel	25,000	12,000
	Rental Equipment & tubular inspection	-	-
	Core & Analyses	-	-
	Bottle Tests & Sidewall Cores	10,000	-
	Perforate	25,000	-
Variable	Acid & Frack	5,000	2,500
	Geological & Engineering	20,000	20,000
	Mud Logger	5,400	5,400
.468	Cost of Control Insurance (SRC Only)	24,800	10,100
	Miscellaneous & Unforseen	3,000	2,000
	District & Overhead Expense		
	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
		$ 136,534	$112,510
	Tenneco .25368638		
	GRAND TOTAL COSTS	$ 767,010	$ 488,000
		$ 194,579	$123,799
	Tenneco .25368638		

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: ___

BY: ___

DATE: ___

Form 9-1123
(Rev. Dec. 1957)

(Submit in triplicate to appropriate
Regional Oil and Gas or Mining Supervisor)

File-500340

DESIGNATION OF OPERATOR

The undersigned is, on the records of the Bureau of Land Management, holder of lease

DISTRICT LAND OFFICE: Artesia , New Mexico
SERIAL NO.: NM-010907- A

and hereby designates

NAME: Southland Royalty Company
ADDRESS: 1100 Wall Towers West, Midland, TX 79701

as his operator and local agent, with full authority to act in his behalf in complying with the terms of the lease and regulations applicable thereto and on whom the supervisor or his representative may serve written or oral instructions in securing compliance with the Operating Regulations with respect to (describe acreage to which this designation is applicable):

Lot 3, Lot 4, and NE/4 SW/4 Section 35, T18S, R29E
Eddy County, New Mexico

It is understood that this designation of operator does not relieve the lessee of responsibility for compliance with the terms of the lease and the Operating Regulations. It is also understood that this designation of operator does not constitute an assignment of any interest in the lease.

In case of default on the part of the designated operator, the lessee will make full and prompt compliance with all regulations, lease terms, or orders of the Secretary of the Interior or his representative.

The lessee agrees promptly to notify the supervisor of any change in the designated operator.

FEATHERSTONE FARMS, LTD.

BY: .....
(Signature of lessee)
Olen F. Featherstone II
Managing Partner
1717 West Second, Roswell, NM 88201
(Address)

7/23/80
(Date)

U.S. GOVERNMENT PRINTING OFFICE: 1964—O-726-354
910-536

Copy sent to Meta

Southland Royalty Company

July 25, 1980

Bassett-Birney Oil Corp.
207 South Fourth Street
Artesia, New Mexico 88210

Attention: Mr. Jack McCaw

Re: SRC Empire Fed. "35" Comm. #1 &
SRC Empire Fed. "35-A" Comm. #1
Sec. 35, T18S, R29E
Eddy County, New Mexico
SRC 500340 J/O; 500422 J/O
F/O 382; F/O 399

Dear Mr. McCaw:

Reference is made to my earlier letters concerning the proposed SRC Empire Fed. "35" Comm. No. 1, and to our most recent telephone conversation concerning my attempts to form a one section working interest unit encompassing all of Section 35, T18S, R29E. In that telephone conversation, you indicated that at this time, Bassett-Birney would not join in any well drilled on this acreage.

Due to the tight rig situation, and obligation dates SRC has under our support agreements in Section 35, SRC must attempt to acquire support for two Morrow tests under Section 35 on a well-to-well basis. Enclosed are three original AFE's along with a Joint Operating Agreement which contains three extra sets of signature pages for the newly proposed SRC Empire Fed. "35-A" Comm. No. 1. This well is proposed to be drilled 1980' FSL & 660' FEL of Section 35, in a E/2 proration unit. If you choose to join in this well, please execute all AFE's and signature pages to the Joint Operating Agreement, returning two originals of each to our Midland Office. If, instead, you decide to farmout under this well, SRC will be happy to prepare a farmout agreement which will provide you with a 1/16th of 8/3ths overriding royalty interest with the option to convert this override to a 50% working interest at payout (proportionately reduced).

If you have any questions concerning this matter, please don't hesitate calling.

Yours very truly,

Don Davis

Don W. Davis
Landman

DWD:lh

1100 WALL TOWERS WEST (915) 682-8641 MIDLAND, TEXAS 79701

			3,000	2,000
39		TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
40	Bassett-Birney	.063199	$ 34,014	$ 28,029
41		GRAND TOTAL COSTS	$ 767,010	$ 489,000
42	Bassett-Birney	.063199	$ 48,474	$ 30,841

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: _____

BY: _____

DATE: _____

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 Wall Towers West Midland Texas 79701

COMPANY NO C'

AFE NUMBER 022E

ADD A CHANGE DELETE PROPERTY NUMBER 0-5 0 0 3 1 0-

AFE DATE 3 / 17 / 80 NAME SRC Empire Fed. "35-A" Comm. No. 1

ORIGINAL 0 SUPPLEMENTAL PRODUCER DRY HOLE SRC OPERATOR MANUAL

AUTHORITY IS REQUESTED TO:

WILDCAT DEV. (1) Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980' FSL & 660' FEL, Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249	$ -	$ -
350	01 Conductor or Drive Pipe	5,860	5,860
3200'	02 Casing 11/3/4" 42# H-40 ST&C @ $16.75	33,600	33,600
1870'	03 8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	14,620	-
5470'	04 4 1/2" 13.5 #N-80 LT&C @ $7.82	36,760	-
3020'	05 4 1/2" 11.6# N-80 LT&C @ $6.72	15,250	-
1090'	06 4 1/2" 11.6# K-55 ST&C @ $5.05	7,810	-
11,450'	07 4 1/2" 11.6# N-80 Butt. @ $7.17	-	-
11,450'	08	40,880	-
	09 Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	26,000	2,000
	10 Wellhead & Safety Equipment	4,500	-
	11 Packer & Special Equipment	-	-
	12 Artificial Lift	36,000	-
	13 Tank Battery and process equip.	7,530	3,040
	14 Other Equipment	$ 228,810	$ 44,500
	15 TOTAL TANGIBLE 100%	$ 14,461	$ 2,812
	16 Bassett-Birney .063199		
	INTANGIBLE - 248		
	17 Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	18 Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	19 Rig Moving Costs	-	-
	20 Completion Rig 10 Days @ $ 1200 /day	12,000	-
	21 Roustabout & Miscellaneous Labor	4,000	2,000
	22 Auto, Trucking, Barge, Tug	4,500	2,000
	23 Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	24 Mud, Oil, Water, Chemicals	45,000	40,000
	25 Drill Stem Tests	5,000	5,000
	26 Electric Logs & Bond Logs	35,000	35,000
	27 Cement, Centralizer, Scratchers, Service	45,000	40,000
	28 Bits, Fuel	20,000	20,000
	29 Rental Equipment & tubular inspection	25,000	12,000
	30 Core & Analyses	-	-
	31 Bottle Tests & Sidewall Cores	-	-
	32 Perforate	10,000	-
	33 Acid & Frack Variable	25,000	-
	34 Geological & Engineering	5,000	-
	35 Mud Logger	20,000	2,500
	36 Cost of Control Insurance (SRC Only) .468	5,400	20,000
	37 Miscellaneous & Unforseen	24,800	5,400
	38 District & Overhead Expense	3,000	10,100
	39		2,000
	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	46 Bassett-Birney .063199	$ 34,014	$ 28,029
	47 GRAND TOTAL COSTS	$ 767,010	$ 488,000
	47 Bassett-Birney .063199	$ 48,474	$ 30,841

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: _____

BY: _____

DATE: _____

Southland Royalty Company

July 29, 1980

Flag-Redfern Oil Company
1200 Wall Towers West
Midland, Texas 79701

Attention: Mr. John Smart

RE: SRC-Empire Federal "35-A" Comm #1
1980' FSL & 660' FEL Section 35
T18S, R29E, Eddy County, New Mexico
Empire South Prospect #1873
J/O 500422

Dear John:

Reference is made to our recent conversations concerning SRC's original proposal to drill a Morrow test in the W/2 of Section 35, and our most recent attempts to form a one section working interest unit encompassing all of section 35. As I related to you earlier, due to the conflict concerning R. E. McKee's interest in Section 35, Bassett-Birney Corporation has refused to join in a working interest unit.

Therefore, Southland Royalty Company, once again, is proceeding with its plans to drill two wells in Section 35 on a well by well basis. Enclosed, are three original AFE's along with a Joint Operating Agreement which contains three extra signature pages, for the newly proposed SRC-Empire Federal "35-A" Comm. #1 well to be drilled 1980' FSL & 660' FEL of Section 35, T18S, R29E. The well will encompass an E/2 proration unit.

At such time as this well is approved by Flag-Redfern,please have the appropriate company officers execute all AFE's and signature pages, returning two executed originals of each to our Midland Office for our further handling. If instead, Flag-Redfern chooses to farmout to this well, Southland Royalty Company will be happy to prepare a Farmout Agreement which will provide for a 1/16th overrride convertible to a 50% working interest at payout.

If there are any questions, or if I can be of assistance concerning this matter, please don't hesitate calling.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 Mile Towers West Midland Texas 79701

COMPANY NO C

AFE NUMBER 022E

ADD A CHANGE DELETE PROPERTY NUMBER C-5 0 0 3 1 0-

AFE DATE 3 / 17 / 80 NAME SRC Empire Fed. "35-A" Comm. No. 1

ORIGINAL 0 SUPPLEMENTAL PRODUCER DRY HOLE SRC OPERATOR MANUAL

AUTHORITY IS REQUESTED TO:

WILDCAT DEV. DEV

Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980' FSL & 660' FEL, Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249		
350	01 01 Conductor or Drive Pipe	$ -	$ -
3200'	01 02 Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
1870'	01 03 8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
5470'	01 04 4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
3020'	01 05 4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
1090'	01 06 4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
11,450'	01 07 4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	01 08	-	-
	02 09 Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	03 10 Wellhead & Safety Equipment	26,000	2,000
	04 11 Packer & Special Equipment	4,500	-
	05 12 Artificial Lift	-	-
	10 13 Tank Battery and process equip.	36,000	-
	10 14 Other Equipment	7,530	3,040
	15 TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16 Flag-Redfern .252797	$ 57,842	$ 11,249
	INTANGIBLE - 248		
	01 17 Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	01 18 Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	01 19 Rig Moving Costs	-	-
	01 20 Completion Rig 10 Days @ $ 1200 /day	12,000	-
	02 21 Roustabout & Miscellaneous Labor	4,000	2,000
	01 22 Auto, Trucking, Barge, Tug	4,500	2,000
	04 23 Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	05 24 Mud, Oil, Water, Chemicals	45,000	40,000
	06 25 Drill Stem Tests	5,000	5,000
	05 26 Electric Logs & Bond Logs	35,000	35,000
	07 27 Cement, Centralizer, Scratchers, Service	45,000	40,000
	08 28 Bits, Fuel	20,000	20,000
	08 29 Rental Equipment & tubular inspection	25,000	12,000
	09 30 Core & Analyses	-	-
	09 31 Bottle Tests & Sidewall Cores	-	-
	09 32 Perforate	10,000	-
	09 33 Acid & Frack Variable	25,000	-
	01 34 Geological & Engineering	5,000	2,500
	09 35 Mud Logger	20,000	20,000
	10 36 Cost of Control Insurance (SRC Only) .468	5,400	5,400
	10 37 Miscellaneous & Unforseen	24,800	10,100
	11&12 38 District & Overhead Expense	3,000	2,000
	39 TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40 Flag-Redfern .252797	$ 136,055	$ 112,115
	41 GRAND TOTAL COSTS	$ 767,010	$ 488,000
	42 Flag-Redfern .252797	$ 193,898	$ 123,365

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: _____

BY: _____

DATE: _____

BASSETT-BIRNEY OIL CORPORATION

Oil Producers and Operators

ARTESIA, NEW MEXICO 88210

YATES BUILDING — 207 SOUTH FOURTH

PHONE: (505) 748-1331

September 4, 1980

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis, Landman

Re: Proposed Southland Royalty Company Empire
Federal "35" Com. No. 1 and "35-A" Com. No. 1
Wells, W/2 and E/2 Sec. 35, T-18-S, R-29-E,
Eddy County, New Mexico

Gentlemen:

This acknowledges receipt of your letters of July 8 and July 25, 1980, together with joint operating agreements and AFEs covering the proposed drilling of the subject wells.

The joint operating agreement dated July 8 covering W/2 Section 35 and the AFE for your No. "35" Com. No. 1, credits our company with a 19.026479% (60/315.35) interest, when in fact we own a 38.052957% (120/315.35) interest. The joint operating agreement dated July 17, 1980 covering E/2 Section 35 and the AFE for your No. "35-A" Com. No. 1, credits our company with a 6.3199% (20/316.46) interest, when in fact we own a 12.6398% (40/316.46) interest. Southland Royalty has instituted a suit against, among other parties, Bassett-Birney Oil Corporation, in the United States District Court for the District of New Mexico, Case No. CIV-80-0614 HB, contesting a portion of our title to the working interest underlying the proposed wells. In view of the incorrect statements in your operating agreements and AFEs as to our ownership in the proposed wells and the pending lawsuit, we are unable to approve either the AFEs or joint operating agreements.

Bassett-Birney is willing to pool its interests in the W/2 of Section 35 and in the E/2 of Section 35 for the drilling of the "35" Com. No. 1 Well and the "35-A" Com. No. 1 Well.

RECEIVED
LAND DEPT.
SEP 5 1980
SOUTHLAND ROYALTY CO.
MIDLAND, TEXAS

If you have any questions, please do not hesitate to call me.

Very truly yours,

BASSETT-BIRNEY OIL CORPORATION

By: Jack W. McCaw

Jack W. McCaw,
Vice President

September 4, 1980

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis, Landman

Re: Proposed Southland Royalty Company Empire
Federal "35" Com. No. 1 and "35-A" Com. No. 1
Wells, W/2 and E/2 Sec. 35, T-18-S, R-29-E,
Eddy County, New Mexico

Gentlemen:

This acknowledges receipt of your letters of July 8 and July 25, 1980, together with joint operating agreements and AFEs covering the proposed drilling of the subject wells.

The joint operating agreement dated July 8 covering W/2 Section 35 and the AFE for your No. "35" Com. No. 1, credits our company with a 19.026479% (60/315.35) interest, when in fact we own a 38.052957% (120/315.35) interest. The joint operating agreement dated July 17, 1980 covering E/2 Section 35 and the AFE for your No. "35-A" Com. No. 1, credits our company with a 6.3199% (20/316.46) interest, when in fact we own a 12.6398% (40/316.46) interest. Southland Royalty has instituted a suit against, among other parties, Bassett-Birney Oil Corporation, in the United States District Court for the District of New Mexico, Case No. CIV-80-0614 HB, contesting a portion of our title to the working interest underlying the proposed wells. In view of the incorrect statements in your operating agreements and AFEs as to our ownership in the proposed wells and the pending lawsuit, we are unable to approve either the AFEs or joint operating agreements.

Bassett-Birney is willing to pool its interests in the W/2 of Section 35 and in the E/2 of Section 35 for the drilling of the "35" Com. No. 1 Well and the "35-A" Com. No. 1 Well.

Case Nos. 7024 and 7025
N.M. Oil Conservation Div.
Examiner Hearing of 9/17/80
Bassett-Birney Oil Corp.
Exhibit No. 1

September 4, 1980

If you have any questions, please do not hesitate to call me.

Very truly yours,

BASSETT-BIRNEY OIL CORPORATION

By: Jack W. McCaw

Jack W. McCaw,
Vice President

COPY

FILED
UNITED STATES DISTRICT CO
SANTA FE, NEW MEXICO

JUL 23 1980

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEW MEXICO

CLERK

BY _____ DEP. CL

SOUTHLAND ROYALTY COMPANY,

Plaintiff,

vs.

CIV 80-0314HB
No.

ROBERT E. McKEE, INC.,
BASSETT-BIRNEY OIL CORPORATION
and the UNITED STATES DEPARTMENT OF THE INTERIOR, BUREAU
OF LAND MANAGEMENT,

Defendants.

COMPLAINT

COMES NOW the Plaintiff, SOUTHLAND ROYALTY COMPANY, by and through its attorneys, and for its Complaint against Defendants states:

The Parties - Jurisdiction - Venue

1. Plaintiff, Southland Royalty Company ("Southland") is a corporation, incorporated by the State of Delaware, having its principal place of business in the State of Texas.

2. Defendant Robert E. McKee, Inc., ("McKee") is a corporation, incorporated by the State of Nevada, having, upon information and belief, its principal place of business in the State of California.

3. Defendant Bassett-Birney Oil Corporation ("Bassett-Birney") is a corporation, incorporated by the State of New Mexico, having its principal place of business in the State of New Mexico.

4. Defendant United States Department of the Interior, Bureau of Land Management, is charged by statute with the administration and supervision of federal oil and gas leases and is the lessor of certain oil and gas properties as more particularly alleged herein.

Case Nos. 7024 and 7025
N.M. Oil Conservation Div.
Examiner Hearing of 9/17/80
Bassett-Birney Oil Corp.
Exhibit No. 2

5. This is a suit to adjudicate a disputed title to real estate in which the United States claims an interest and the Court has jurisdiction over the subject matter herein by reason of 28 U.S.C. 1346 (f) and 28 U.S.C. 2409 (a).

6. Venue in the District of New Mexico is proper by reason of 28 U.S.C. 1402 (d).

General Allegations

7. The real estate to which title is disputed is certain acreage specified in Federal Oil and Gas Lease No. LC-062029, dated May 1, 1942, more particularly described as follows:

Township 18 South, Range 29 East, Eddy County, New Mexico:

(a) Section 33 - N1/2 SE1/4
- SE1/4 SW1/4

(b) Section 34 - Lots 1 and 2 (S1/2 SE1/4) and 4 (SW1/4 SW1/4)
- NW1/4 SW1/4

(c) Section 35 - NW1/4 SW1/4
- S1/2 NW1/4
- NW1/4 SE1/4

hereinafter referred to as the "Disputed Acreage."

8. In late 1979, Southland initiated a program to drill and to develop an oil and gas well on a 320 acre proration unit in the eastern half (E1/2) of Section 34, T18S, R29E, Eddy County, New Mexico, hereinafter referred to as "The Tract." Ownership of oil and gas interests in The Tract was divided in varying proportions among several individuals and entities, and included a portion of the Disputed Acreage.

9. In order to develop an oil and gas tract, the ownership of which is divided among several individuals and entities, appropriate parties contract and agree among themselves regarding relevant rights, duties, and obligations, with respect to the tract. Two of the most common forms of such agreement are a) a Farmout Agreement, and b) an Operating Agreement:

a) Farmout Agreement - In the usual and customary practice of the oil and gas industry, a Farmout Agreement is a contract between operators whereby the owner of a lease not desirous of drilling at the time agrees to assign the lease to another operator who is desirous of drilling the tract. The primary characteristic of a farmout is the obligation of the assignee to drill a well on the assigned acreage as a prerequisite to the formal assignment of interests. In exchange for the assignment of interests, the assignor is usually granted an overriding royalty interest in production from the tract.

b) Operating Agreement - In the usual and customary practice of the oil and gas industry, an Operating Agreement is a contract between owners of leases in a tract who are desirous of drilling a well. The owners agree to name an Operator to drill the well, designate their specific acreage interest in the tract, and agree to divide costs in the well and interest in production.

10. In late 1979, Southland conducted a title search to determine ownership of oil and gas interest in the Tract. Such title search revealed that McKee and Bassett-Birney each possessed a one-half (1/2) working interest in Lots 1 and 2 (S1/2 SE1/4) of the Tract and that McKee and Bassett-Birney each possessed a one-half (1/2) working interest in the remainder of the Disputed Acreage.

11. By letter dated September 27, 1979, Southland informed McKee that the title seach revealed McKee's one-half (1/2)

working interest in Lots 1 and 2 (S1/2 SE1/4) of the Tract and one-half (1/2) working interest in the remainder of the Disputed Acreage and requested McKee to execute a Farmout of the Disputed Acreage in favor of Southland, such letter is attached hereto and incorporated herein as Exhibit "A."

12. On October 15, 1979, McKee formally executed a Farmout Agreement of the Disputed Acreage in favor of Southland, such Farmout Agreement is attached hereto and incorporated herein as Exhibit "B."

13. Under the terms of the Farmout Agreement, McKee promised to assign to Southland its one-half (1/2) working interest in the Disputed Acreage in the event Southland, at its sole risk and expense, was successful in drilling a natural gas well. In exchange for such assignment, McKee was granted a 1/16 of 8/8 overriding royalty interest in production from the Disputed Acreage with the option to convert to a 50% working interest at payout.

14. By executing the Farmout Agreement, McKee acknowledged and represented that it possessed a one-half (1/2) working interest in Lots 1 and 2 of the Tract and one-half (1/2) working interest in the remainder of the Disputed Acreage.

15. By letter dated February 26, 1980, Southland informed Bassett-Birney that the title search revealed Bassett-Birney's one-half (1/2) working interest in Lots 1 and 2 (S1/2 SE1/4) of the Tract and one-half (1/2) working interest in the remainder of the Disputed Acreage and requested Bassett-Birney to execute either a Farmout of the Disputed Acreage in favor of Southland or an Operating Agreement for the Tract, such letter is attached hereto and incorported herein as Exhibit "C."

16. By letter dated March 21, 1980, Southland again informed Bassett-Birney that the title seach revealed

Bassett-Birney's one-half (1/2) working interest in Lots 1 and (S1/2 SE1/4) of the Tract and again requested Basset-Birney to execute either a Farmout of Lots 1 and 2 of the Tract or an Operating Agreement for the Tract, such letter is attached here and incorporated herein as Exhibit "D."

17. By letter dated April 8, 1980, and pursuant to a request by Bassett-Birney, Southland forwarded to Bassett-Birney a xerox copy of the formal Title Opinion on the Disputed Acreage, such letter and Title Opinion are attached hereto and incorporated herein as Exhibit "E."

18. By letter dated April 22, 1980, and after complete review of the Title Opinion showing as its only ownership a one-half (1/2) working interest in the Disputed Acreage, Bassett-Birney executed an Authorization for Expenditure (AFE) and an Operating Agreement for the Tract, which letter, AFE and Operating Agreement are attached hereto and incorporated herein as Exhibit "F," "F(1)," and "F(2)," respectively.

19. Under the terms of the Operating Agreement, Bassett-Birney agreed that Southland would drill and operate an 11,000 foot Morrow natural gas well on the Tract.

20. By executing the AFE after complete review of the Title Opinion, Bassett-Birney acknowledged and represented that it possessed only a one-half (1/2) working interest in Lots 1 and 2 of the Tract and only a one-half (1/2) working interest in the remainder of the Disputed Acreage.

21. By executing the Operating Agreement after complete review of the Title Opinion, Bassett-Birney acknowledged and represented that it possessed only a one-half (1/2) working interest in Lots 1 and 2 of the Tract and only a one-half (1/2) working interest in the remainder of the Disputed Acreage.

22. At 10:00 a.m. on May 11, 1980, on the basis of and in reliance on the Title Opinion concerning the Disputed Acreage, the execution of the Farmout Agreement by McKee, and the execution of the AFE and Operating Agreement by Bassett-Birney, Southland initiated the drilling of a natural gas well on the Tract. The natural gas well, desginated as the Southland Royalty Company Federal Comm. "34" #1 Well, has been completed as a commercial producing gas well on the Tract.

23. On May 23, 1980, after Southland initiated drilling on the Tract, Bassett-Birney informed Southland that Bassett-Birney claimed an ownership interest in the Tract and the remainder of Disputed Acreage in an amount greater that its ownership interest as specified in the Title Opinion, the Farmout Agreement with McKee and the AFE and Operating Agreement with Bassett-Birney.

24. On the basis of an unrecorded Operating Agreement between Bassett-Birney and McKee, Bassett-Birney claims ownership of one-hundred percent (100%) of the working interest in Lots 1 and 2 of the Tract and one-hundred percent (100%) of the working interest in the remainder of the Disputed Acreage, such Operating Agreement as was supplied to Southland by Bassett-Birney is attached hereto and incorporated herein as "Exhibit G."

25. On June 6, 1980, on demand by Bassett-Birney, McKee executed an Assignment to Bassett-Birney of fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and fifty percent (50%) of the working interest in the remainder of the Disputed Acreage, such Assignment is attached hereto and incorporated herein as "Exhibit H."

FIRST CAUSE OF ACTION

26. Southland adopts and incorporates herein by reference the allegations contained in Paragraphs 1 through 25.

27. On the basis of the Farmout Agreement with McKee, Southland owns a fifty percent (50%) working interest in Lots 1

and 2 of the Tract and a fifty percent (50%) working interest in the remainder of the Disputed Acreage.

28. Bassett-Birney's claim that it owns one-hundred percent (100%) of the working interest in Lots 1 and 2 of the Tract and one-hundred percent (100%) working interest in the remainder of the Disputed Acreage is adverse to Southland and Bassett-Birney owns only fifty percent (50%) of such working interest.

29. Bassett-Birney's adverse claim is based on an Operating Agreement ("Exhibit G"), which is invalid and unenforceable on grounds of laches, waiver, and estoppel.

30. The Assignment from McKee to Bassett-Birney ("Exhibit H") constitutes a cloud on Southland's title to fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and fifty percent (50%) of the working interest in the remainder of the Disputed Acreage.

WHEREFORE, Southland requests judgment against McKee and Bassett-Birney as follows:

A. Declaring that the Operating Agreement ("Exhibit G") between McKee and Bassett-Birney is invalid and unenforceable on grounds of laches, waiver and estoppel;

B. Cancelling the Assignment ("Exhibit H") from McKee to Bassett-Birney;

C. Quieting title in fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and fifty percent (50%) of the working interest in the remainder of the Disputed Acreage in Southland and against McKee and Bassett-Birney; and

D. For such other relief as the Court deems just and proper.

SECOND CAUSE OF ACTION

31. Southland adopts and incorporates herein by reference the allegations contained in Paragraphs 1 through 28.

32. The Operating Agreement ("Exhibit G") under which Bassett-Birney claims an interest adverse to Southland's was not recorded as required by law and was not in the record chain of title of the Disputed Acreage.

33. With respect to fifty percent (50%) of the working interest in the Disputed Acreage, Southland is a good-faith, innocent purchaser for value without notice or knowledge of the adverse claim by Bassett-Birney.

WHEREFORE, Southland requests judgment against McKee and Bassett-Birney as follows:

A. Declaring that with respect to the Disputed Acreage, Southland is an innocent purchaser for value without notice or knowledge of the adverse claim by Bassett-Birney.

B. Cancelling the Assignment ("Exhibit H") from McKee to Bassett-Birney.

C. Quieting title in fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and 50% of the working interest in the remainder of the Disputed Acreage in Southland and against Mckee and Bassett-Birney; and

D. For such other relief as ther Court deems just and proper.

THIRD CAUSE OF ACTION

34. Southland adopts and incorporates by reference herein the allegations contained in Paragraphs 1 through 28.

35. At the time McKee executed the Farmout Agreement and at the time Bassett-Birney executed the Operating Agreement, McKee and Bassett-Birney knew or reasonably should have known of the existence and terms of the Operating Agreement ("Exhibit H") under which the parties claim an interest in the Disputed Acreage adverse to Southland.

36. At the time McKee executed the Farmout Agreement and at the time Bassett-Birney executed the Operating Agreement, the

parties made no claims to an interest in the Disputed Acreage adverse to Southland.

37. By executing the Farmout Agreement and Operating Agreement, McKee and Bassett-Birney waived any claims to an interest in the Disputed Acreage adverse to Southland and are now barred by estoppel from asserting such claims.

WHEREFORE, Southland requests judgment against McKee and Bassett-Birney as follows:

A. Declaring that with respect to the Disputed Acreage, McKee and Bassett-Birney have waived any claims to an interest in the Disputed Acreage adverse to Southland and are now estopped from asserting such claims; and

B. Cancelling the Assignment ("Exhibit H") from McKee to Bassett-Birney.

C. Quieting title in fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and 50% of the working interest in the remainder of the Disputed Acreage in Southland and against Mckee and Bassett-Birney; and

D. For such other relief as the Court deems just and proper.

FOURTH CAUSE OF ACTION

38. Southland adopts and incorporates by reference herein the allegations contained in Paragraphs 1 through 25.

39. Under the terms and conditions of the Farmout Agreement between Southland and McKee, McKee promised to assign to Southland its one-half (1/2) working interest in the Disputed Acreage upon Southland's drilling and completion of a well capable of producing gas in paying quantities.

40. By drilling and completing the Federal Comm. "34" #1 Well, Southland has performed its drilling obligations under the

Farmout Agreement with McKee and has performed and is in compliance with all other terms and conditions of the Farmout Agreement.

41. Pursuant to the terms and conditions of the Farmout Agreement, Southland has made demand on McKee for an assignment of its one-half (1/2) working interest in the Disputed Acreage, but McKee has refused to tender such assignment and McKee has instead unlawfully and without authority assigned such interests to Bassett-Birney.

42. The actions of McKee in refusing to assign to Southland its one-half (1/2) working interest in the Disputed Acreage and instead assigning such interests to Bassett-Birney constitutes a breach of the Farmout Agreement between Southland and McKee.

43. As a direct and proximate result of McKee's breach of the terms and conditions of the Farmout Agreement, Southland has suffered damages in an amount as yet unascertainable, but in no event less than $10,000.

WHEREFORE, Southland requests judgment against McKee as follows:

A. Declaring that McKee has breached the Farmout Agreement with Southland.

B. Awarding Southland actual damages incurred as a result of McKee's breach of the Farmout Agreement.

C. For such other relief as the Court deems just and proper.

Respectfully submitted,

CAMPBELL & BLACK, P.A.

By _____

Michael B. Campbell
Attorney for Plaintiff, Southland Royalty Company
Post Office Box 2208
Santa Fe, NM 87501
Telephone: (505) 988-4421

Southland Royalty Company

September 27, 1979

Robert E. McKee Co.
P. O. Box 20562
El Paso, Texas 79998

Attention: Mr. Jerry Watkins

Re: Portions of T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

Gentlemen:

SRC is presently attempting to secure support from the leasehold owners under portions of T18S, R29E, Eddy County, New Mexico. With adequate support SRC plans to drill a Morrow test well at a legal offset location to your leasehold.

Due to the diverse ownership in this area, a successful attempt to explore a deep formation like the Morrow will require the cooperation of numerous parties. Before SRC can attempt such a risky venture, we must acquire a substantial amount of support through option farmouts, allowing SRC the opportunity to earn additional acreage through drilling and producing.

A check of the records indicates that Robert E. McKee Co. owns a leasehold under the following tract(s) of land:

SECTION	W.I.	GROSS ACRES	NET ACRES
Sec. 33: N/2SE/4, SE/4SW/4	50%	120	60
Sec. 34: Lots 1,2,4 & NW/4SW/4	50%	160	60
Sec. 35: Lot 2, NW/4, NW/4SW/4, NW/2SE/4	50%	280	140
	Total:	560	280

Upon verfication that our information on your ownership is correct, SRC requests your support by granting a Farmout of your leasehold interest under the following general terms:

1. Ninety days from the completion of an offset well, Southland will commence a well at a legal location on your leasehold in Section 33, 34, or 35, or on land unitized herewith.
2. Upon completion of a well capable of producing oil and/or gas in commercial quantities Robert E. McKee will assign 100% of its leasehold interest to SRC, subject to a 1/16 of 8/8 overriding royalty interest with an option

EXHIBIT A

to convert said interest to a 50% working interest at payout, both pro-proportionately reduced, in the proration unit drilled. Also, SRC will have the option to drill on the balance of your acreage in Section 33, 34, and 35, under a 90 day continuous development provision, with a clause providing for a depth severance of 100' below the deepest producing interval on proration unit basis, as well as the ipso facto termination of any undeveloped proration units not drilled under the continuous development provision.

3. Upon completion or abandonment of an offset well, Southland will have a 120 day option to commence a subsequent well in the drilled proration unit.

Upon receiving approval for this proposal, Southland will be happy to prepare a Farmout Agreement containing the above provisions.

Should you have any questions regarding the above, please do not hesitate contacting me at (915) 682-8641, Ext. 27. Your earliest attention concerning this proposal will be greatly appreciated.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:lh

F/O 392

FARMOUT AGREEMENT

Date: October 9, 1979

Robert E. McKee Co.
P. O. Box 20562
El Paso, Texas 79998

Attention: Bob Hazelton

Re: Farmout Agreement
Portions of T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

This letter when accepted by you as "Farmor", shall evidence Southland Royalty Company's, hereinafter called "SRC", right to earn from Robert E. McKee Co., hereinafter called "McKee", an assignment of an interest in the leases described in Exhibit "A" attached hereto, hereinafter called "said leases", upon SRC fulfilling the requirements, conditions, and obligations contained herein.

I. DRILLING REQUIREMENTS: The drilling and completion requirements FARMOUTEE must satisfy, as a condition for earning, are as follows:

TEST WELL: A. This agreement shall terminate unless on or before ninety (90) days from the date hereof, FARMOUTEE shall commence, at FARMOUTEE's sole cost, risk and expense, the actual drilling of a well, hereafter called "Test Well", at a location in the S/2 of Section 27, T18S, R29E, Eddy County, New Mexico.

Once timely commenced, Test Well shall be drilled with due diligence to the "Objective Depth" described as 11,500 feet or a depth sufficient to test the Morrow formation, XXXXXXXXXXXXXXXXXXX (as to all of which drilling and testing the decision of McKee shall be conclusive) and shall thereafter be completed as a well capable of producing oil and/or gas in paying quantities or shall be plugged and abandoned as a dry hole.

B. By timely commencing and drilling Test Well to the Objective Depth and completing same as a well capable of producing oil and/or gas in paying quantities, FAPMOUTEE shall not earn the assignment provided for below.

C. If Test Well is completed as a dry hole, FARMOUTEE shall not earn the assignment provided for below.

SUCCESSIVE WELL: (Applicable only if FARMOUTEE has not earned said assignment by the drilling of the Test Well).

CONTINUOUS DEVELOPMENT: A. If the Successive Well is timely commenced and drilled to the Objective Depth and is capable of producing oil and/or gas in paying quantities, SRC thereby earns an assignment of McKee's interest in the acreage as it appears in Exhibit "A" attached hereto. SRC shall be required to continuously develop "said leases" to the extent of one gas well to 320 acres, one oil well to 80 acres, or as prescribed by the New Mexico Oil Conservation Commission. SRC shall have 120 days from completion or abandonment to commence operations on each subsequent well. If not sooner terminated by the provisions contained herein, Farmee's right to earn additional acreage hereunder shall ipso facto terminate in the absence of drilling in compliance with the continuous drilling obligation above and each proration unit upon which there is not located a well capable of producing oil and/or gas in paying quantities shall be reassigned to Farmor.

II. GEOLOGICAL INFORMATION, NOTICES, AND REPORTS: FARMOUTEE agrees to furnish to McKee the notices and reports provided for in Exhibit "B" attached hereto and to conduct the tests and surveys provided for therein. McKee shall be afforded an opportunity to witness such tests and surveys and the results thereof. (Please attach your requirements).

III. ADDITIONAL COVENANTS, CONDITIONS, AND OBLIGATIONS: FARMOUTEE agrees to comply with the additional covenants, conditions, and obligations provided for in Exhibit "C" attached hereto and shall reimburse McKee upon billing by McKee for 100% of the delay rentals paid in accordance with Paragraph 9 thereof. FARMOUTEE is not obligated to drill any well hereunder, however, FARMOUTEE shall comply with all of

EXHIBIT B

the obligations of this agreement that accrue during the period FARMOUTEE has the right to earn and all obligations arising from, related to, or based upon the drilling operations which FARMOUTEE conducts hereunder.

IV. ASSIGNMENT: In the event that Test Well or Successive Well (if Successive Well is provided for) is drilled to the Objective Depth and is completed with the results required herein for earning an assignment, hereafter called "Earning Well", and FARMOUTEE has otherwise complied with the requirements, conditions, and obligations hereof, McKee shall assign to FARMOUTEE, in the form attached hereto as Exhibit "D", 100% of McKee's interest in said leases described in Exhibit "A", reserving to McKee 1/16 of 8/8 overriding royalty interest with the option to convert to a 50% working interest at payout. Such assignment shall be effective as of the date hereof; shall be limited to oil and gas rights under said leases; shall provide for continuous development, and shall be limited in depth to 100 feet below the deepest depth drilled.

V. OTHER PROVISIONS: A. If not sooner terminated by other provisions hereof, this Agreement and FARMOUTEE's right to earn said assignment shall terminate at such time as FARMOUTEE fails to earn said assignment under either paragraph B or C of the Drilling requirements for Test Well or Successive Well (if Successive Well is provided for).

B. If the assignment earned by FARMOUTEE covers less than all of McKee's interest in said leases and McKee retains a working interest therein, the form of the Operating Agreement to be entered into by the parties covering operation of said leases or any part thereof in which McKee and FARMOUTEE concurrently own an undivided interest, is attached hereto as Exhibit "E", and said Operating Agreement shall be effective with said assighment. A Special Agreement relating to revenue from the Earning Well is attached to said Operating Agreement as Exhibit "E".

C. If any of said leases is a federal lease, the parties hereto agree to comply with the provisions of Exhibit "F" attached hereto. Reference to contractor therein means any and all parties performing work under this agreement.

If this letter correctly sets forth your understanding of our agreement, please signify your acceptance in the space provided below and return two (2) executed copies to SRC at 1100 Wall Towers West, Midland, Texas, 79701, within fifteen (15) days from the date hereof.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

By C. E. Mear
Attorney-In-Fact

AGREED TO AND ACCEPTED this 15th day of October, 1979.

By: C. D. McKee, President

For: Robert E. McKee, Inc.

EXHIBIT "A"

To Farmout Agreement dated October 9, 1979, between Robert E. McKee Co. as Farmor and Southland Royalty Company as Farmoutee.

LANDS SUBJECT TO THIS AGREEMENT:

N½SE¼; SE¼SW¼ of Section 33, Township 18 South, Range 29 East, Eddy County, New Mexico (below the San Andres formation).

Lots 1, 2, 4; NW¼SW¼ of Section 34, Township 18 South, Range 29 East, Eddy County, New Mexico (below the San Andres formation).

Lot 2; NW¼; NW¼SW¼; W/½SE¼ of Section 35, Township 18 South, Range 29 East, Eddy County, New Mexico (below the San Andres formation).

EXHIBIT "B"

Attached to and made a part of Farmout Agreement dated October 9, 1979, between Southland Royalty Company, and Robert E. McKee Co.

GEOLOGICAL REQUIREMENTS AND NOTICES:

EXHIBIT "C"

Attached to and made a part of Farmout Agreement dated October 9, 1979, by and between Southland Royalty Company and Robert E. McKee Co.

THERE IS NO EXHIBIT "C"

Southland Royalty Company

February 26, 1980

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: Farmout Request
Portions of Sections 33, 34 & 35
T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

Gentlemen:

Reference is made to your leasehold located in the above subject tracts. Southland Royalty Company is presently attempting to secure support from the leasehold owners under these sections for the drilling of several Morrow wells.

A check of the records indicates that Bassett & Birney Oil Corporation owns a 50% working interest in a lease covering the deep rights in the following tracts of land:

Section	W.I.	Gross Acres	Net Acres
Section 33: N½SE¼, SE¼SW¼	50%	120	60
Section 34: Lots 1, 2, 4 & NW¼SW¼	50%	160	80
Section 35: Lot 2, NW¼ NW¼SW¼, NW¼SE¼	50%	280	140
Totals		560	280

Southland requests your support for the project by granting of a Farmout of your acreage under the following general terms:

1. Bassett-Birney deliver its leasehold interest in the E½ of Section 34 to Southland Royalty Company for the drilling of a Morrow well. Southland Royalty Company will have a period of ninety (90) days in which to commence drilling this well. Upon obtaining production from this well, Southland Royalty Company will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled. The remainder of Bassett-Birney's leasehold in Sections 33, 34 and 35,

EXHIBIT C

out side the drilled proration unit will fall under a 120-day continuous development program.

2. Under the terms of this Agreement; Bassett & Birney will retain a 1/16th of 8/8ths ORRI convertible to a 50% working interest at payout on the initial well.

Upon receiving approval for this proposal, Southland will be happy to prepare a Farmout Agreement containing the above provisions. If instead, you choose to join in this well, an AFE and Joint Operating Agreement will be forwarded to you at once.

If there are any questions concerning the above, please do not hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am

Southland Royalty Company

March 21, 1980

Empire Federal "34" #1

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: SRC-Empire Federal Comm. 34 #1
1980' FNL & 1980' FEL, Section 34,
T-18-S, R29-E,
Eddy County, New Mexico
Empire, South Prospect #1873
F/O 382, F/O 399

Gentlemen:

Reference is made to the proposed well and to a Farmout request mailed to Bassett & Birney Oil Corporation dated February 26, 1980. In this letter, Southland Royalty Company requested a Farmout of your acreage in Sections 33, 34 and 35.

Southland Royalty Company is now prepared to drill a Morrow well in the E½ of Section 34, and by this letter, requests your support for the well.

A check of the records indicates that Bassett & Birney Oil Company owns a 50% working interest in a lease covering the deep rights in the S½SE¼ (Lots 1 and 2) of Section 34. Southland requests a Farmout of your acreage under the following general terms:

1. Bassett & Birney deliver its leasehold interest in the E½ of Section 34 for the drilling of the SRC-Empire Federal Comm. 34 #1 well. Southland will have a ninety (90) day period in which to commence the drilling of this well. Upon obtaining production from this well, Southland will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled.

2. Under the terms of this agreement, Bassett & Birney will retain a 1/16th of 8/8ths ORRI convertible to a 50% working interest at payout, proportionately reduced.

Upon receiving approval for this proposal, Southland Royalty Company will be happy to prepare a Farmout Agreement containing the above provisions.

If instead, Bassett & Birney Oil Company chooses to join in this well, upon approval, please execute the three (3) enclosed AFEs, returning two (2) originals to Southland Royalty Company's Midland office, while retaining one (1) original for your files. At such time as we have received the signed AFEs, a Joint Operating Agreement and Communitization Agreement will be forwarded for your approval.

If there are any questions concerning the above, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am
Enclosures

April 8, 1990

Bassett-Birney Oil Corporation
207 South Fourth Street
Artesia, New Mexico 88210

Attention: Jack McCall

Re: SRC Empire Fed. Comm. "34" #1
1980' FNL & 1980' FEL,
Section 34, T18S, R29E
Eddy County, New Mexico
Empire South Prospect #1873
F/O 382; F/O 399

Gentlemen:

Reference is made to our telephone conversation of even date concerning the subject well. Enclosed are the following:

1. Complete set of logs for the SRC Empire Fed. Comm. #1 well.

2. Xerox copy of an original Title Opinion by Stubbeman, McRae, Sealy, Laughlin & Browder dated February 21, 1980.

3. Operating Agreement for the proposed SRC Empire Fed. Comm. "34" #1, along with two extra signature pages.

I hope this information will aid you in making your decision to either join or farmout in the subject well. If you choose to join, please have the appropriate company officer execute the signature pages to the Operating Agreement, returning the two extra signature pages to our Midland office, along with two original signed AFE's which were mailed to you earlier. If instead, you choose to farmout, a Farmout Agreement will be prepared to cover your interest.

As time is of the essence in this matter, your immediate attention will be greatly appreciated. If you have any questions, or any further information is needed, please don't hesitate calling.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don H. Davis

Don H. Davis
Landman

DHD:lh

EXHIBIT E

STUBBEMAN, MCRAE, SEALY, LAUGHLIN & BROWDER

ATTORNEYS AT LAW

FRANK STUBBEMAN (1908-1978)
HAMILTON E. MCRAE
TOM SEALY
BOYD LAUGHLIN
FRED H. CASSIDY
WM. B. BROWDER JR.
WALTER C. BEARDSLEY
W. F. PENNEBAKER
DUNCAN M. GOOLSBY
JAMES L. PARDUE
JAMES G. HOLLAND
ROBERT J. COMAN
MILTON L. RANNSTON
WALTER A. BOYD, JR.
MARRELL FELDT
SMITH MAY
J. P. HOOD
J. J. BOWDEN
NICHOLAS C. TAYLOR
T. B. WRIGHT
JOE D. MERONEY
ALVIN WALWOORD JR.
RODNEY M. SATTERWHITE
HAL L. KEMP
JOE R. GREENHILL, JR.
THOS. L. LOWRY
JAMES V. HAMMETT, JR.
DANIEL W. HERD
JOSEPH V. CRAWFORD
JO ANNE CHRISTIAN
PATRICIA A. ENGLISH
GREGORY D. HOOSER
AL W. SCHORRE, JR.
JAMES ENRISHAW PHILLIPS
MARA R. LEAVERTON
BARRY BARKER
RANDAL M. KIRK
JACK D. LADD
MICHAEL R. STOLTZ
J. STOCKTON WILLIAMS, JR.
WOFFORD DENIUS
BRAD CUMMINS

MIDLAND, TEXAS
MIDLAND SAVINGS BUILDING-ZIP CODE 79701
300 WEST WALL STREET
P. O. BOX 1540-ZIP CODE 79702
A.C. 915 682-1616

AUSTIN, TEXAS
1800 AMERICAN BANK TOWER-ZIP CODE 78701
221 WEST 6TH STREET
P. O. BOX 2268-ZIP CODE 78768
A.C. 512 476-3502

JAMES W. WILSON
OF COUNSEL

February 21, 1980

ADDRESS REPLY TO:

Midland

Empire, S. Prospect
F/O 382 & 399

SOUTHLAND ROYALTY COMPANY
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis

Re: ORIGINAL TITLE OPINION
Federal Oil and Gas Lease LC-062029
insofar as it covers Lots 1, 2, 3, 4, N/2 S/2 of Section 34, and Lot 2, NW/4, NW/4 SE/4 and NW/4 SW/4 of Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico, containing 585.31 acres, more or less
(Empire, South Prospect #1873).

Gentlemen:

At your request, we have examined title to the captioned land as reflected by the following:

ABSTRACTS

1. Abstract No. 32209 certified by Federal Abstract Company covering, among other land, the captioned land based on the Records of the Bureau of Land Management from Inception of the Records to February 5, 1980 at 10:00 A.M., containing 279 pages.

2. Abstract No. 80,008 certified by Currier Abstract Company covering, among other land, the mineral interest in the captioned land from Inception of the Records to January 22, 1980 at 8:00 A.M., containing 692 pages.

INSTRUMENTS

Letter dated December 27, 1979 by Mr. Don W. Davis.

Based upon our examination of the foregoing and subject to the requirements hereinafter set forth, we find that title to the captioned land is vested as follows:

I. Lessee of Record:

A. Lot 3, NE/4 SW/4, N/2 SE/4 of Section 34 (156.65 acres):

Bassett-Birney Oil Corporation	1/2
Carper Drilling Company, Inc.	1/2
Total	2/2

B. Lots 1, 2, 4, NW/4 SW/4 of Section 34 and Lot 2, NW/4, NW/4 SW/4 and NW/4 SE/4 of Section 35 (428.66 acres):

Bassett-Birney Oil Corporation	1/2
Robert E. McKee General Contractor, Inc.	1/2
Total	2/2

II. Ownership of Production:

A. Lot 3, Section 34 from the surface to the base of the Queen Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI

Robert E. McKee General Contractor, Inc.	1/2 of 30% of 85.5% or	.1282500	WI
Mack Chase, Inc.	1/4 of 85% of 85.5% or	.1816875	WI#**
Marbob Energy Corporation	1/4 of 85% of 85.5% or	.1816875	WI#**
Harlan Oil Company, a Limited Partnership	1/4 of 85% of 85.5% or	.1816875	WI#**
Stevenson-Roach Tank Company, Inc.	1/4 of 85% of 85.5% or	.1816875	WI#**
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#This interest shall bear and pay 1/4 of a .062438 to .0 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .0085 to .0 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 85% of 85.5% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964,

recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

B. NW/4 SW/4 of Section 34 from the surface to the base of the Queen Formation, or 2,505 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI#
Robert E. McKee General Contractor, Inc.	30% of 79.25% or	.2377500	WI
Mack Chase, Inc.	1/4 of 70% of 79.25% or	.1386875	WI$**
Marbob Energy Corporation	1/4 of 70% of 79.25% or	.1386875	WI$**
Harlan Oil Company, a Limited Partnership	1/4 of 70% of 79.25% or	.1386875	WI$**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 79.25% or	.1386875	WI$**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of

oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

§This interest shall bear and pay 1/4 of a .049875 to .0 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 79.25% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

C. NE/4 SW/4 of said Section 34 from the surface to the base of the Queen Formation, or 2,200 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Robert E. McKee General Contractor, Inc.	30% of 85.5% or	.2565000	WI

Mack Chase, Inc.	1/4 of 70% of 85.5% or	.1496250	WI#**
Marbob Energy Corporation	1/4 of 70% of 85.5% or	.1496250	WI#**
Harlen Oil Company, a Limited Partnership	1/4 of 70% of 85.5% or	.1496250	WI#**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 85.5% or	.1496250	WI#**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#This interest shall bear and pay 1/4 of a .049875 to .0089446 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0005963 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 85.5% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

D. Lot 2 of said Section 34 from the surface to the base of the Queen Formation, or 2,543 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI#
Robert E. McKee General Contractor, Inc.	30% of 79.25% or	.2377500	WI
Mack Chase, Inc.	1/4 of 70% of 79.25% or	.1386875	WI$**
Marbob Energy Corporation	1/4 of 70% of 79.25% or	.1386875	WI$**
Harlan Oil Company, a Limited Partnership	1/4 of 70% of 79.25% or	.1386875	WI$**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 79.25% or	.1386875	WI$**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

§This interest shall bear and pay 1/4 of a .049875 to .0 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 79.25% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

E. NW/4 SE/4 of said Section 34 from the surface to the base of the Queen Formation, or 2,200 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI

Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Robert E. McKee General Contractor, Inc.	30% of 85.5% or	.2565000	WI
Mack Chase, Inc.	1/4 of 70% of 85.5% or	.1496250	WI#**
Marbob Energy Corporation	1/4 of 70% of 85.5% or	.1496250	WI#**
Harlan Oil Company, a Limited Partnership	1/4 of 70% of 85.5% or	.1496250	WI#**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 85.5% or	.1496250	WI#**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#This interest shall bear and pay 1/4 of a .049875 to .0089446 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0005963 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 85.5% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

F. NW/4 SE/4 and NE/4 SW/4 of Section 34 from the base of the Queen Formation to the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Mack Chase, Inc.	1/4 of 85.5% or	.2137500	WI**
Marbob Energy Corporation	1/4 of 85.5% or	.2137500	WI**
Harlan Oil Company, a Limited Partnership	1/4 of 85.5% or	.2137500	WI**
Stevenson-Roach Tank Company, Inc.	1/4 of 85.5% or	.2137500	WI**
	Total	1.0000000	

Note: For rights above the base of the Queen Formation, see Paragraph E, and for rights below the top of the San Andres Formation, see Paragraph G.

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35% to 25% of 70% of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

G. Lot 3 of said Section 34 from the base of the Queen Formation to the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Mack Chase, Inc.	1/4 of 1/2 of 85.5% or	.1068750	WI#

Marbob Energy Corporation	1/4 of 1/2 of 85.5% or	.1068750	WI#
Harlan Oil Company, a Limited Partnership	1/4 of 1/2 of 85.5% or	.1068750	WI#
Stevenson-Roach Tank Company, Inc.	1/4 of 1/2 of 85.5% or	.1068750	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 1/2 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35%-25% of 1/2 of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

H. NE/4 SE/4 of Section 34 from the surface down to 750 feet:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Cities Service Company	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

I. NE/4 SE/4 of Section 34 from 750 feet down to the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Mack Chase, Inc.	1/4 of 85.5% or	.2137500	WI#
Marbob Energy Corporation	1/4 of 85.5% or	.2137500	WI#
Harlan Oil Company, a Limited Partnership	1/4 of 85.5% or	.2137500	WI#
Stevenson-Roach Tank Company, Inc.	1/4 of 85.5% or	.2137500	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35% to 25% of 70% of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

J. NE/4 SE/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Cities Service Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying a Production Payment of $1,000.00 a net acre payable out of 3% of 85.5% from all formations below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.

K. NW/4 SE/4 and NE/4 SW/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI

J. NE/4 SE/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Cities Service Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying a Production Payment of $1,000.00 a net acre payable out of 3% of 85.5% from all formations below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.

K. NW/4 SE/4 and NE/4 SW/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI

Meryl Story Tatman	1% or	.0100000	ORI
Cities Service Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying a Production Payment of $1,000.00 a net acre payable out of 3% of 85.5% from all formations below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.

L. Lot 3 of said Section 34 below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Cities Service Company	1/2 of 85.5% or	.4275000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 1/2 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35%-25% of 1/2 of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

M. Lot 2 of said Section 34 below the base of the Queen Formation, or 2,543 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

N. NW/4 SW/4 of Section 34 below the base of the Queen Formation, or 2,505 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

O. Lot 4 of said Section 34 from the surface down to the base of the Queen Formation, or 2,373 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI
Robert E. McKee General Contractor, Inc.	79.25% or	.7925000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

P. Lot 4 of said Section 34 below the base of the Queen Formation, or 2,373 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
R. E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

Q. Lot 1 of said Section 34 from the surface to the base of the Queen Formation, or feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI

Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI#
Robert E. McKee General Contractor, Inc.	79.25% or	.7925000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

R. Lot 1 of said Section 34 below the base of the Queen Formation, or feet, whichever is the lesser:

United States of America	-1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

S. NW/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
Julia Brainard Estate	2% or	.0200000	ORI
Tenneco Oil Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying (1) a $750.00 per acre Production Payment payable out of 1/16 of 7/8 less 1/2 of 2%, subject to suspension when oil production is 15 barrels or less of oil as to excess over 17-1/2% total burdens and royalty, which is owned by Robert E. McKee General Contractor, Inc., and (2) a $3,000,000.00 Production Payment payable out of 3/32 of the production from said land and others which is owned by Robert J. Leonard, Patrick J. Leonard and Timothy T. Leonard.

T. NE/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
C. Melvin Neal	2.5% or	.0250000	ORI
Tenneco Oil Company	85% or	.8500000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying (1) a $750.00 per acre Production Payment payable out of 1/16 of 7/8 less 1/2 of 2-1/2%, subject to suspension when oil production is 15 barrels or less of oil as to excess over 17-1/2% total burdens and royalty, which is owned by Robert E. McKee General Contractor, Inc., and (2) a $3,000,000.00 Production Payment payable out of 3/32 of the production from said land and others which is owned by Robert J. Leonard, Patrick J. Leonard and Timothy T. Leonard.

U. SW/4 SE/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Tenneco Oil Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying (1) a $750.00 per acre Production Payment payable out of 1/16 of 7/8 less 1/2 of 2%, subject to suspension when oil production is 15 barrels or less of oil as to excess over 17-1/2% total burdens and royalty, which is owned by Robert E. McKee General Contractor, Inc., and (2) a $3,000,000.00 Production Payment payable out of 3/32 of the production from said land and others which is owned by Robert J. Leonard, Patrick J. Leonard and Timothy T. Leonard.

V. SW/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*

Julia Brainard Estate	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.42750000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

W. SE/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
C. Melvin Neal	2.5% or	.0250000	ORI
Bassett-Birney Oil Corporation	1/2 of 85% or	.4250000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85% or	.4250000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

X. NW/4 SE/4 of Section 35:

United States of America	1/8 or	.1250000	RI*

Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

Y. NW/4 SW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
Neil B. Watson	5% or	.0500000	ORI
Bassett-Birney Oil Corporation	1/2 of 82.5% or	.4125000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 82.5% or	.4125000	WI
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

OIL AND GAS LEASE

Form: 4-208F (January 1943).
Serial No.: LC 062029 (Consolidated).
Date: May 1, 1942.
Recorded: Unrecorded, however recording is not necessary.

Lessor: United States of America.
Lessee: Robert E. McKee and C. N. Bassett.
Land Covered: Township 18 South, Range 29 East, N.M.
Section 33: Lots 1,2,3, NE/4 SW/4, N/2 SE/4
Section 34: Lots 1,2,3,4, N/2 S/2
Section 35: Lot 2, NW/4, NW/4 SW/4, NW/4 SE/4
containing 812.67 acres, more or less.

Term: 5 years and usual thereafter clause.
Royalty:

On Oil

When the average production for the calendar month in barrels per well per day is

not over				50,	the royalty shall be	12.5	percent;
over	50	but not over		60,	" "	13	"
"	60	" "	"	70,	" "	14	"
"	70	" "	"	80,	" "	15	"
"	80	" "	"	90,	" "	16	"
"	90	" "	"	110,	" "	17	"
"	110	" "	"	130,	" "	18	"
"	130	" "	"	150,	" "	19	"
"	150	" "	"	200,	" "	20	"
"	200	" "	"	250,	" "	21	"
"	250	" "	"	300,	" "	22	"
"	300	" "	"	350,	" "	23	"
"	350	" "	"	400,	" "	24	"
"	400	" "	"	450,	" "	25	"
"	450	" "	"	500,	" "	26	"
"	500	" "	"	750,	" "	27	"
"	750	" "	"	1,000,	" "	28	"
"	1,000	" "	"	1,250,	" "	29	"
"	1,250	" "	"	1,500,	" "	30	"
"	1,500	" "	"	2,000,	" "	31	"
"	2,000	" "	"			32	"

On Gas

When the average production of gas per well per day for the calendar month does not exceed 5,000,000 cubic feet, 12-1/2 percent; and when said production of gas exceeds 5,000,000 cubic feet,

16-2/3 percent of the amount or value of the gas and liquid products produced, said amount or value of such liquid products to be net after an allowance for the cost of manufacture; Provided, That the allowance for cost of manufacture may exceed two-thirds of the amount or value of any product only on approval by the Secretary of the Interior; and that said value of gas and of liquid products shall be as determined by said Secretary.

Delay Rentals: No longer applicable. Lease is on a producing status.

PATENT INFORMATION AND SURVEYING DATA

The captioned land is public domain. The following lots contain the following land:

Section 34:

Lot	Land
1	37.22
2	36.93
3	36.65
4	36.36

Section 35:

Lot	Land
1	38.31
2	38.15
3	37.88
4	37.47

ENCUMBRANCES

1. Deed of Trust dated April 1, 1968, recorded in Book 247, Page 703, by December, Inc. to First City National Bank of Houston, Texas, covering a $745,000.00 Production Payment reserved by Aurora Corporation of Illinois to secure a $745,000.00 note. (This instrument has been briefed).

2. Deed of Trust dated December 21, 1976, recorded in Volume 284, Page 100, by D. R. Clary, et ux, to Wilbur A. Yeager, Jr. covering his interest in the captioned land (which is now owned by Mack C. Chase, et al) to secure payment of a $60,000.00 note to The First National Bank of Midland.

EASEMENTS

The Plat shows a pipeline (NM 28526) as crossing the NW/4 of Section 35.

CASINGHEAD GAS CONTRACTS

Casinghead Gas Contract dated January 16, 1978, recorded in Volume 153, Page 592, by Marbob Energy Corporation to Phillips Petroleum Company covering the NE/4 SW/4, SE/4 SW/4, SW/4 SE/4 of Section 34. There is no depth limitation in this instrument.

TITLE REQUIREMENTS

I.

Certain of the tracts above are limited in depth to the base of the Queen Formation or a specific footage depth. In each instance, we have assumed that the footage depth is below the base of the Queen Formation. In the event this is not true, then we should be furnished with the footage depths of the base of the Queen Formation under each quarter/quarter section of land at which time we will advise you of the ownership of the zone lying between the footage depth and the base of the Queen Formation.

REQUIREMENT NO. 1: As stated.

II.

Bassett-Birney Oil Corporation owned a 1/2 interest in the operating rights in the NE/4 SW/4 and NW/4 SE/4 of Section 34. R. E. McKee General Contractor, Inc. owned the other 1/2 interest in the operating rights. R. E. McKee General Contractor, Inc. assigned its 1/2 interest in the operating rights to Stanton Oil Company. The Assignment purported to cover all of the operating rights. The Assignment of Operating Rights from R. E. McKee General Contractor, Inc. to Stanton Oil Company was approved as to only a 1/2 interest in such operating rights. Stanton Oil Company, in turn, assigned its interest in the operating rights to Richard D. Davoust. This Assignment was approved for a 1/2 interest in the operating rights insofar as it covers the NE/4 SW/4 and NW/4 SE/4 of said Section 34. Richard D. Davoust, et ux, in turn, assigned his interest to Texas City Refining Co., Inc. This conveyance was approved as covering all of the operating rights. We have examined no instrument whereby Bassett-Birney Oil Corporation conveyed its 1/2 interest in the operating rights in said NW/4 SE/4 and NE/4 SW/4 of Section 34. The Brainard No. 4 and No.

6 Wells are located on this land, and we assume that they are completed in the zone lying between the base of the Queen Formation and the top of the San Andres Formation.

REQUIREMENT NO. 2: We should be furnished with information as to how Stanton Oil Company or Richard D. Davoust acquired the 1/2 interest in the operating rights of Bassett-Birney Oil Corporation, and also we should be furnished with the complete well history of the Brainard No. 4 and No. 6 wells, and especially information showing where said wells were completed.

III.

The Stipulation Concerning Interest between Joe L. Stanton and Stanton Oil Company, Ltd. indicates that Bassett-Birney Oil Corporation has an option to acquire a paid-up working interest in the NW/4 SW/4, Lot 2 and Lot 4 of said Section 34, insofar as their interest covers from the surface down to depth limitation or the base of the Queen Formation, whichever is the lesser depth.

REQUIREMENT NO. 3: We have not examined the instrument whereby this option was reserved.

IV.

The abstract does not contain the instruments in the case file for NM 010907 and LC-056845 out of which LC-062029 was consolidated. LC 061439, LC 061440, LC 062076 and LC 060629 were also included in this consolidation. It would be helpful to examine each of these old case files which have been sent to the Dead Record Center in Denver. Since we have not been able to examine the case files on NM-010907 and LC-056845, there is a possibility that Bassett-Birney Oil Corporation conveyed a 1/2 interest in certain tracts and depths which we have credited with above to Robert E. McKee General Contractor, Inc. This possibility appears to be heightened by the fact that in a number of instances Robert E. McKee General Contractor, Inc. stated that their net interest covered the full working interest, when we credited them with only 1/2. You should investigate further into this possibility in the event you desire to acquire the shallow interests which we have credited to Bassett-Birney Oil Corporation.

REQUIREMENT NO. 4: None. Advisory only.

V.

Under Paragraphs Q and R we have left the depth limitation blank as we have seen no evidence as to the depth to which the required well was drilled. The Operating Agreement dated June 29, 1956 by Bassett-Birney Oil Corporation to Robert E. McKee, General Contractor, Inc. covering said Lot 4 required a continuous drilling program until all of the land is developed. The Affidavit dated June 10, 1957 by Bassett-Birney Oil Corporation specified the depths limit on all of the land covered by the Operating Agreement dated June 29, 1956, except as to Lot 4. We have assumed that a well was drilled on Lot 4 and Robert E. McKee, General Contractor, Inc. earned Bassett-Birney Oil Corporation's 1/2 interest down to total depth plus 100 feet or the base of the Queen Formation, whichever is the lesser.

REQUIREMENT NO. 5: Submit evidence that a well was timely commenced on said Lot 4 and that Robert E. McKee, General Contractor, Inc. earned said 1/2 interest in the shallow operating rights, together with evidence as to the depth to which said well was drilled.

VI.

Under Paragraphs S and V of Ownership, we have shown the Julia Brainard Estate as having a 2% Overriding Royalty Interest. These Overriding Royalty Interests were not listed in her Estate. In the event that you acquire these two properties, inquiries should be made concerning the ownership of this Overriding Royalty Interest.

REQUIREMENT NO. 6: As stated.

VII.

In the event you acquire an interest in any of the captioned land, it would be helpful for us to examine the Division Orders and lease files of your Seller in order to verify the ownership of the captioned land. This Opinion is based solely on the data examined, and there are numerous questions and ambiguities reflected by this information. As a result, we have made certain assumptions which need to be clarified.

REQUIREMENT NO. 7: Advisory:

VIII.

We have examined no information showing that the lease is in good standing and that the wells located thereon have been drilled and operated in accordance with the rules and regulations of the New Mexico Oil Conservation Division, the United States Geological Survey and any other governmental agency having jurisdiction over the captioned land. You should satisfy yourself concerning these matters.

REQUIREMENT NO. 8: As stated.

COMMENTS

1. This opinion cannot cover such matters as area, boundaries, location on the ground or other matters that can be determined by an actual on-the-ground survey.

2. This opinion does not cover matters concerning regulations by the Federal Energy Regulatory Commission and other governmental agencies.

We return herewith the material furnished.

Respectfully submitted,

STUBBEMAN, McRAE, SEALY, LAUGHLIN & BROWDER

By ORIGINAL SIGNED BY J. J. BOWDEN
J. J. Bowden

JJB/bb

Enclosures

BASSETT-BIRNEY OIL CORPORATION

ARTESIA, NEW MEXICO — *OIL PRODUCERS AND OPERATORS* — EL PASO, TEXAS

ARTESIA, NEW MEXICO

April 22, 1980

RECEIVED
LAND DEPT.
APR 23 1980
SOUTHLAND ROYALTY CO.
MIDLAND, TEXAS

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Don W. Davis

Re: SRC Empire Fed. Comm. "34" #1
Township 18 South, Range 29 East, NMPM
Section 34
Eddy County, New Mexico

Gentlemen:

We enclose 2 executed copies of the AFE and 2 copies of the signature pages for the Operating Agreement on the captioned well.

We have executed the Operating Agreement with the understanding there will be no charge to us for the Drilling Title Opinion.

Very truly yours,

Randy G. Patterson
Land Department

By: Jack W. McCaw

JWM/kc
Enclosures

EXHIBIT F

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 WILCO TOWERS WEST MIDLAND TEXAS 79701

COMPANY NO ___ RECORD ID ___

AFE NUMBER ___

ADD X CHANGE ___ DELETE ___ PROPERTY NUMBER ___

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "34" No. 1

ORIGINAL 0 SUPPLEMENTAL ___ PRODUCER ___ DRY HOLE ___ SRC OPERATOR ___ MANUAL ___

AUTHORITY IS REQUESTED TO:

WILDCAT ___ DEV. X Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980 FEL 1980 FNL Sec. 34 T-18-S R-29-E Eddy, N.M.

FOOTAGE		TANGIBLE - 249	ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	01 01	Conductor or Drive Pipe	$ -	$ -
350	01 02	Casing 11 3/4" 42# H-40 ST&C @ $16.75	5,860	5,850
3200'	03	8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	04	4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	05	4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	06	4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	07	4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	08		-	-
11,450'	02 09	Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	03 10	Wellhead & Safety Equipment	26,000	2,000
	04 11	Packer & Special Equipment	4,500	-
	04 12	Artificial Lift	-	-
	05 13	Tank Battery and process equip.	36,000	-
	10 14	Other Equipment	7,530	3,040
	15	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16	BASSETT & BIRNEY .11801687	$ 27,003	$ 5,252
		INTANGIBLE - 248		
	01 17	Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	01 18	Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	01 19	Rig Moving Costs	-	-
	01 20	Completion Rig 10 Days @ $ 1200 /day	12,000	-
	02 21	Roustabout & Miscellaneous Labor	4,000	2,000
	03 22	Auto, Trucking, Barge, Tug	4,500	2,000
	04 23	Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	05 24	Mud, Oil, Water, Chemicals	45,000	40,000
	05 25	Drill Stem Tests	5,000	5,000
	05 26	Electric Logs & Bond Logs	35,000	35,000
	07 27	Cement, Centralizer, Scratchers, Service	45,000	40,000
	08 28	Bits, Fuel	20,000	20,000
	28 29	Rental Equipment & tubular inspection	25,000	12,000
	09 30	Core & Analyses	-	-
	09 31	Bottle Tests & Sidewall Cores	-	-
	09 32	Perforate	10,000	-
	29 33	Acid & Frack Variable	25,000	-
	09 34	Geological & Engineering	5,000	2,500
	09 35	Mud Logger	20,000	20,000
	10 36	Cost of Control Insurance (SRC Only) .468	5,400	5,400
	10 37	Miscellaneous & Unforseen	24,800	10,100
	11 12 37	District & Overhead Expense	3,000	2,000
	37	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40	BASSETT & BIRNEY .11801687	$ 63,516	$ 52,340
	41	GRAND TOTAL COSTS	$ 767,010	$ 488,000
	47	BASSETT & BIRNEY .11801687	$ 90,520	$ 57,592

AUTHORIZATION REQUESTED

K. W. Johnson

AUTHORIZATION APPROVED

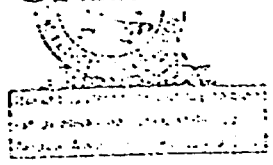
COMPANY: Bassett & Burney & Dorp

BY: Eng. V

DATE: 4-11-80

A.A.P.L. FORM 610 - 1977

MODEL FORM OPERATING AGREEMENT



OPERATING AGREEMENT

DATED

April 8, 1980,

OPERATOR SOUTHLAND ROYALTY COMPANY

CONTRACT AREA E/2 Section 34, T18S, R29E, below the San Andres Formation

COUNTY ~~OR PARISH~~ OF Eddy STATE OF New Mexico

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EXHIBIT F(2)

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between SOUTHLAND ROYALTY COMPANY, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators",

WITNESSETH:

WHEREAS, the parties to this agreement are owners of oil and gas leases and/or oil and gas interests in the land identified in Exhibit "A", and the parties hereto have reached an agreement to explore and develop these leases and/or oil and gas interests for the production of oil and gas to the extent and as hereinafter provided:

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.
DEFINITIONS

As used in this agreement, the following words and terms shall have the meanings here ascribed to them:

A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.

B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.

D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".

E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.

F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.

G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.

H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II.
EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

☒ A. Exhibit "A", shall include the following information:
- (1) Identification of lands subject to agreement,
- (2) Restrictions, if any, as to depths or formations,
- (3) Percentages or fractional interests of parties to this agreement,
- (4) Oil and gas leases and/or oil and gas interests subject to this agreement,
- (5) Addresses of parties for notice purposes.

☒ B. Exhibit "B", Form of Lease.

☒ C. Exhibit "C", Accounting Procedure.

☒ D. Exhibit "D", Insurance.

☒ E. Exhibit "E", Gas Balancing Agreement.

☒ F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.

If any provision of any exhibit, except Exhibit "E", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

ARTICLE III.
INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an unleased oil and gas interest in the Contract Area, that interest shall be treated for the purpose of this agreement and during the term hereof as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B". As to such interest, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the lessee interest.

B. Interest of Parties in Costs and Production:

Exhibit "A" lists all of the parties and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and material acquired in operations on the Contract Area shall be owned by the parties as their interests are shown in Exhibit "A". All production of oil and gas from the Contract Area, subject to the payment of lessor's royalties which will be borne by the Joint Account, shall also be owned by the parties in the same manner during the term hereof; provided, however, this shall not be deemed an assignment or cross-assignment of interests covered hereby.

ARTICLE IV.
TITLES

A. Title Examination:

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including Federal Lease Status Reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

~~☐ Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be a part of the administrative overhead as provided in Exhibit "C," and shall not be a direct charge, whether performed by Operator's staff attorneys or by outside attorneys.~~

☒ Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in gas royalty opinions, and division order title opinions) shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Exhibit "A". * Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection with leases or oil and gas interests contributed by such party. The Operator shall be responsible for the preparation and recording of Pooling Designations or Declarations as well as the conduct of hearings before Governmental Agencies for the securing of spacing or pooling orders. This shall not prevent any party from appearing on its own behalf at any such hearing.

~~No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to participate in the drilling of the well.~~

B. Loss of Title:

1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A", this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests, and

(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development [illegible] when such costs are incurred in connection with an operation conducted under Article VI, in which event such costs are to be borne by the [illegible] owners of the productive

or operating costs which it may have theretofore paid, but there shall be no monetary liability on its part to the other parties hereto for drilling, development, operating or other similar costs by reason of such title failure; and

(b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract Area by the amount of the interest lost; and

(c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract Area is increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such interests (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well; and

(d) Should any person not a party to this agreement, who is determined to be the owner of any interest in the title which has failed, pay in any manner any part of the cost of operation, development, or equipment, such amount shall be paid to the party or parties who bore the costs which are so refunded; and

(e) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be borne by the party or parties in the same proportions in which they shared in such prior production; and

(f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in connection therewith.

2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, is not paid or is erroneously paid, and as a result a lease or interest therein terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new lease covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties shall be revised on an acreage basis, effective as of the date of termination of the lease involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the lease or interest which has terminated. In the event the party who failed to make the required payment shall not have been fully reimbursed, at the time of the loss, from the proceeds of the sale of oil and gas attributable to the lost interest, calculated on an acreage basis, for the development and operating costs theretofore paid on account of such interest, it shall be reimbursed for unrecovered actual costs theretofore paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost interest, on an acreage basis, up to the amount of unrecovered costs;

(b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an acreage basis, of that portion of oil and gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such lease termination, would be attributable to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said portion of the oil and gas to be contributed by the other parties in proportion to their respective interests; and

(c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall not be considered failure of title but shall be joint losses and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of the Contract Area.

ARTICLE V.
OPERATOR

A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:

SOUTHLAND ROYALTY COMPANY shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operator, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the Parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed, shall be determined by Operator, and all such employees shall be the employees of Operator.

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the 1st day of June, 1980, Operator shall commence the drilling of a well for oil and gas at the following location:

1980' FNL & 1980' FEL of Section 34, T18S, R29E, Eddy County, New Mexico

and shall thereafter continue the drilling of the well with due diligence to

11,700' or a depth sufficient to test the Morrow formation

unless granite or other practically impenetrable substance or condition in the hole, which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E.1. hereof.

B. Subsequent Operations:

1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday or legal holidays. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or response given by telephone shall be promptly confirmed in writing.

2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, within sixty (60) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period where the drilling rig is on location, as the case may be) actually commence work on the proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest of the parties approving such operation, and (b) its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A", or (b) carry its proportionate part of Non-Consenting Parties' interest. The proposing party, at its election, may withdraw such proposal if there is insufficient participation, and shall promptly notify all parties of such decision.

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk, and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or market value thereof if such share is not sold (after deducting production taxes, royalty, overriding royalty and other interests existing on the effective date hereof, payable out of or measured by the production from such well accruing with respect to such interest until it reverts) shall equal the total of the following:

(a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to each Non-Consenting Party had it participated in the well from the beginning of the operation; and

(b) 300 % of that portion of the costs and expenses of drilling, reworking, deepening, or plugging back, testing and completing, after deducting any cash contributions received under Article VIII.C., and

300 % of that portion of the cost of newly acquired equipment in the well (to and including the well-head connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's election, shall be sold to its purchaser, if available, under the terms of its existing gas sales contract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from such sale direct to the Consenting Parties until the amounts provided for in this Article are recovered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not contracted for sale of its gas at the time such gas is available for delivery, or has not made the election as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-Consenting Party's share of gas as hereinabove provided during the recoupment period.

During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production.

In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.

Within sixty (60) days after the completion of any operation under this Article, the party conducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas produced during any month, Consenting Parties shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs of the work done and of the equipment purchased, in determining when the interest of such Non-Consenting Party shall revert to it as above provided; and if there is a credit balance, it shall be paid to such Non-Consenting party.

If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent of all parties, no wells shall be completed in or produced from a source of supply from which a well located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such source of supply.

The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b) to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article VI.A.

C. Right to Take Production in Kind:

Each party shall have the right to take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating oil for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any

party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment direct from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate commerce, of any other party's share of gas production without first giving such other party thirty (30) days notice of such intended sale.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any Gas Balancing Agreement between the parties hereto, whether such Agreement is attached as Exhibit "E", or is a separate Agreement.

D. Access to Contract Area and Information:

Each party shall have access to the Contract Area at all reasonable times, at its sole risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the information.

E. Abandonment of Wells:

1. Abandonment of Dry Holes: Except for any well drilled pursuant to Article VI.B.2., any well which has been drilled under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling of such well. Any party who objects to the plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and/or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well which has been drilled or reworked pursuant to Article VI.B.2. hereof for which the Consenting Parties have not been fully reimbursed as therein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of such well, all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one year and so long thereafter as oil and/or gas is produced from the interval or inter-

vals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentages of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interest in the remaining portion of the Contract Area.

Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned well.

ARTICLE VII.
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.

B. Liens and Payment Defaults:

Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share of oil and or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon at the rate provided in the Accounting Procedure attached hereto as Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the State, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's share of oil and or gas until the amount owed by such Non-Operator, plus interest has been paid. Each purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.

If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.

C. Payments and Accounting:

Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in the Accounting Procedure attached hereto as Exhibit "C". Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Limitation of Expenditures:

1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this Agreement, it being understood that the consent to the drilling or deepening shall include:

~~☐ Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and equipping of the well, including necessary tankage and or surface facilities.~~

☒ Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its authorized depth, and all tests have been completed, Operator shall give immediate notice to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion attempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, including necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less than all parties.

2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agreement, it being understood that the consent to the reworking or plugging back of a well shall include consent to all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage and/or surface facilities.

3. Other Operations: Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Twenty-Five Thousand and no/100--- Dollars ($ 25,000.00) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares "Authority for Expenditures" for its own use, Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project costing in excess of Twenty-Five Thousand and no/100------- Dollars ($ 25,000.00).

E. Royalties, Overriding Royalties and Other Payments:

Each party shall pay or deliver, or cause to be paid or delivered, all royalties to the extent of Lessor's royalty due on its share of production and shall hold the other parties free from any liability therefor. If the interest of any party in any oil and gas lease covered by this agreement is subject to any royalty, overriding royalty, production payment, or other charge over and above the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account for or cause to be accounted for, such interest to the owners thereof.

No party shall ever be responsible, on any price basis higher than the price received by such party, to any other party's lessor or royalty owner; and if any such other party's lessor or royalty owner should demand and receive settlements on a higher price basis, the party contributing such lease shall bear the royalty burden insofar as such higher price is concerned.

F. Rentals, Shut-in Well Payments and Minimum Royalties:

Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.2.

Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sunday and holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments-

of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

G. Taxes:

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. Operator shall bill other parties for their proportionate share of all tax payments in the manner provided in Exhibit "C".

If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final determination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint account, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as provided in Exhibit "C".

Each party shall pay or cause to be paid all production, severance, gathering and other taxes imposed upon or with respect to the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.

H. Insurance:

At all times while operations are conducted hereunder, Operator shall comply with the Workmen's Compensation Law of the State where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be an amount equivalent to the premium which would have been paid had such insurance been obtained. Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the Workmen's Compensation Law of the State where the operations are being conducted and to maintain such other insurance as Operator may require.

In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's fully owned automotive equipment.

ARTICLE VIII.
ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

A. Surrender of Leases:

The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole or in part unless all parties consent thereto.

However, should any party desire to surrender its interest in any lease or in any portion thereof, and other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not desiring to surrender it. If the interest of the assigning party includes an oil and gas interest, the assigning party shall execute and deliver to the party or parties not desiring to surrender an oil and gas lease covering such oil and gas interest for a term of one year and so long thereafter as oil and/or gas is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B". Upon such assignment, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the acreage assigned and the operation of any well thereon, and the assigning party shall have no further interest in the lease assigned and its equipment and production other than the royalties retained in any lease made under the terms of this Article. The parties assignee shall pay to the party assignor the reasonable salvage value of the latter's interest in any wells and equipment on the assigned acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. If the assignment is in favor of more than one party, the assigned interest shall

be shared by the parties assignee in the proportions that the interest of each bears to the interest of all parties assignee.

Any assignment or surrender made under this provision shall not reduce or change the assignor's or surrendering parties' interest, as it was immediately before the assignment, in the balance of the Contract Area; and the acreage assigned or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this agreement.

B. Renewal or Extension of Leases:

If any party secures a renewal of any oil and gas lease subject to this Agreement, all other parties shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area.

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this agreement.

The provisions in this Article shall apply also and in like manner to extensions of oil and gas leases.

C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash toward the drilling of a well or any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. If all parties hereto are Drilling Parties and accept such tender, such acreage shall become a part of the Contract Area and be governed by the provisions of this agreement. If less than all parties hereto are Drilling Parties and accept such tender, such acreage shall not become a part of the Contract Area. Each party shall promptly notify all other parties of all acreage or money contributions it may obtain in support of any well or any other operation on the Contract Area.

If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Subsequently Created Interest:

Notwithstanding the provisions of Article VIII.E. and VIII.G., if any party hereto shall, subsequent to execution of this agreement, create an overriding royalty, production payment, or net proceeds interest, which such interests are hereinafter referred to as "subsequently created interest", such subsequently created interest shall be specifically made subject to all of the terms and provisions of this agreement, as follows:

1. If non-consent operations are conducted pursuant to any provision of this agreement, and the party conducting such operations becomes entitled to receive the production attributable to the interest out of which the subsequently created interest is derived, such party shall receive same free and clear of such subsequently created interest. The party creating same shall bear and pay all such subsequently created interests and shall indemnify and hold the other parties hereto free and harmless from any and all liability resulting therefrom.

2. If the owner of the interest from which the subsequently created interest is derived (1) fails to pay, when due, its share of expenses chargeable hereunder, or (2) elects to abandon a well under provisions of Article VI.E. hereof, or (3) elects to surrender a lease under provisions of Article VIII.A. hereof, the subsequently created interest shall be chargeable with the pro rata portion of all expenses hereunder in the same manner as if such interest were a working interest. For purposes of collecting such chargeable expenses, the party or parties who receive assignments as a result of (2) or (3) above shall have the right to enforce all provisions of Article VII.B. hereof against such subsequently created interest.

E. Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or

2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the right of the other parties.

If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such party's interests within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds hereof.

F. Waiver of Right to Partition:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

G. Preferential Right to Purchase:

~~Should any party desire to sell all or any part of its interests under this agreement, or its rights and~~ interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent ~~company, or to any company in which any one party owns a majority of the stock.~~

ARTICLE IX.
INTERNAL REVENUE CODE ELECTION

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No

such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from Operations hereunder can be adequately determined without the computation of partnership taxable income.

ARTICLE X.
CLAIMS AND LAWSUITS

Operator may settle any single damage claim or suit arising from operations hereunder if the expenditure does not exceed Five Thousand and no/100---------- Dollars ($ 5,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, the party shall immediately notify Operator, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

ARTICLE XI.
FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure. The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

ARTICLE XII.
NOTICES

All notices authorized or required between the parties, and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by United States mail or Western Union telegram, postage or charges prepaid, or by teletype, and addressed to the party to whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed, and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid, or when sent by teletype. Each party shall have the right to change its address at any time, and from time to time, by giving written notice hereof to all other parties.

ARTICLE XIII.
TERM OF AGREEMENT

This agreement shall remain in full force and effect as to the oil and gas leases and/or oil and gas interests subjected hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any lease, or oil and gas interest contributed by any other party beyond the term of this agreement.

X Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of 90 days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling or reworking a well or wells hereunder, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and or gas from the Contract Area, this agreement shall terminate unless drilling or reworking operations are commenced within 60 days from the date of abandonment of said well.

It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

ARTICLE XIV.
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the conservation laws of the state in which the committed acreage is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and orders.

B. Governing Law:

The essential validity of this agreement and all matters pertaining thereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state where most of the land in the Contract Area is located shall govern.

ARTICLE XV.
OTHER PROVISIONS

SALE OF ROYALTY GAS

It is recognized by the parties hereto that in addition to each party's share of working interest production, such party shall have the right, subject to existing contracts, to market the royalty gas attributable to each lease which it contributes to the unit area and to receive payments due for such royalty gas produced from or allocated to such lease or leases. It is agreed that, regardless of whether each party markets or contracts for its share of gas, including the royalty gas under the leases which it contributed to the Unit, such party agrees to pay or cause to be paid to the royalty owners under its lease or leases the proceeds attributable to their respective royalty interest and to hold all other parties hereto harmless for its failure to do so.

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of 8th day of April, 19 80.

OPERATOR

SOUTHLAND ROYALTY COMPANY

_____

By: C. E. Mear
For: Kitt
Attorney-in-Fact

NON-OPERATORS

DEPCO, INC.

ATTEST:

_____

By: _____

CITIES SERVICE COMPANY

ATTEST:

_____

By: _____

BASSETT-BIRNEY

ATTEST:

_____ Secretary

By: F. Yates
Frank Yates, Attorney-In-Fact for
Martin Yates, III, Vice President

Form 3106-5
(March 1980)

UNITED STATES
DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT

ASSIGNMENT AFFECTING RECORD TITLE
TO OIL AND GAS LEASE

FORM APPROVED
OMB NO. 42-R1599

Lease Serial No.
LC 062029

Lease effective date
May 1, 1942

FOR BLM OFFICE USE ONLY

New Serial No.

PART I

1. Assignee's Name

Bassett-Birney Oil Corporation

Address *(include zip code)*
207 South 4th Street
Artesia, New Mexico 88210

The undersigned, as owner of 50 percent of the record title of the above-designated oil and gas lease, hereby transfers and assigns to the assignee shown above, the record title interest in and to such lease as specified below.

2. Describe the lands affected by this assignment (43 CFR 3101.2-3)

Township 18 South, Range 29 East, N.M.P.M.

Section 33: Lot 3 ($SE\frac{1}{4}SW\frac{1}{4}$), $N\frac{1}{2}SE\frac{1}{4}$
Section 34: Lot 1 ($SE\frac{1}{4}SE\frac{1}{4}$), Lot 2 ($SW\frac{1}{4}SE\frac{1}{4}$),
Lot 4 ($SW\frac{1}{4}SW\frac{1}{4}$), $NW\frac{1}{4}SW\frac{1}{4}$
Section 35: Lot 2 ($SW\frac{1}{4}SE\frac{1}{4}$), $NW\frac{1}{4}SE\frac{1}{4}$, $NW\frac{1}{4}SW\frac{1}{4}$,
$NW\frac{1}{4}$

containing 544.16 acres, more or less.

3. Specify interest or percent of assignor's record title interest being conveyed to assignee	All, be 50% int
4. Specify interest or percent of record title interest being retained by assignor, if any	None
5. Specify overriding royalty being reserved by assignor	None in Assignm
6. Specify overriding royalty previously reserved or conveyed, if any	Exhibit "A" attached shows ove riding royalties, operating ag ments and production payments heretofore reserved or conveyed
7. If any payments out of production have previously been created out of this lease, or if any such payments are retained reserved under this assignment, attach statement giving full details as to amount, method of payment, and other pertinent terms as provided under 43 CFR 3106.	See Exhibit "A" attached.

It is agreed that the obligation to pay any overriding royalties or payments out of production of oil created herein which, when added to overriding royalties or payments out of production previously created and to the royalty payable to the United States, aggregate in excess of 17½ percent, shall be suspended when the average production of oil per well per day averaged on the monthly basis is 15 barrels or less.

I CERTIFY That the statements made herein are true, complete, and correct to the best of my knowledge and belief and are made in good faith.

Executed this 6th day of June, 19 80
ROBERT E. McKEE GENERAL CONTRACTOR, INC.

By: _____ President P. O. Box 20562
(Assignor's Signature) (Assignor's Address)

ATTEST: _____
Secretary

El Paso, Texas 79998
(City) (State) (Zip Code)

STATE OF TEXAS)
: ss.
COUNTY OF EL PASO)

The foregoing instrument was acknowledged before me this 6th day of June, 1980, by C. D. McKee President of Robert E. McKee General Contractor, Inc., a Nevada corporation, on behalf of said corporation.

My commission expires:
28 September 1983

_____
Notary Public

EXHIBIT "A"

1. 5% overriding royalty on NW/4 SW/4 Section 35, reserved in an assignment dated January 24, 1943, recorded Book 22, Page 171, from Neil B. Watson et ux to Robert E. McKee and C. N. Bassett.

2. 2-1/2% overriding royalty on E/2 NW/4 Section 35, reserved in an assignment dated May 8, 1943, recorded Book 21, Page 283, from C. Melvin Neal et ux to Paul Love.

3. 2% overriding royalty on, among other lands, Lot 3 (SE/4 SW/4) Section 33, Lot 1 (SE/4 SE/4), Lot 4 (SW/4 SW/4), NW/4 SW/4 Section 34, Lot 2 (SW/4 SE/4), NW/4 SE/4 Section 35, reserved in an assignment dated May 28, 1943, recorded Book 21, Page 329, from Martha Featheratone et vir to Robert E. McKee and C. N. Bassett.

4. 2% overriding royalty on, among other lands, N/2 SE/4 Section 33, reserved in an assignment dated June 5, 1943, recorded Book 21, Page 330, from Julia Brainard et vir to Robert E. McKee and C. N. Bassett.

5. 2% overriding royalty on, among other lands, Lot 2 (SW/4 SE/4) Section 34, and N/2 NW/4 Section 35, reserved in an assignment dated October 22, 1943, recorded Book 22, Page 94, from Julia Brainard et vir to Robert E. McKee.

6. Operating rights from surface to base of the Queen formation underlying, among other lands, Lot 2 (SW/4 SE/4), NW/4 SW/4 Section 34, conveyed by assignment dated November 1, 1959, recorded Book 109, Page 274, from Robert E. McKee General Contractor, Inc. to Stanton Oil, Ltd.

7. Operating rights from surface to 2,373 feet, underlying Lot 4 (SW/4 SW/4) Section 34, conveyed by assignment dated August 19, 1964, unrecorded but approved October 7, 1964, from Robert E. McKee General Contractor, Inc. to Stanton Oil, Ltd.

8. Operating rights, without depth limitation, underlying Lot 2 (SW/4 SE/4), N/2 NW/4 Section 35, conveyed by assignment dated March 9, 1960, recorded Book 106, Page 463, from Robert E. McKee General Contractor, Inc. and Bassett-Birney Oil Corporation to Leonard Oil Company.

9. A production payment of $750 per acre, payable out of 1/16th of 7/8ths, but reduced by 1/2 of the then existing overriding royalty burdens from the lands described in 8 above, created by production payment agreement dated March 9, 1960, recorded Book 106, Page 399, from Leonard Oil Company to Robert E. McKee General Contractor, Inc., and presently owned by and reserved to Robert E. McKee General Contractor, Inc.

September 4, 1980

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis, Landman

Re: Proposed Southland Royalty Company Empire
Federal "35" Com. No. 1 and "35-A" Com. No. 1
Wells, W/2 and E/2 Sec. 35, T-18-S, R-29-E,
Eddy County, New Mexico

Gentlemen:

This acknowledges receipt of your letters of July 8 and July 25, 1980, together with joint operating agreements and AFEs covering the proposed drilling of the subject wells.

The joint operating agreement dated July 8 covering W/2 Section 35 and the AFE for your No. "35" Com. No. 1, credits our company with a 19.026479% (60/315.35) interest, when in fact we own a 38.052957% (120/315.35) interest. The joint operating agreement dated July 17, 1980 covering E/2 Section 35 and the AFE for your No. "35-A" Com. No. 1, credits our company with a 6.3199% (20/316.46) interest, when in fact we own a 12.6398% (40/316.46) interest. Southland Royalty has instituted a suit against, among other parties, Bassett-Birney Oil Corporation, in the United States District Court for the District of New Mexico, Case No. CIV-80-0614 HB, contesting a portion of our title to the working interest underlying the proposed wells. In view of the incorrect statements in your operating agreements and AFEs as to our ownership in the proposed wells and the pending lawsuit, we are unable to approve either the AFEs or joint operating agreements.

Bassett-Birney is willing to pool its interests in the W/2 of Section 35 and in the E/2 of Section 35 for the drilling of the "35" Com. No. 1 Well and the "35-A" Com. No. 1 Well.

Case Nos. 7024 and 7025
N.M. Oil Conservation Div.
Examiner Hearing of 9/17/80
Bassett-Birney Oil Corp.
Exhibit No. 1

September 4, 1980

If you have any questions, please do not hesitate to call me.

Very truly yours,

BASSETT-BIRNEY OIL CORPORATION

By: Jack W. McCaw

Jack W. McCaw,
Vice President

COPY

FILED
UNITED STATES DISTRICT COURT
SANTA FE, NEW MEXICO

JUL 23 1980

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEW MEXICO

BY _____ DEP. CLK

SOUTHLAND ROYALTY COMPANY,

Plaintiff,

vs.

CIV 80-0514 HB
No.

ROBERT E. McKEE, INC.,
BASSETT-BIRNEY OIL CORPORATION
and the UNITED STATES DEPARTMENT OF THE INTERIOR, BUREAU OF LAND MANAGEMENT,

Defendants.

COMPLAINT

COMES NOW the Plaintiff, SOUTHLAND ROYALTY COMPANY, by and through its attorneys, and for its Complaint against Defendants states:

The Parties - Jurisdiction - Venue

1. Plaintiff, Southland Royalty Company ("Southland") is a corporation, incorporated by the State of Delaware, having its principal place of business in the State of Texas.

2. Defendant Robert E. McKee, Inc., ("McKee") is a corporation, incorporated by the State of Nevada, having, upon information and belief, its principal place of business in the State of California.

3. Defendant Bassett-Birney Oil Corporation ("Bassett-Birney") is a corporation, incorporated by the State of New Mexico, having its principal place of business in the State of New Mexico.

4. Defendant United States Department of the Interior, Bureau of Land Management, is charged by statute with the administration and supervision of federal oil and gas leases and is the lessor of certain oil and gas properties as more particularly alleged herein.

Case Nos. 7024 and 7025
N.M. Oil Conservation Div.
Examiner Hearing of 9/17/80
Bassett-Birney Oil Corp.
Exhibit No. 2

5. This is a suit to adjudicate a disputed title to real estate in which the United States claims an interest and the Court has jurisdiction over the subject matter herein by reason of 28 U.S.C. 1346 (f) and 28 U.S.C. 2409 (a).

6. Venue in the District of New Mexico is proper by reason of 28 U.S.C. 1402 (d).

General Allegations

7. The real estate to which title is disputed is certain acreage specified in Federal Oil and Gas Lease No. LC-062029, dated May 1, 1942, more particularly described as follows:

Township 18 South, Range 29 East, Eddy County, New Mexico:

(a) Section 33 - N1/2 SE1/4
- SE1/4 SW1/4

(b) Section 34 - Lots 1 and 2 (S1/2 SE1/4) and 4 (SW1/4 SW1/4)
- NW1/4 SW1/4

(c) Section 35 - NW1/4 SW1/4
- S1/2 NW1/4
- NW1/4 SE1/4

hereinafter referred to as the "Disputed Acreage."

8. In late 1979, Southland initiated a program to drill and to develop an oil and gas well on a 320 acre proration unit in the eastern half (E1/2) of Section 34, T18S, R29E, Eddy County, New Mexico, hereinafter referred to as "The Tract." Ownership of oil and gas interests in The Tract was divided in varying proportions among several individuals and entities, and included a portion of the Disputed Acreage.

9. In order to develop an oil and gas tract, the ownership of which is divided among several individuals and entities, appropriate parties contract and agree among themselves regarding relevant rights, duties, and obligations, with respect to the tract. Two of the most common forms of such agreement are a) a Farmout Agreement, and b) an Operating Agreement:

a) Farmout Agreement - In the usual and customary practice of the oil and gas industry, a Farmout Agreement is a contract between operators whereby the owner of a lease not desirous of drilling at the time agrees to assign the lease to another operator who is desirous of drilling the tract. The primary characteristic of a farmout is the obligation of the assignee to drill a well on the assigned acreage as a prerequisite to the formal assignment of interests. In exchange for the assignment of interests, the assignor is usually granted an overriding royalty interest in production from the tract.

b) Operating Agreement - In the usual and customary practice of the oil and gas industry, an Operating Agreement is a contract between owners of leases in a tract who are desirous of drilling a well. The owners agree to name an Operator to drill the well, designate their specific acreage interest in the tract, and agree to divide costs in the well and interest in production.

10. In late 1979, Southland conducted a title search to determine ownership of oil and gas interest in the Tract. Such title search revealed that McKee and Bassett-Birney each possessed a one-half (1/2) working interest in Lots 1 and 2 (S1/2 SE1/4) of the Tract and that McKee and Bassett-Birney each possessed a one-half (1/2) working interest in the remainder of the Disputed Acreage.

11. By letter dated September 27, 1979, Southland informed McKee that the title seach revealed McKee's one-half (1/2)

working interest in Lots 1 and 2 (S1/2 SE1/4) of the Tract and one-half (1/2) working interest in the remainder of the Disputed Acreage and requested McKee to execute a Farmout of the Disputed Acreage in favor of Southland, such letter is attached hereto and incorporated herein as Exhibit "A."

12. On October 15, 1979, McKee formally executed a Farmout Agreement of the Disputed Acreage in favor of Southland, such Farmout Agreement is attached hereto and incorporated herein as Exhibit "B."

13. Under the terms of the Farmout Agreement, McKee promised to assign to Southland its one-half (1/2) working interest in the Disputed Acreage in the event Southland, at its sole risk and expense, was successful in drilling a natural gas well. In exchange for such assignment, McKee was granted a 1/16 of 8/8 overriding royalty interest in production from the Disputed Acreage with the option to convert to a 50% working interest at payout.

14. By executing the Farmout Agreement, McKee acknowledged and represented that it possessed a one-half (1/2) working interest in Lots 1 and 2 of the Tract and one-half (1/2) working interest in the remainder of the Disputed Acreage.

15. By letter dated February 26, 1980, Southland informed Bassett-Birney that the title search revealed Bassett-Birney's one-half (1/2) working interest in Lots 1 and 2 (S1/2 SE1/4) of the Tract and one-half (1/2) working interest in the remainder of the Disputed Acreage and requested Bassett-Birney to execute either a Farmout of the Disputed Acreage in favor of Southland or an Operating Agreement for the Tract, such letter is attached hereto and incorported herein as Exhibit "C."

16. By letter dated March 21, 1980, Southland again informed Bassett-Birney that the title seach revealed

Bassett-Birney's one-half (1/2) working interest in Lots 1 and (S1/2 SE1/4) of the Tract and again requested Basset-Birney to execute either a Farmout of Lots 1 and 2 of the Tract or an Operating Agreement for the Tract, such letter is attached here and incorporated herein as Exhibit "D."

17. By letter dated April 8, 1980, and pursuant to a request by Bassett-Birney, Southland forwarded to Bassett-Birney a xerox copy of the formal Title Opinion on the Disputed Acreage, such letter and Title Opinion are attached hereto and incorporated herein as Exhibit "E."

18. By letter dated April 22, 1980, and after complete review of the Title Opinion showing as its only ownership a one-half (1/2) working interest in the Disputed Acreage, Bassett-Birney executed an Authorization for Expenditure (AFE) and an Operating Agreement for the Tract, which letter, AFE and Operating Agreement are attached hereto and incorporated herein as Exhibit "F," "F(1)," and "F(2)," respectively.

19. Under the terms of the Operating Agreement, Bassett-Birney agreed that Southland would drill and operate an 11,000 foot Morrow natural gas well on the Tract.

20. By executing the AFE after complete review of the Title Opinion, Bassett-Birney acknowledged and represented that it possessed only a one-half (1/2) working interest in Lots 1 and 2 of the Tract and only a one-half (1/2) working interest in the remainder of the Disputed Acreage.

21. By executing the Operating Agreement after complete review of the Title Opinion, Bassett-Birney acknowledged and represented that it possessed only a one-half (1/2) working interest in Lots 1 and 2 of the Tract and only a one-half (1/2) working interest in the remainder of the Disputed Acreage.

22. At 10:00 a.m. on May 11, 1980, on the basis of and in reliance on the Title Opinion concerning the Disputed Acreage, the execution of the Farmout Agreement by McKee, and the execution of the AFE and Operating Agreement by Bassett-Birney, Southland initiated the drilling of a natural gas well on the Tract. The natural gas well, desginated as the Southland Royalty Company Federal Comm. "34" #1 Well, has been completed as a commercial producing gas well on the Tract.

23. On May 23, 1980, after Southland initiated drilling on the Tract, Bassett-Birney informed Southland that Bassett-Birney claimed an ownership interest in the Tract and the remainder of Disputed Acreage in an amount greater that its ownership interest as specified in the Title Opinion, the Farmout Agreement with McKee and the AFE and Operating Agreement with Bassett-Birney.

24. On the basis of an unrecorded Operating Agreement between Bassett-Birney and McKee, Bassett-Birney claims ownership of one-hundred percent (100%) of the working interest in Lots 1 and 2 of the Tract and one-hundred percent (100%) of the working interest in the remainder of the Disputed Acreage, such Operating Agreement as was supplied to Southland by Bassett-Birney is attached hereto and incorporated herein as "Exhibit G."

25. On June 6, 1980, on demand by Bassett-Birney, McKee executed an Assignment to Bassett-Birney of fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and fifty percent (50%) of the working interest in the remainder of the Disputed Acreage, such Assignment is attached hereto and incorporated herein as "Exhibit H."

FIRST CAUSE OF ACTION

26. Southland adopts and incorporates herein by reference the allegations contained in Paragraphs 1 through 25.

27. On the basis of the Farmout Agreement with McKee, Southland owns a fifty percent (50%) working interest in Lots 1

and 2 of the Tract and a fifty percent (50%) working interest in the remainder of the Disputed Acreage.

28. Bassett-Birney's claim that it owns one-hundred percent (100%) of the working interest in Lots 1 and 2 of the Tract and one-hundred percent (100%) working interest in the remainder of the Disputed Acreage is adverse to Southland and Bassett-Birney owns only fifty percent (50%) of such working interest.

29. Bassett-Birney's adverse claim is based on an Operating Agreement ("Exhibit G"), which is invalid and unenforceable on grounds of laches, waiver, and estoppel.

30. The Assignment from McKee to Bassett-Birney ("Exhibit H") constitutes a cloud on Southland's title to fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and fifty percent (50%) of the working interest in the remainder of the Disputed Acreage.

WHEREFORE, Southland requests judgment against McKee and Bassett-Birney as follows:

A. Declaring that the Operating Agreement ("Exhibit G") between McKee and Bassett-Birney is invalid and unenforceable on grounds of laches, waiver and estoppel;

B. Cancelling the Assignment ("Exhibit H") from McKee to Bassett-Birney;

C. Quieting title in fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and fifty percent (50%) of the working interest in the remainder of the Disputed Acreage in Southland and against McKee and Bassett-Birney; and

D. For such other relief as the Court deems just and proper.

SECOND CAUSE OF ACTION

31. Southland adopts and incorporates herein by reference the allegations contained in Paragraphs 1 through 28.

32. The Operating Agreement ("Exhibit G") under which Bassett-Birney claims an interest adverse to Southland's was not recorded as required by law and was not in the record chain of title of the Disputed Acreage.

33. With respect to fifty percent (50%) of the working interest in the Disputed Acreage, Southland is a good-faith, innocent purchaser for value without notice or knowledge of the adverse claim by Bassett-Birney.

WHEREFORE, Southland requests judgment against McKee and Bassett-Birney as follows:

A. Declaring that with respect to the Disputed Acreage, Southland is an innocent purchaser for value without notice or knowledge of the adverse claim by Bassett-Birney.

B. Cancelling the Assignment ("Exhibit H") from McKee to Bassett-Birney.

C. Quieting title in fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and 50% of the working interest in the remainder of the Disputed Acreage in Southland and against Mckee and Bassett-Birney; and

D. For such other relief as ther Court deems just and proper.

THIRD CAUSE OF ACTION

34. Southland adopts and incorporates by reference herein the allegations contained in Paragraphs 1 through 28.

35. At the time McKee executed the Farmout Agreement and at the time Bassett-Birney executed the Operating Agreement, McKee and Bassett-Birney knew or reasonably should have known of the existence and terms of the Operating Agreement ("Exhibit H") under which the parties claim an interest in the Disputed Acreage adverse to Southland.

36. At the time McKee executed the Farmout Agreement and at the time Bassett-Birney executed the Operating Agreement, the

parties made no claims to an interest in the Disputed Acreage adverse to Southland.

37. By executing the Farmout Agreement and Operating Agreement, McKee and Bassett-Birney waived any claims to an interest in the Disputed Acreage adverse to Southland and are now barred by estoppel from asserting such claims.

WHEREFORE, Southland requests judgment against McKee and Bassett-Birney as follows:

A. Declaring that with respect to the Disputed Acreage, McKee and Bassett-Birney have waived any claims to an interest in the Disputed Acreage adverse to Southland and are now estopped from asserting such claims; and

B. Cancelling the Assignment ("Exhibit H") from McKee to Bassett-Birney.

C. Quieting title in fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and 50% of the working interest in the remainder of the Disputed Acreage in Southland and against Mckee and Bassett-Birney; and

D. For such other relief as the Court deems just and proper.

FOURTH CAUSE OF ACTION

38. Southland adopts and incorporates by reference herein the allegations contained in Paragraphs 1 through 25.

39. Under the terms and conditions of the Farmout Agreement between Southland and McKee, McKee promised to assign to Southland its one-half (1/2) working interest in the Disputed Acreage upon Southland's drilling and completion of a well capable of producing gas in paying quantities.

40. By drilling and completing the Federal Comm. "34" #1 Well, Southland has performed its drilling obligations under the

Farmout Agreement with McKee and has performed and is in compliance with all other terms and conditions of the Farmout Agreement.

41. Pursuant to the terms and conditions of the Farmout Agreement, Southland has made demand on McKee for an assignment of its one-half (1/2) working interest in the Disputed Acreage, but McKee has refused to tender such assignment and McKee has instead unlawfully and without authority assigned such interests to Bassett-Birney.

42. The actions of McKee in refusing to assign to Southland its one-half (1/2) working interest in the Disputed Acreage and instead assigning such interests to Bassett-Birney constitutes a breach of the Farmout Agreement between Southland and McKee.

43. As a direct and proximate result of McKee's breach of the terms and conditions of the Farmout Agreement, Southland has suffered damages in an amount as yet unascertainable, but in no event less than $10,000.

WHEREFORE, Southland requests judgment against McKee as follows:

A. Declaring that McKee has breached the Farmout Agreement with Southland.

B. Awarding Southland actual damages incurred as a result of McKee's breach of the Farmout Agreement.

C. For such other relief as the Court deems just and proper.

Respectfully submitted,

CAMPBELL & BLACK, P.A.

By _____
Michael B. Campbell
Attorney for Plaintiff, Southland Royalty Company
Post Office Box 2208
Santa Fe, NM 87501
Telephone: (505) 988-4421

Southland Royalty Company

September 27, 1979

Robert E. McKee Co.
P. O. Box 20562
El Paso, Texas 79998

Attention: Mr. Jerry Watkins

Re: Portions of T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

Gentlemen:

SRC is presently attempting to secure support from the leasehold owners under portions of T18S, R29E, Eddy County, New Mexico. With adequate support SRC plans to drill a Morrow test well at a legal offset location to your leasehold.

Due to the diverse ownership in this area, a successful attempt to explore a deep formation like the Morrow will require the cooperation of numerous parties. Before SRC can attempt such a risky venture, we must acquire a substantial amount of support through option farmouts, allowing SRC the opportunity to earn additional acreage through drilling and producing.

A check of the records indicates that Robert E. McKee Co. owns a leasehold under the following tract(s) of land:

SECTION	W.I.	GROSS ACRES	NET ACRES
Sec. 33: N/2SE/4, SE/4SW/4	50%	120	60
Sec. 34: Lots 1,2,4 & NW/4SW/4	50%	160	60
Sec. 35: Lot 2, NW/4, NW/4SW/4, NW/2SE/4	50%	280	140
	Total:	560	280

Upon verfication that our information on your ownership is correct, SRC requests your support by granting a Farmout of your leasehold interest under the following general terms:

1. Ninety days from the completion of an offset well, Southland will commence a well at a legal location on your leasehold in Section 33, 34, or 35, or on land unitized herewith.
2. Upon completion of a well capable of producing oil and/or gas in commercial quantities Robert E. McKee will assign 100% of its leasehold interest to SRC, subject to a 1/16 of 8/8 overriding royalty interest with an option

EXHIBIT A

to convert said interest to a 50% working interest at payout, both proportionately reduced, in the proration unit drilled. Also, SRC will have the option to drill on the balance of your acreage in Section 33, 34, and 35, under a 90 day continuous development provision, with a clause providing for a depth severance of 100' below the deepest producing interval on proration unit basis, as well as the ipso facto termination of any undeveloped proration units not drilled under the continuous development provision.

3. Upon completion or abandonment of an offset well, Southland will have a 120 day option to commence a subsequent well in the drilled proration unit.

Upon receiving approval for this proposal, Southland will be happy to prepare a Farmout Agreement containing the above provisions.

Should you have any questions regarding the above, please do not hesitate contacting me at (915) 682-8641, Ext. 27. Your earliest attention concerning this proposal will be greatly appreciated.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:lh

FARMOUT AGREEMENT F/O 382

Date: October 9, 1979

Robert E. McKee Co.
P. O. Box 20562
El Paso, Texas 79998

Attention: Bob Hazelton

Re: Farmout Agreement
Portions of T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

This letter when accepted by you as "Farmor", shall evidence Southland Royalty Company's, hereinafter called "SRC", right to earn from Robert E. McKee Co., hereinafter called "McKee", an assignment of an interest in the leases described in Exhibit "A" attached hereto, hereinafter called "said leases", upon SRC fulfilling the requirements, conditions, and obligations contained herein.

I. DRILLING REQUIREMENTS: The drilling and completion requirements FARMOUTEE must satisfy, as a condition for earning, are as follows:

TEST WELL: A. This agreement shall terminate unless on or before ninety (90) days from the date hereof, FARMOUTEE shall commence, at FARMOUTEE's sole cost, risk and expense, the actual drilling of a well, hereafter called "Test Well", at a location in the S/2 of Section 27, T18S, R29E, Eddy County, New Mexico.

Once timely commenced, Test Well shall be drilled with due diligence to the "Objective Depth" described as 11,500 feet or a depth sufficient to test the Morrow formation, XXXXXXXXXXXXXXXXXXXX (as to all of which drilling and testing the decision of McKee shall be conclusive) and shall thereafter be completed as a well capable of producing oil and/or gas in paying quantities or shall be plugged and abandoned as a dry hole.

B. By timely commencing and drilling Test Well to the Objective Depth and completing same as a well capable of producing oil and/or gas in paying quantities, FARMOUTEE shall not earn the assignment provided for below.

C. If Test Well is completed as a dry hole, FARMOUTEE shall not earn the assignment provided for below.

SUCCESSIVE WELL: (Applicable only if FARMOUTEE has not earned said assignment by the drilling of the Test Well).

CONTINUOUS DEVELOPMENT: A. If the Successive Well is timely commenced and drilled to the Objective Depth and is capable of producing oil and/or gas in paying quantities, SRC thereby earns an assignment of McKee's interest in the acreage as it appears in Exhibit "A" attached hereto. SRC shall be required to continuously develop "said leases" to the extent of one gas well to 320 acres, one oil well to 80 acres, or as prescribed by the New Mexico Oil Conservation Commission. SRC shall have 120 days from completion or abandonment to commence operations on each subsequent well. If not sooner terminated by the provisions contained herein, Farmee's right to earn additional acreage hereunder shall ipso facto terminate in the absence of drilling in compliance with the continuous drilling obligation above and each proration unit upon which there is not located a well capable of producing oil and/or gas in paying quantities shall be reassigned to Farmor.

II. GEOLOGICAL INFORMATION, NOTICES, AND REPORTS: FARMOUTEE agrees to furnish to McKee the notices and reports provided for in Exhibit "B" attached hereto and to conduct the tests and surveys provided for therein. McKee shall be afforded an opportunity to witness such tests and surveys and the results thereof. (Please attach your requirements).

III. ADDITIONAL COVENANTS, CONDITIONS, AND OBLIGATIONS: FARMOUTEE agrees to comply with the additional covenants, conditions, and obligations provided for in Exhibit "C" attached hereto and shall reimburse McKee upon billing by McKee for 100% of the delay rentals paid in accordance with Paragraph 9 thereof. FARMOUTEE is not obligated to drill any well hereunder, however, FARMOUTEE shall comply with all of

EXHIBIT B

the obligations of this agreement that accrue during the period FARMOUTEE has the right to earn and all obligations arising from, related to, or based upon the drilling operations which FARMOUTEE conducts hereunder.

IV. ASSIGNMENT: In the event that Test Well or Successive Well (if Successive Well is provided for) is drilled to the Objective Depth and is completed with the results required herein for earning an assignment, hereafter called "Earning Well", and FARMOUTEE has otherwise complied with the requirements, conditions, and obligations hereof, McKee shall assign to FARMOUTEE, in the form attached hereto as Exhibit "D", 100% of McKee's interest in said leases described in Exhibit "A", reserving to McKee 1/16 of 8/8 overriding royalty interest with the option to convert to a 50% working interest at payout. Such assignment shall be effective as of the date hereof; shall be limited to oil and gas rights under said leases; shall provide for continuous development, and shall be limited in depth to 100 feet below the deepest depth drilled.

V. OTHER PROVISIONS: A. If not sooner terminated by other provisions hereof, this Agreement and FARMOUTEE's right to earn said assignment shall terminate at such time as FARMOUTEE fails to earn said assignment under either paragraph B or C of the Drilling requirements for Test Well or Successive Well (if Successive Well is provided for).

B. If the assignment earned by FARMOUTEE covers less than all of McKee's interest in said leases and McKee retains a working interest therein, the form of the Operating Agreement to be entered into by the parties covering operation of said leases or any part thereof in which McKee and FARMOUTEE concurrently own an undivided interest, is attached hereto as Exhibit "E", and said Operating Agreement shall be effective with said assighment. A Special Agreement relating to revenue from the Earning Well is attached to said Operating Agreement as Exhibit "E".

C. If any of said leases is a federal lease, the parties hereto agree to comply with the provisions of Exhibit "F" attached hereto. Reference to contractor therein means any and all parties performing work under this agreement.

If this letter correctly sets forth your understanding of our agreement, please signify your acceptance in the space provided below and return two (2) executed copies to SRC at 1100 Wall Towers West, Midland, Texas, 79701, within fifteen (15) days from the date hereof.

Yours very truly,

SOUTHLAND ROYALTY COMPANY DLB

By C. E. Mear
Asst. Div.
Attorney-In-Fact

AGREED TO AND ACCEPTED this 15th day of October, 1979.

By: C. D. McKee
C. D. McKee, President

For: Robert E. McKee, Inc.

EXHIBIT "A"

To Farmout Agreement dated October 9, 1979, between Robert E. McKee Co. as Farmor and Southland Royalty Company as Farmoutee.

LANDS SUBJECT TO THIS AGREEMENT:

N½SE¼; SE¼SW¼ of Section 33, Township 18 South, Range 29 East, Eddy County, New Mexico (below the San Andres formation).

Lots 1, 2, 4; NW¼SW¼ of Section 34, Township 18 South, Range 29 East, Eddy County, New Mexico (below the San Andres formation).

Lot 2; NW¼; NW¼SW¼; W/½SE¼ of Section 35, Township 18 South, Range 29 East, Eddy County, New Mexico (below the San Andres formation).

EXHIBIT "B"

Attached to and made a part of Farmout Agreement dated October 9, 1979, between Southland Royalty Company, and Robert E. McKee Co.

GEOLOGICAL REQUIREMENTS AND NOTICES:

EXHIBIT "C"

Attached to and made a part of Farmout Agreement dated October 9, 1979, by and between Southland Royalty Company and Robert E. McKee Co.

THERE IS NO EXHIBIT "C"

Southland Royalty Company

February 26, 1980

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: Farmout Request
Portions of Sections 33, 34 & 35
T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

Gentlemen:

Reference is made to your leasehold located in the above subject tracts. Southland Royalty Company is presently attempting to secure support from the leasehold owners under these sections for the drilling of several Morrow wells.

A check of the records indicates that Bassett & Birney Oil Corporation owns a 50% working interest in a lease covering the deep rights in the following tracts of land:

Section	W.I.	Gross Acres	Net Acres
Section 33: N½SE¼, SE¼SW¼	50%	120	60
Section 34: Lots 1, 2, 4 & NW¼SW¼	50%	160	80
Section 35: Lot 2, NW¼ NW¼SW¼, NW¼SE¼	50%	280	140
Totals		560	280

Southland requests your support for the project by granting of a Farmout of your acreage under the following general terms:

1. Bassett-Birney deliver its leasehold interest in the E½ of Section 34 to Southland Royalty Company for the drilling of a Morrow well. Southland Royalty Company will have a period of ninety (90) days in which to commence drilling this well. Upon obtaining production from this well, Southland Royalty Company will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled. The remainder of Bassett-Birney's leasehold in Sections 33, 34 and 35,

EXHIBIT C

out side the drilled proration unit will fall under a 120-day continuous development program.

2. Under the terms of this Agreement; Bassett & Birney will retain a 1/16th of 8/8ths ORRI convertible to a 50% working interest at payout on the initial well.

Upon receiving approval for this proposal, Southland will be happy to prepare a Farmout Agreement containing the above provisions. If instead, you choose to join in this well, an AFE and Joint Operating Agreement will be forwarded to you at once.

If there are any questions concerning the above, please do not hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don W. Davis
Landman

DWD:am

Southland Royalty Company

March 21, 1980

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Empire Federal "34" 47

Attention: Mr. Randy Patterson

Re: SRC-Empire Federal Comm. 34 #1
1980' FNL & 1980' FEL, Section 34,
T-18-S, R29-E,
Eddy County, New Mexico
Empire, South Prospect #1873
F/O 382, F/O 399

Gentlemen:

Reference is made to the proposed well and to a Farmout request mailed to Bassett & Birney Oil Corporation dated February 26, 1980. In this letter, Southland Royalty Company requested a Farmout of your acreage in Sections 33, 34 and 35.

Southland Royalty Company is now prepared to drill a Morrow well in the E½ of Section 34, and by this letter, requests your support for the well.

A check of the records indicates that Bassett & Birney Oil Company owns a 50% working interest in a lease covering the deep rights in the S½SE½ (Lots 1 and 2) of Section 34. Southland requests a Farmout of your acreage under the following general terms:

1. Bassett & Birney deliver its leasehold interest in the E½ of Section 34 for the drilling of the SRC-Empire Federal Comm. 34 #1 well. Southland will have a ninety (90) day period in which to commence the drilling of this well. Upon obtaining production from this well, Southland will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled.

2. Under the terms of this agreement, Bassett & Birney will retain a 1/16th of 8/8ths ORRI convertible to a 50% working interest at payout, proportionately reduced.

Upon receiving approval for this proposal, Southland Royalty Company will be happy to prepare a Farmout Agreement containing the above provisions.

If instead, Bassett & Birney Oil Company chooses to join in this well, upon approval, please execute the three (3) enclosed AFEs, returning two (2) originals to Southland Royalty Company's Midland office, while retaining one (1) original for your files. At such time as we have received the signed AFEs, a Joint Operating Agreement and Communitization Agreement will be forwarded for your approval.

If there are any questions concerning the above, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am
Enclosures

April 8, 1980

Bassett-Birney Oil Corporation
207 South Fourth Street
Artesia, New Mexico 88210

Attention: Jack McCall

Re: SRC Empire Fed. Comm. "34" #1
1980' FNL & 1980' FEL,
Section 34, T18S, R29E
Eddy County, New Mexico
Empire South Prospect #1873
F/O 382; F/O 399

Gentlemen:

Reference is made to our telephone conversation of even date concerning the subject well. Enclosed are the following:

1. Complete set of logs for the SRC Empire Fed. Comm. #1 well.

2. Xerox copy of an original Title Opinion by Stubbeman, McRae, Sealy, Laughlin & Browder dated February 21, 1980.

3. Operating Agreement for the proposed SRC Empire Fed. Comm. "34" #1, along with two extra signature pages.

I hope this information will aid you in making your decision to either join or farmout in the subject well. If you choose to join, please have the appropriate company officer execute the signature pages to the Operating Agreement, returning the two extra signature pages to our Midland office, along with two original signed AFE's which were mailed to you earlier. If instead, you choose to farmout, a Farmout Agreement will be prepared to cover your interest.

As time is of the essence in this matter, your immediate attention will be greatly appreciated. If you have any questions, or any further information is needed, please don't hesitate calling.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:lh

EXHIBIT E

STUBBEMAN, McRAE, SEALY, LAUGHLIN & BROWDER
ATTORNEYS AT LAW

FRANK STUBBEMAN (1906-1974)
HAMILTON E. McRAE
JOHN SEALY
FOYD LAUGHLIN
FRED M. CASSIDY
WM. B. BROWDER JR.
WALTER C. BEARDSLEY
W. F. PENNEBAKER
DURHAM M. GOOLSBY
JAMES L. PARDUE
JAMES G. HOLAND
ROBERT J. COMAN
MILTON L. RANASTON
WALTER A. BOYD JR.
MARSELL FELDT
SMITH MAY
J. F. WORD
J. J. BOWDEN
NICHOLAS C. TAYLOR
T. B. WRIGHT
JOE D. HERONEY
ALVIN WALWORD JR.
RODNEY M. SATTERWHITE
HALL L. NEWBY
JOE R. GREENHILL JR.
THOS. L. LOWRY
JAMES V. HAWKETT, JR.
DANIEL W. HERD
JOSEPH V. CRAWFORD
JO ANNE CHRISTIAN
PATRICIA A. ENGLISH
GREGORY D. HOOSER
AL M. SCHOPPE JR.
JAMES CHRISMAN PHILLIPS
MARK A. LEAVERTON
KAREN PARKER
RANDAL M. KIRK
JACK D. LADD
MICHAEL B. STOLTZ
J. STOCKTON WILLIAMS, JR.
WOFFORD DENIUS
BRAD CUMMINS

MIDLAND, TEXAS
MIDLAND SAVINGS BUILDING-ZIP CODE 79701
300 WEST WALL STREET
P. O. BOX 1540-ZIP CODE 79702
A.C. 915 682-1616

AUSTIN, TEXAS
1800 AMERICAN BANK TOWER-ZIP CODE 78701
221 WEST 6TH STREET
P. O. BOX 2286-ZIP CODE 78768
A.C. 512 476-3502

JAMES W. WILSON
OF COUNSEL

February 21, 1980

ADDRESS REPLY TO:

Midland

Empire, S. Prospect
F/O 382 & 399

SOUTHLAND ROYALTY COMPANY
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis

Re: ORIGINAL TITLE OPINION
Federal Oil and Gas Lease LC-062029
insofar as it covers Lots 1, 2, 3, 4, N/2 S/2 of Section 34, and Lot 2, NW/4, NW/4 SE/4 and NW/4 SW/4 of Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico, containing 585.31 acres, more or less
(Empire, South Prospect #1873).

Gentlemen:

At your request, we have examined title to the captioned land as reflected by the following:

ABSTRACTS

1. Abstract No. 32209 certified by Federal Abstract Company covering, among other land, the captioned land based on the Records of the Bureau of Land Management from Inception of the Records to February 5, 1980 at 10:00 A.M., containing 279 pages.

2. Abstract No. 80,008 certified by Currier Abstract Company covering, among other land, the mineral interest in the captioned land from Inception of the Records to January 22, 1980 at 8:00 A.M., containing 692 pages.

INSTRUMENTS

Letter dated December 27, 1979 by Mr. Don W. Davis.

Based upon our examination of the foregoing and subject to the requirements hereinafter set forth, we find that title to the captioned land is vested as follows:

I. Lessee of Record:

A. Lot 3, NE/4 SW/4, N/2 SE/4 of Section 34 (156.65 acres):

Bassett-Birney Oil Corporation	1/2
Carper Drilling Company, Inc.	1/2
Total	2/2

B. Lots 1, 2, 4, NW/4 SW/4 of Section 34 and Lot 2, NW/4, NW/4 SW/4 and NW/4 SE/4 of Section 35 (428.66 acres):

Bassett-Birney Oil Corporation	1/2
Robert E. McKee General Contractor, Inc.	1/2
Total	2/2

II. Ownership of Production:

A. Lot 3, Section 34 from the surface to the base of the Queen Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI

Robert E. McKee General Contractor, Inc.	1/2 of 30% of 85.5% or	.1282500	WI
Mack Chase, Inc.	1/4 of 85% of 85.5% or	.1816875	WI#**
Marbob Energy Corporation	1/4 of 85% of 85.5% or	.1816875	WI#**
Harlan Oil Company, a Limited Partnership	1/4 of 85% of 85.5% or	.1816875	WI#**
Stevenson-Roach Tank Company, Inc.	1/4 of 85% of 85.5% or	.1816875	WI#**
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#This interest shall bear and pay 1/4 of a .062438 to .0 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .0085 to .0 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 85% of 85.5% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964,

recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

B. NW/4 SW/4 of Section 34 from the surface to the base of the Queen Formation, or 2,505 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI#
Robert E. McKee General Contractor, Inc.	30% of 79.25% or	.2377500	WI
Mack Chase, Inc.	1/4 of 70% of 79.25% or	.1386875	WI$**
Marbob Energy Corporation	1/4 of 70% of 79.25% or	.1386875	WI$**
Harlan Oil Company, a Limited Partnership	1/4 of 70% of 79.25% or	.1386875	WI$**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 79.25% or	.1386875	WI$**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of

oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

$This interest shall bear and pay 1/4 of a .049875 to .0 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 79.25% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

C. NE/4 SW/4 of said Section 34 from the surface to the base of the Queen Formation, or 2,200 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Robert E. McKee General Contractor, Inc.	30% of 85.5% or	.2565000	WI

Mack Chase, Inc.	1/4 of 70% of 85.5% or	.1496250 WI#**
Marbob Energy Corporation	1/4 of 70% of 85.5% or	.1496250 WI#**
Harlen Oil Company, a Limited Partnership	1/4 of 70% of 85.5% or	.1496250 WI#**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 85.5% or	.1496250 WI#**
Total		1.0000000

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#This interest shall bear and pay 1/4 of a .049875 to .0089446 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0005963 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 85.5% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

D. Lot 2 of said Section 34 from the surface to the base of the Queen Formation, or 2,543 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI#
Robert E. McKee General Contractor, Inc.	30% of 79.25% or	.2377500	WI
Mack Chase, Inc.	1/4 of 70% of 79.25% or	.1386875	WI§**
Marbob Energy Corporation	1/4 of 70% of 79.25% or	.1386875	WI§**
Harlan Oil Company, a Limited Partnership	1/4 of 70% of 79.25% or	.1386875	WI§**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 79.25% or	.1386875	WI§**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

§This interest shall bear and pay 1/4 of a .049875 to .0 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 79.25% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

E. NW/4 SE/4 of said Section 34 from the surface to the base of the Queen Formation, or 2,200 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI

Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Robert E. McKee General Contractor, Inc.	30% of 85.5% or	.2565000	WI
Mack Chase, Inc.	1/4 of 70% of 85.5% or	.1496250	WI‡**
Marbob Energy Corporation	1/4 of 70% of 85.5% or	.1496250	WI‡**
Harlan Oil Company, a Limited Partnership	1/4 of 70% of 85.5% or	.1496250	WI‡**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 85.5% or	.1496250	WI‡**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

‡This interest shall bear and pay 1/4 of a .049875 to .0089446 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0005963 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 85.5% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

F. NW/4 SE/4 and NE/4 SW/4 of Section 34 from the base of the Queen Formation to the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Mack Chase, Inc.	1/4 of 85.5% or	.2137500	WI**
Marbob Energy Corporation	1/4 of 85.5% or	.2137500	WI**
Harlan Oil Company, a Limited Partnership	1/4 of 85.5% or	.2137500	WI**
Stevenson-Roach Tank Company, Inc.	1/4 of 85.5% or	.2137500	WI**
Total		1.0000000	

Note: For rights above the base of the Queen Formation, see Paragraph E, and for rights below the top of the San Andres Formation, see Paragraph G.

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35% to 25% of 70% of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

G. Lot 3 of said Section 34 from the base of the Queen Formation to the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Mack Chase, Inc.	1/4 of 1/2 of 85.5% or	.1068750	WI#

Marbob Energy Corporation	1/4 of 1/2 of 85.5% or	.1068750	WI#
Harlan Oil Company, a Limited Partnership	1/4 of 1/2 of 85.5% or	.1068750	WI#
Stevenson-Roach Tank Company, Inc.	1/4 of 1/2 of 85.5% or	.1068750	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 1/2 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35%-25% of 1/2 of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

H. NE/4 SE/4 of Section 34 from the surface down to 750 feet:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Cities Service Company	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

I. NE/4 SE/4 of Section 34 from 750 feet down to the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Mack Chase, Inc.	1/4 of 85.5% or	.2137500	WI#
Marbob Energy Corporation	1/4 of 85.5% or	.2137500	WI#
Harlan Oil Company, a Limited Partnership	1/4 of 85.5% or	.2137500	WI#
Stevenson-Roach Tank Company, Inc.	1/4 of 85.5% or	.2137500	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35% to 25% of 70% of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

J. NE/4 SE/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Cities Service Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying a Production Payment of $1,000.00 a net acre payable out of 3% of 85.5% from all formations below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.

K. NW/4 SE/4 and NE/4 SW/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI

J. NE/4 SE/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Cities Service Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying a Production Payment of $1,000.00 a net acre payable out of 3% of 85.5% from all formations below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.

K. NW/4 SE/4 and NE/4 SW/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI

Meryl Story Tatman	1% or	.0100000 ORI
Cities Service Company	85.5% or	.8550000 WI#
Total		1.0000000

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying a Production Payment of $1,000.00 a net acre payable out of 3% of 85.5% from all formations below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.

L. Lot 3 of said Section 34 below the top of the San Andres Formation:

United States of America	1/8 or	.1250000 RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333 ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333 ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334 ORI
Meryl Story Tatman	1% or	.0100000 ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000 WI
Cities Service Company	1/2 of 85.5% or	.4275000 WI#
Total		1.0000000

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 1/2 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35%-25% of 1/2 of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

M. Lot 2 of said Section 34 below the base of the Queen Formation, or 2,543 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

N. NW/4 SW/4 of Section 34 below the base of the Queen Formation, or 2,505 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

O. Lot 4 of said Section 34 from the surface down to the base of the Queen Formation, or 2,373 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI*
Robert E. McKee General Contractor, Inc.	79.25% or	.7925000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

P. Lot 4 of said Section 34 below the base of the Queen Formation, or 2,373 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
R. E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

Q. Lot 1 of said Section 34 from the surface to the base of the Queen Formation, or feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI

Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI#
Robert E. McKee General Contractor, Inc.	79.25% or	.7925000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

R. Lot 1 of said Section 34 below the base of the Queen Formation, or feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

S. NW/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
Julia Brainard Estate	2% or	.0200000	ORI
Tenneco Oil Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying (1) a $750.00 per acre Production Payment payable out of 1/16 of 7/8 less 1/2 of 2%, subject to suspension when oil production is 15 barrels or less of oil as to excess over 17-1/2% total burdens and royalty, which is owned by Robert E. McKee General Contractor, Inc., and (2) a $3,000,000.00 Production Payment payable out of 3/32 of the production from said land and others which is owned by Robert J. Leonard, Patrick J. Leonard and Timothy T. Leonard.

T. NE/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
C. Melvin Neal	2.5% or	.0250000	ORI
Tenneco Oil Company	85% or	.8500000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying (1) a $750.00 per acre Production Payment payable out of 1/16 of 7/8 less 1/2 of 2-1/2%, subject to suspension when oil production is 15 barrels or less of oil as to excess over 17-1/2% total burdens and royalty, which is owned by Robert E. McKee General Contractor, Inc., and (2) a $3,000,000.00 Production Payment payable out of 3/32 of the production from said land and others which is owned by Robert J. Leonard, Patrick J. Leonard and Timothy T. Leonard.

U. SW/4 SE/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Tenneco Oil Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying (1) a $750.00 per acre Production Payment payable out of 1/16 of 7/8 less 1/2 of 2%, subject to suspension when oil production is 15 barrels or less of oil as to excess over 17-1/2% total burdens and royalty, which is owned by Robert E. McKee General Contractor, Inc., and (2) a $3,000,000.00 Production Payment payable out of 3/32 of the production from said land and others which is owned by Robert J. Leonard, Patrick J. Leonard and Timothy T. Leonard.

V. SW/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*

Julia Brainard Estate	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.42750000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

W. SE/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
C. Melvin Neal	2.5% or	.0250000	ORI
Bassett-Birney Oil Corporation	1/2 of 85% or	.4250000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85% or	.4250000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

X. NW/4 SE/4 of Section 35:

United States of America	1/8 or	.1250000	RI*

Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

Y. NW/4 SW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
Neil B. Watson	5% or	.0500000	ORI
Bassett-Birney Oil Corporation	1/2 of 82.5% or	.4125000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 82.5% or	.4125000	WI
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

OIL AND GAS LEASE

Form:	4-208F (January 1943).
Serial No.:	LC 062029 (Consolidated).
Date:	May 1, 1942.
Recorded:	Unrecorded, however recording is not necessary.
Lessor:	United States of America.
Lessee:	Robert E. McKee and C. N. Bassett.
Land Covered:	Township 18 South, Range 29 East, N.M. Section 33: Lots 1,2,3, NE/4 SW/4, N/2 SE/4 Section 34: Lots 1,2,3,4, N/2 S/2 Section 35: Lot 2, NW/4, NW/4 SW/4, NW/4 SE/4 containing 812.67 acres, more or less.
Term:	5 years and usual thereafter clause.
Royalty:	

On Oil

When the average production for the calendar month in barrels per well per day is

not over					50,	the royalty shall be		12.5	percent;
over	50	but not	over		60,	"	"	13	"
"	60	"	"	"	70,	"	"	14	"
"	70	"	"	"	80,	"	"	15	"
"	80	"	"	"	90,	"	"	16	"
"	90	"	"	"	110,	"	"	17	"
"	110	"	"	"	130,	"	"	18	"
"	130	"	"	"	150,	"	"	19	"
"	150	"	"	"	200,	"	"	20	"
"	200	"	"	"	250,	"	"	21	"
"	250	"	"	"	300,	"	"	22	"
"	300	"	"	"	350,	"	"	23	"
"	350	"	"	"	400,	"	"	24	"
"	400	"	"	"	450,	"	"	25	"
"	450	"	"	"	500,	"	"	26	"
"	500	"	"	"	750,	"	"	27	"
"	750	"	"	"	1,000,	"	"	28	"
"	1,000	"	"	"	1,250,	"	"	29	"
"	1,250	"	"	"	1,500,	"	"	30	"
"	1,500	"	"	"	2,000,	"	"	31	"
"	2,000	"	"	"		"	"	32	"

On Gas

When the average production of gas per well per day for the calendar month does not exceed 5,000,000 cubic feet, 12-1/2 percent; and when said production of gas exceeds 5,000,000 cubic feet,

16-2/3 percent of the amount or value of the gas and liquid products produced, said amount or value of such liquid products to be net after an allowance for the cost of manufacture; Provided, That the allowance for cost of manufacture may exceed two-thirds of the amount or value of any product only on approval by the Secretary of the Interior; and that said value of gas and of liquid products shall be as determined by said Secretary.

Delay Rentals: No longer applicable. Lease is on a producing status.

PATENT INFORMATION AND SURVEYING DATA

The captioned land is public domain. The following lots contain the following land:

Section 34:

Lot	Land
1	37.22
2	36.93
3	36.65
4	36.36

Section 35:

Lot	Land
1	38.31
2	38.15
3	37.88
4	37.47

ENCUMBRANCES

1. Deed of Trust dated April 1, 1968, recorded in Book 247, Page 703, by December, Inc. to First City National Bank of Houston, Texas, covering a $745,000.00 Production Payment reserved by Aurora Corporation of Illinois to secure a $745,000.00 note. (This instrument has been briefed).

2. Deed of Trust dated December 21, 1976, recorded in Volume 284, Page 100, by D. R. Clary, et ux, to Wilbur A. Yeager, Jr. covering his interest in the captioned land (which is now owned by Mack C. Chase, et al) to secure payment of a $60,000.00 note to The First National Bank of Midland.

EASEMENTS

The Plat shows a pipeline (NM 28526) as crossing the NW/4 of Section 35.

CASINGHEAD GAS CONTRACTS

Casinghead Gas Contract dated January 16, 1978, recorded in Volume 153, Page 592, by Marbob Energy Corporation to Phillips Petroleum Company covering the NE/4 SW/4, SE/4 SW/4, SW/4 SE/4 of Section 34. There is no depth limitation in this instrument.

TITLE REQUIREMENTS

I.

Certain of the tracts above are limited in depth to the base of the Queen Formation or a specific footage depth. In each instance, we have assumed that the footage depth is below the base of the Queen Formation. In the event this is not true, then we should be furnished with the footage depths of the base of the Queen Formation under each quarter/quarter section of land at which time we will advise you of the ownership of the zone lying between the footage depth and the base of the Queen Formation.

REQUIREMENT NO. 1: As stated.

II.

Bassett-Birney Oil Corporation owned a 1/2 interest in the operating rights in the NE/4 SW/4 and NW/4 SE/4 of Section 34. R. E. McKee General Contractor, Inc. owned the other 1/2 interest in the operating rights. R. E. McKee General Contractor, Inc. assigned its 1/2 interest in the operating rights to Stanton Oil Company. The Assignment purported to cover all of the operating rights. The Assignment of Operating Rights from R. E. McKee General Contractor, Inc. to Stanton Oil Company was approved as to only a 1/2 interest in such operating rights. Stanton Oil Company, in turn, assigned its interest in the operating rights to Richard D. Davoust. This Assignment was approved for a 1/2 interest in the operating rights insofar as it covers the NE/4 SW/4 and NW/4 SE/4 of said Section 34. Richard D. Davoust, et ux, in turn, assigned his interest to Texas City Refining Co., Inc. This conveyance was approved as covering all of the operating rights. We have examined no instrument whereby Bassett-Birney Oil Corporation conveyed its 1/2 interest in the operating rights in said NW/4 SE/4 and NE/4 SW/4 of Section 34. The Brainard No. 4 and No.

6 Wells are located on this land, and we assume that they are completed in the zone lying between the base of the Queen Formation and the top of the San Andres Formation.

REQUIREMENT NO. 2: We should be furnished with information as to how Stanton Oil Company or Richard D. Davoust acquired the 1/2 interest in the operating rights of Bassett-Birney Oil Corporation, and also we should be furnished with the complete well history of the Brainard No. 4 and No. 6 wells, and especially information showing where said wells were completed.

III.

The Stipulation Concerning Interest between Joe L. Stanton and Stanton Oil Company, Ltd. indicates that Bassett-Birney Oil Corporation has an option to acquire a paid-up working interest in the NW/4 SW/4, Lot 2 and Lot 4 of said Section 34, insofar as their interest covers from the surface down to depth limitation or the base of the Queen Formation, whichever is the lesser depth.

REQUIREMENT NO. 3: We have not examined the instrument whereby this option was reserved.

IV.

The abstract does not contain the instruments in the case file for NM 010907 and LC-056845 out of which LC-062029 was consolidated. LC 061439, LC 061440, LC 062076 and LC 060629 were also included in this consolidation. It would be helpful to examine each of these old case files which have been sent to the Dead Record Center in Denver. Since we have not been able to examine the case files on NM-010907 and LC-056845, there is a possibility that Bassett-Birney Oil Corporation conveyed a 1/2 interest in certain tracts and depths which we have credited with above to Robert E. McKee General Contractor, Inc. This possibility appears to be heightened by the fact that in a number of instances Robert E. McKee General Contractor, Inc. stated that their net interest covered the full working interest, when we credited them with only 1/2. You should investigate further into this possibility in the event you desire to acquire the shallow interests which we have credited to Bassett-Birney Oil Corporation.

REQUIREMENT NO. 4: None. Advisory only.

V.

Under Paragraphs Q and R we have left the depth limitation blank as we have seen no evidence as to the depth to which the required well was drilled. The Operating Agreement dated June 29, 1956 by Bassett-Birney Oil Corporation to Robert E. McKee, General Contractor, Inc. covering said Lot 4 required a continuous drilling program until all of the land is developed. The Affidavit dated June 10, 1957 by Bassett-Birney Oil Corporation specified the depths limit on all of the land covered by the Operating Agreement dated June 29, 1956, except as to Lot 4. We have assumed that a well was drilled on Lot 4 and Robert E. McKee, General Contractor, Inc. earned Bassett-Birney Oil Corporation's 1/2 interest down to total depth plus 100 feet or the base of the Queen Formation, whichever is the lesser.

REQUIREMENT NO. 5: Submit evidence that a well was timely commenced on said Lot 4 and that Robert E. McKee, General Contractor, Inc. earned said 1/2 interest in the shallow operating rights, together with evidence as to the depth to which said well was drilled.

VI.

Under Paragraphs S and V of Ownership, we have shown the Julia Brainard Estate as having a 2% Overriding Royalty Interest. These Overriding Royalty Interests were not listed in her Estate. In the event that you acquire these two properties, inquiries should be made concerning the ownership of this Overriding Royalty Interest.

REQUIREMENT NO. 6: As stated.

VII.

In the event you acquire an interest in any of the captioned land, it would be helpful for us to examine the Division Orders and lease files of your Seller in order to verify the ownership of the captioned land. This Opinion is based solely on the data examined, and there are numerous questions and ambiguities reflected by this information. As a result, we have made certain assumptions which need to be clarified.

REQUIREMENT NO. 7: Advisory.

VIII.

We have examined no information showing that the lease is in good standing and that the wells located thereon have been drilled and operated in accordance with the rules and regulations of the New Mexico Oil Conservation Division, the United States Geological Survey and any other governmental agency having jurisdiction over the captioned land. You should satisfy yourself concerning these matters.

REQUIREMENT NO. 8: As stated.

COMMENTS

1. This opinion cannot cover such matters as area, boundaries, location on the ground or other matters that can be determined by an actual on-the-ground survey.

2. This opinion does not cover matters concerning regulations by the Federal Energy Regulatory Commission and other governmental agencies.

We return herewith the material furnished.

Respectfully submitted,

STUBBEMAN, McRAE, SEALY, LAUGHLIN & BROWDER

By ORIGINAL SIGNED BY J. J. BOWDEN
J. J. Bowden

JJB/bb

Enclosures

BASSETT-BIRNEY OIL CORPORATION

OIL PRODUCERS AND OPERATORS

ARTESIA, NEW MEXICO — EL PASO, TEXAS

ARTESIA, NEW MEXICO

April 22, 1980

RECEIVED
LAND DEPT.
APR 23 1980
SOUTHLAND ROYALTY CO.
MIDLAND, TEXAS

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Don W. Davis

Re: SRC Empire Fed. Comm. "34" #1
Township 18 South, Range 29 East, NMPM
Section 34
Eddy County, New Mexico

Gentlemen:

We enclose 2 executed copies of the AFE and 2 copies of the signature pages for the Operating Agreement on the captioned well.

We have executed the Operating Agreement with the understanding there will be no charge to us for the Drilling Title Opinion.

Very truly yours,

Randy G. Patterson
Land Department

By: Jack W. McCaw

JWM/kc
Enclosures

EXHIBIT F

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 WILCO TOWERS WEST MIDLAND TEXAS 79701

COMPANY NO —
AFE NUMBER —
PROPERTY NUMBER —

ADD — A CHANGE — DELETE —

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "34" No. 1

ORIGINAL 0 SUPPLEMENTAL — PRODUCER — DRY HOLE — SRC OPERATOR — MANUAL —

AUTHORITY IS REQUESTED TO: Drill and complete to TD of 11,450' as gas well in

WILDCAT — DEV. X Morrow formation complete w/tank battery.

LOCATION: 1980 FEL 1980 FNL Sec. 34 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249	$ –	$ –
350	01 01 Conductor or Drive Pipe	5,860	5,860
3200'	01 02 Casing 11/3/4" 42# H-40 ST&C @ $16.75	33,600	33,600
1870'	03 8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	14,620	–
5470'	04 4 1/2" 13.5 #N-80 LT&C @ $7.82	36,760	–
3020'	05 4 1/2" 11.6# N-80 LT&C @ $6.72	15,250	–
1090'	06 4 1/2" 11.6# K-55 ST&C @ $5.05	7,810	–
11,450'	07 4 1/2" 11.6# N-80 Butt. @ $7.17	–	–
11,450'	08	40,880	–
	02 09 Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	26,000	2,000
	01 10 Wellhead & Safety Equipment	4,500	–
	01 11 Packer & Special Equipment	–	–
	01 12 Artificial Lift	36,000	–
	05 13 Tank Battery and process equip.	7,530	3,040
	10 14 Other Equipment		
	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	15	$ 27,003	$ 5,252
	BASSETT & BIRNEY .11801687		
	16	$ 170,000	$170,000
	INTANGIBLE - 248		
	01 17 Drilling 10,000 ft. @ $ 17.00 /ft.	67,500	67,500
	01 18 Rig, Day Work 15 Days @ $ 4500 /day	–	–
	01 19 Rig Moving Costs	12,000	–
	01 20 Completion Rig 10 Days @ $ 1200 /day	4,000	2,000
	07 21 Roustabout & Miscellaneous Labor	4,500	2,000
	03 22 Auto, Trucking, Barge, Tug	12,000	10,000
	04 23 Roads, Canals, Location, Damages, Cleanup	45,000	40,000
	05 24 Mud, Oil, Water, Chemicals	5,000	5,000
	06 25 Drill Stem Tests	35,000	35,000
	05 26 Electric Logs & Bond Logs	45,000	40,000
	07 27 Cement, Centralizer, Scratchers, Service	20,000	20,000
	03 28 Bits, Fuel	25,000	12,000
	28 29 Rental Equipment & tubular inspection	–	–
	09 30 Core & Analyses	–	–
	09 31 Bottle Tests & Sidewall Cores	10,000	–
	09 32 Perforate	25,000	–
	09 33 Acid & Frack Variable	5,000	2,500
	09 34 Geological & Engineering	20,000	20,000
	09 35 Mud Logger	5,400	5,400
	10 36 Cost of Control Insurance (SRC Only) .468	24,800	10,100
	10 37 Miscellaneous & Unforseen	3,000	2,000
	11312 38 District & Overhead Expense		
	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	39	$ 63,516	$ 52,340
	BASSETT & BIRNEY .11801687		
	40 GRAND TOTAL COSTS	$ 767,010	$ 488,000
	41	$ 90,520	$ 57,592
	BASSETT & BIRNEY .11801687		

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

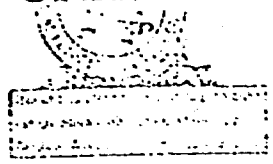
COMPANY: Bassett & Birney Oil Corp.

BY: Dist. Engr.

DATE: 4-18-80

A.A.P.L. FORM 610 - 1977

MODEL FORM OPERATING AGREEMENT



OPERATING AGREEMENT

DATED

April 8, 1980,

OPERATOR SOUTHLAND ROYALTY COMPANY

CONTRACT AREA E/2 Section 34, T18S, R29E, below the San Andres Formation

COUNTY ~~OR~~ OF Eddy STATE OF New Mexico

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between SOUTHLAND ROYALTY COMPANY, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators".

WITNESSETH:

WHEREAS, the parties to this agreement are owners of oil and gas leases and/or oil and gas interests in the land identified in Exhibit "A", and the parties hereto have reached an agreement to explore and develop these leases and/or oil and gas interests for the production of oil and gas to the extent and as hereinafter provided:

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.
DEFINITIONS

As used in this agreement, the following words and terms shall have the meanings here ascribed to them:

A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.

B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.

D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".

E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.

F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.

G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.

H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II.
EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

[X] A. Exhibit "A", shall include the following information:
- (1) Identification of lands subject to agreement,
- (2) Restrictions, if any, as to depths or formations,
- (3) Percentages or fractional interests of parties to this agreement,
- (4) Oil and gas leases and/or oil and gas interests subject to this agreement,
- (5) Addresses of parties for notice purposes.

[X] B. Exhibit "B", Form of Lease.

[X] C. Exhibit "C", Accounting Procedure.

[X] D. Exhibit "D", Insurance.

[X] E. Exhibit "E", Gas Balancing Agreement.

[X] F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.

If any provision of any exhibit, except Exhibit "E", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

ARTICLE III.
INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an unleased oil and gas interest in the Contract Area, that interest shall be treated for the purpose of this agreement and during the term hereof as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B". As to such interest, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the lessee interest.

B. Interest of Parties in Costs and Production:

Exhibit "A" lists all of the parties and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and material acquired in operations on the Contract Area shall be owned by the parties as their interests are shown in Exhibit "A". All production of oil and gas from the Contract Area, subject to the payment of lessor's royalties which will be borne by the Joint Account, shall also be owned by the parties in the same manner during the term hereof; provided, however, this shall not be deemed an assignment or cross-assignment of interests covered hereby.

ARTICLE IV.
TITLES

A. Title Examination:

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including Federal Lease Status Reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

☐ ~~Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be a part of the administrative overhead as provided in Exhibit "C," and shall not be a direct charge, whether performed by Operator's staff attorneys or by outside attorneys.~~

☒ Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Exhibit "A". * Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection with leases or oil and gas interests contributed by such party. The Operator shall be responsible for the preparation and recording of Pooling Designations or Declarations as well as the conduct of hearings before Governmental Agencies for the securing of spacing or pooling orders. This shall not prevent any party from appearing on its own behalf at any such hearing.

~~No well shall be drilled on the Contract Area until after (1) the title to the drill site or drilling unit has been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to participate in the drilling of the well.~~

B. Loss of Title:

1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A", this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests, and

(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development

except when such costs are incurred in connection with an operation conducted under Article VI in which event such costs are to be borne by the drilling parties in the proportions

or operating costs which it may have theretofore paid, but there shall be no monetary liability on its part to the other parties hereto for drilling, development, operating or other similar costs by reason of such title failure; and

(b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract Area by the amount of the interest lost; and

(c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract Area is increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such interests (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well; and

(d) Should any person not a party to this agreement, who is determined to be the owner of any interest in the title which has failed, pay in any manner any part of the cost of operation, development, or equipment, such amount shall be paid to the party or parties who bore the costs which are so refunded; and

(e) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be borne by the party or parties in the same proportions in which they shared in such prior production; and

(f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in connection therewith.

2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, is not paid or is erroneously paid, and as a result a lease or interest therein terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new lease covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties shall be revised on an acreage basis, effective as of the date of termination of the lease involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the lease or interest which has terminated. In the event the party who failed to make the required payment shall not have been fully reimbursed, at the time of the loss, from the proceeds of the sale of oil and gas attributable to the lost interest, calculated on an acreage basis, for the development and operating costs theretofore paid on account of such interest, it shall be reimbursed for unrecovered actual costs theretofore paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost interest, on an acreage basis, up to the amount of unrecovered costs;

(b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an acreage basis, of that portion of oil and gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such lease termination, would be attributable to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said portion of the oil and gas to be contributed by the other parties in proportion to their respective interests; and

(c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall not be considered failure of title but shall be joint losses and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of the Contract Area.

ARTICLE V.
OPERATOR

A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:

SOUTHLAND ROYALTY COMPANY shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operator, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the Parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed, shall be determined by Operator, and all such employees shall be the employees of Operator.

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the 1st day of June, 1980, Operator shall commence the drilling of a well for oil and gas at the following location:

1980' FNL & 1980' FEL of Section 34, T16S, R29E, Eddy County, New Mexico

and shall thereafter continue the drilling of the well with due diligence to

11,700' or a depth sufficient to test the Morrow formation

unless granite or other practically impenetrable substance or condition in the hole, which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E.1. hereof.

B. Subsequent Operations:

1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday or legal holidays. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or response given by telephone shall be promptly confirmed in writing.

2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, within sixty (60) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period where the drilling rig is on location, as the case may be) actually commence work on the proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest of the parties approving such operation, and (b) its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A", or (b) carry its proportionate part of Non-Consenting Parties' interest. The proposing party, at its election, may withdraw such proposal if there is insufficient participation, and shall promptly notify all parties of such decision.

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk, and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or market value thereof if such share is not sold (after deducting production taxes, royalty, overriding royalty and other interests existing on the effective date hereof, payable out of or measured by the production from such well accruing with respect to such interest until it reverts) shall equal the total of the following:

(a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to each Non-Consenting Party had it participated in the well from the beginning of the operation; and

(b) 300 % of that portion of the costs and expenses of drilling, reworking, deepening, or plugging back, testing and completing, after deducting any cash contributions received under Article VIII.C., and

300 % of that portion of the cost of newly acquired equipment in the well (to and including the well-head connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's election, shall be sold to its purchaser, if available, under the terms of its existing gas sales contract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from such sale direct to the Consenting Parties until the amounts provided for in this Article are recovered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not contracted for sale of its gas at the time such gas is available for delivery, or has not made the election as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-Consenting Party's share of gas as hereinabove provided during the recoupment period.

During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production.

In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.

Within sixty (60) days after the completion of any operation under this Article, the party conducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas produced during any month, Consenting Parties shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs of the work done and of the equipment purchased, in determining when the interest of such Non-Consenting Party shall revert to it as above provided; and if there is a credit balance, it shall be paid to such Non-Consenting party.

If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent of all parties, no wells shall be completed in or produced from a source of supply from which a well located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such source of supply.

The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b) to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article VI.A.

C. Right to Take Production in Kind:

Each party shall have the right to take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating oil for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any

party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment direct from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate commerce, of any other party's share of gas production without first giving such other party thirty (30) days notice of such intended sale.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any Gas Balancing Agreement between the parties hereto, whether such Agreement is attached as Exhibit "E", or is a separate Agreement.

D. Access to Contract Area and Information:

Each party shall have access to the Contract Area at all reasonable times, at its sole risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the information.

E. Abandonment of Wells:

1. Abandonment of Dry Holes: Except for any well drilled pursuant to Article VI.B.2., any well which has been drilled under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling of such well. Any party who objects to the plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well which has been drilled or reworked pursuant to Article VI.B.2. hereof for which the Consenting Parties have not been fully reimbursed as therein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of such well, all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one year and so long thereafter as oil and or gas is produced from the interval or inter-

vals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentages of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interest in the remaining portion of the Contract Area.

Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned well.

ARTICLE VII.
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.

B. Liens and Payment Defaults:

Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share of oil and or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon at the rate provided in the Accounting Procedure attached hereto as Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the State, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's share of oil and or gas until the amount owed by such Non-Operator, plus interest has been paid. Each purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.

If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.

C. Payments and Accounting:

Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in the Accounting Procedure attached hereto as Exhibit "C". Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Limitation of Expenditures:

1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this Agreement, it being understood that the consent to the drilling or deepening shall include:

~~☐ Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and equipping of the well, including necessary tankage and or surface facilities.~~

☒ Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its authorized depth, and all tests have been completed, Operator shall give immediate notice to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion attempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, including necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less than all parties.

2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agreement, it being understood that the consent to the reworking or plugging back of a well shall include consent to all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage and/or surface facilities.

3. Other Operations: Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Twenty-Five Thousand and no/100--- Dollars ($ 25,000.00) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares "Authority for Expenditures" for its own use, Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project costing in excess of Twenty-Five Thousand and no/100------- Dollars ($ 25,000.00).

E. Royalties, Overriding Royalties and Other Payments:

Each party shall pay or deliver, or cause to be paid or delivered, all royalties to the extent of Lessor's royalty due on its share of production and shall hold the other parties free from any liability therefor. If the interest of any party in any oil and gas lease covered by this agreement is subject to any royalty, overriding royalty, production payment, or other charge over and above the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account for or cause to be accounted for, such interest to the owners thereof.

No party shall ever be responsible, on any price basis higher than the price received by such party, to any other party's lessor or royalty owner; and if any such other party's lessor or royalty owner should demand and receive settlements on a higher price basis, the party contributing such lease shall bear the royalty burden insofar as such higher price is concerned.

F. Rentals, Shut-in Well Payments and Minimum Royalties:

Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.2.

Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sunday and holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments

of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

G. Taxes:

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. Operator shall bill other parties for their proportionate share of all tax payments in the manner provided in Exhibit "C".

If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final determination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint account, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as provided in Exhibit "C".

Each party shall pay or cause to be paid all production, severance, gathering and other taxes imposed upon or with respect to the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.

H. Insurance:

At all times while operations are conducted hereunder, Operator shall comply with the Workmen's Compensation Law of the State where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be an amount equivalent to the premium which would have been paid had such insurance been obtained. Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the Workmen's Compensation Law of the State where the operations are being conducted and to maintain such other insurance as Operator may require.

In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's fully owned automotive equipment.

ARTICLE VIII.
ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

A. Surrender of Leases:

The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole or in part unless all parties consent thereto.

However, should any party desire to surrender its interest in any lease or in any portion thereof, and other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not desiring to surrender it. If the interest of the assigning party includes an oil and gas interest, the assigning party shall execute and deliver to the party or parties not desiring to surrender an oil and gas lease covering such oil and gas interest for a term of one year and so long thereafter as oil and/or gas is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B". Upon such assignment, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the acreage assigned and the operation of any well thereon, and the assigning party shall have no further interest in the lease assigned and its equipment and production other than the royalties retained in any lease made under the terms of this Article. The parties assignee shall pay to the party assignor the reasonable salvage value of the latter's interest in any wells and equipment on the assigned acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. If the assignment is in favor of more than one party, the assigned interest shall

be shared by the parties assignee in the proportions that the interest of each bears to the interest of all parties assignee.

Any assignment or surrender made under this provision shall not reduce or change the assignor's or surrendering parties' interest, as it was immediately before the assignment, in the balance of the Contract Area; and the acreage assigned or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this agreement.

B. Renewal or Extension of Leases:

If any party secures a renewal of any oil and gas lease subject to this Agreement, all other parties shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area.

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this agreement.

The provisions in this Article shall apply also and in like manner to extensions of oil and gas leases.

C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash toward the drilling of a well or any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. If all parties hereto are Drilling Parties and accept such tender, such acreage shall become a part of the Contract Area and be governed by the provisions of this agreement. If less than all parties hereto are Drilling Parties and accept such tender, such acreage shall not become a part of the Contract Area. Each party shall promptly notify all other parties of all acreage or money contributions it may obtain in support of any well or any other operation on the Contract Area.

If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Subsequently Created Interest:

Notwithstanding the provisions of Article VIII.E. and VIII.G., if any party hereto shall, subsequent to execution of this agreement, create an overriding royalty, production payment, or net proceeds interest, which such interests are hereinafter referred to as "subsequently created interest", such subsequently created interest shall be specifically made subject to all of the terms and provisions of this agreement, as follows:

1. If non-consent operations are conducted pursuant to any provision of this agreement, and the party conducting such operations becomes entitled to receive the production attributable to the interest out of which the subsequently created interest is derived, such party shall receive same free and clear of such subsequently created interest. The party creating same shall bear and pay all such subsequently created interests and shall indemnify and hold the other parties hereto free and harmless from any and all liability resulting therefrom.

2. If the owner of the interest from which the subsequently created interest is derived (1) fails to pay, when due, its share of expenses chargeable hereunder, or (2) elects to abandon a well under provisions of Article VI.E. hereof, or (3) elects to surrender a lease under provisions of Article VIII.A. hereof, the subsequently created interest shall be chargeable with the pro rata portion of all expenses hereunder in the same manner as if such interest were a working interest. For purposes of collecting such chargeable expenses, the party or parties who receive assignments as a result of (2) or (3) above shall have the right to enforce all provisions of Article VII.B. hereof against such subsequently created interest.

E. Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or

2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the right of the other parties.

If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such party's interests within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds hereof.

F. Waiver of Right to Partition:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

G. Preferential Right to Purchase:

~~Should any party desire to sell all or any part of its interests under this agreement, or its rights and~~ interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent ~~company, or to any company in which any one party owns a majority of the stock.~~

ARTICLE IX.
INTERNAL REVENUE CODE ELECTION

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No

such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from Operations hereunder can be adequately determined without the computation of partnership taxable income.

ARTICLE X.
CLAIMS AND LAWSUITS

Operator may settle any single damage claim or suit arising from operations hereunder if the expenditure does not exceed Five Thousand and no/100---------- Dollars ($ 5,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, the party shall immediately notify Operator, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

ARTICLE XI.
FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure. The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

ARTICLE XII.
NOTICES

All notices authorized or required between the parties, and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by United States mail or Western Union telegram, postage or charges prepaid, or by teletype, and addressed to the party to whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed, and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid, or when sent by teletype. Each party shall have the right to change its address at any time, and from time to time, by giving written notice hereof to all other parties.

ARTICLE XIII.
TERM OF AGREEMENT

This agreement shall remain in full force and effect as to the oil and gas leases and or oil and gas interests subjected hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any lease, or oil and gas interest contributed by any other party beyond the term of this agreement.

~~Option No. 1: So long as any of the oil and gas leases subject to this agreement remain or are held in force and effect after the Contract Area is established hereunder, and so long as drilling, reworking, or other operations are prosecuted with no cessation of more than 120 consecutive days, whether or not any such operations are prosecuted on the Contract Area or on lands pooled or unitized therewith.~~

X Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of 90 days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling or reworking a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and or gas from the Contract Area, this agreement shall terminate unless drilling or reworking operations are commenced within 60 days from the date of abandonment of said well.

It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

ARTICLE XIV.
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the conservation laws of the state in which the committed acreage is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and orders.

B. Governing Law:

The essential validity of this agreement and all matters pertaining thereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state where most of the land in the Contract Area is located shall govern.

ARTICLE XV.
OTHER PROVISIONS

SALE OF ROYALTY GAS

It is recognized by the parties hereto that in addition to each party's share of working interest production, such party shall have the right, subject to existing contracts, to market the royalty gas attributable to each lease which it contributes to the unit area and to receive payments due for such royalty gas produced from or allocated to such lease or leases. It is agreed that, regardless of whether each party markets or contracts for its share of gas, including the royalty gas under the leases which it contributed to the Unit, such party agrees to pay or cause to be paid to the royalty owners under its lease or leases the proceeds attributable to their respective royalty interest and to hold all other parties hereto harmless for its failure to do so.

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of 8th day of April, 19 80.

OPERATOR

SOUTHLAND ROYALTY COMPANY

By: C. E. Mean
Attorney-in-Fact

NON-OPERATORS

DEPCO, INC.

ATTEST:

By: _____

CITIES SERVICE COMPANY

ATTEST:

By: _____

BASSETT-BIRNEY

ATTEST:

By: _____
Frank Yates, Attorney-In-Fact for
Martin Yates, III, Vice President

Form 3106-5
(March 1980)

UNITED STATES
DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT

FORM APPROVED
OMB NO. 42-R1599

Lease Serial No.
LC 062029

Lease effective date
May 1, 1942

FOR BLM OFFICE USE ONLY
New Serial No.

ASSIGNMENT AFFECTING RECORD TITLE TO OIL AND GAS LEASE

PART I

1. Assignee's Name

Bassett-Birney Oil Corporation

Address (include zip code)
207 South 4th Street
Artesia, New Mexico 88210

The undersigned, as owner of 50 percent of the record title of the above-designated oil and gas lease, hereby transfers and assigns to the assignee shown above, the record title interest in and to such lease as specified below.

2. Describe the lands affected by this assignment (43 CFR 3101.2-3)

Township 18 South, Range 29 East, N.M.P.M.

Section 33: Lot 3 ($SE\frac{1}{4}SW\frac{1}{4}$), $N\frac{1}{2}SE\frac{1}{4}$
Section 34: Lot 1 ($SE\frac{1}{4}SE\frac{1}{4}$), Lot 2 ($SW\frac{1}{4}SE\frac{1}{4}$),
Lot 4 ($SW\frac{1}{4}SW\frac{1}{4}$), $NW\frac{1}{4}SW\frac{1}{4}$
Section 35: Lot 2 ($SW\frac{1}{4}SE\frac{1}{4}$), $NW\frac{1}{4}SE\frac{1}{4}$, $NW\frac{1}{4}SW\frac{1}{4}$, $NW\frac{1}{4}$

containing 544.16 acres, more or less.

3. Specify interest or percent of assignor's record title interest being conveyed to assignee	All, be: 50% int
4. Specify interest or percent of record title interest being retained by assignor, if any	None
5. Specify overriding royalty being reserved by assignor	None in Assignm
6. Specify overriding royalty previously reserved or conveyed, if any	Exhibit "A" attached shows ove riding royalties, operating ag ments and production payments heretofore reserved or conveye
7. If any payments out of production have previously been created out of this lease, or if any such payments are rein reserved under this assignment, attach statement giving full details as to amount, method of payment, and othe pertinent terms as provided under 43 CFR 3106.	See Exhibit "A" attached.

It is agreed that the obligation to pay any overriding royalties or payments out of production of oil created herein which, when added to overriding royalties or payments out of production previously created and to the royalty payable to the United States, aggregate in excess of 17½ percent, shall be suspended when the average production of oil per well per day averaged on the monthly basis is 15 barrels or less.

I CERTIFY That the statements made herein are true, complete, and correct to the best of my knowledge and belief and are made in good faith.

Executed this 6th day of June, 19 80

ROBERT E. McKEE GENERAL CONTRACTOR, INC.

By: _____ President P. O. Box 20562
(Assignor's Signature) (Assignor's Address)

ATTEST: _____ El Paso, Texas 79998
(City) (State) (Zip Code)

Secretary

ATE OF TEXAS)
: ss.
UNTY OF EL PASO)

The foregoing instrument was acknowledged before me this 6th day
, 1980, by C. D. McKee President of Robert E. McKee
eral Contractor, Inc., a Nevada corporation, on behalf of said corporation.

_____
Notary Public

commission expires:
[illegible]

EXHIBIT "A"

1. 5% overriding royalty on NW/4 SW/4 Section 35, reserved in an assignment dated January 24, 1943, recorded Book 22, Page 171, from Neil B. Watson et ux to Robert E. McKee and C. N. Bassett.

2. 2-1/2% overriding royalty on E/2 NW/4 Section 35, reserved in an assignment dated May 8, 1943, recorded Book 21, Page 283, from C. Melvin Neal et ux to Paul Love.

3. 2% overriding royalty on, among other lands, Lot 3 (SE/4 SW/4) Section 33, Lot 1 (SE/4 SE/4), Lot 4 (SW/4 SW/4), NW/4 SW/4 Section 34, Lot 2 (SW/4 SE/4), NW/4 SE/4 Section 35, reserved in an assignment dated May 28, 1943, recorded Book 21, Page 329, from Martha Featherstone et vir to Robert E. McKee and C. N. Bassett.

4. 2% overriding royalty on, among other lands, N/2 SE/4 Section 33, reserved in an assignment dated June 5, 1943, recorded Book 21, Page 330, from Julia Brainard et vir to Robert E. McKee and C. N. Bassett.

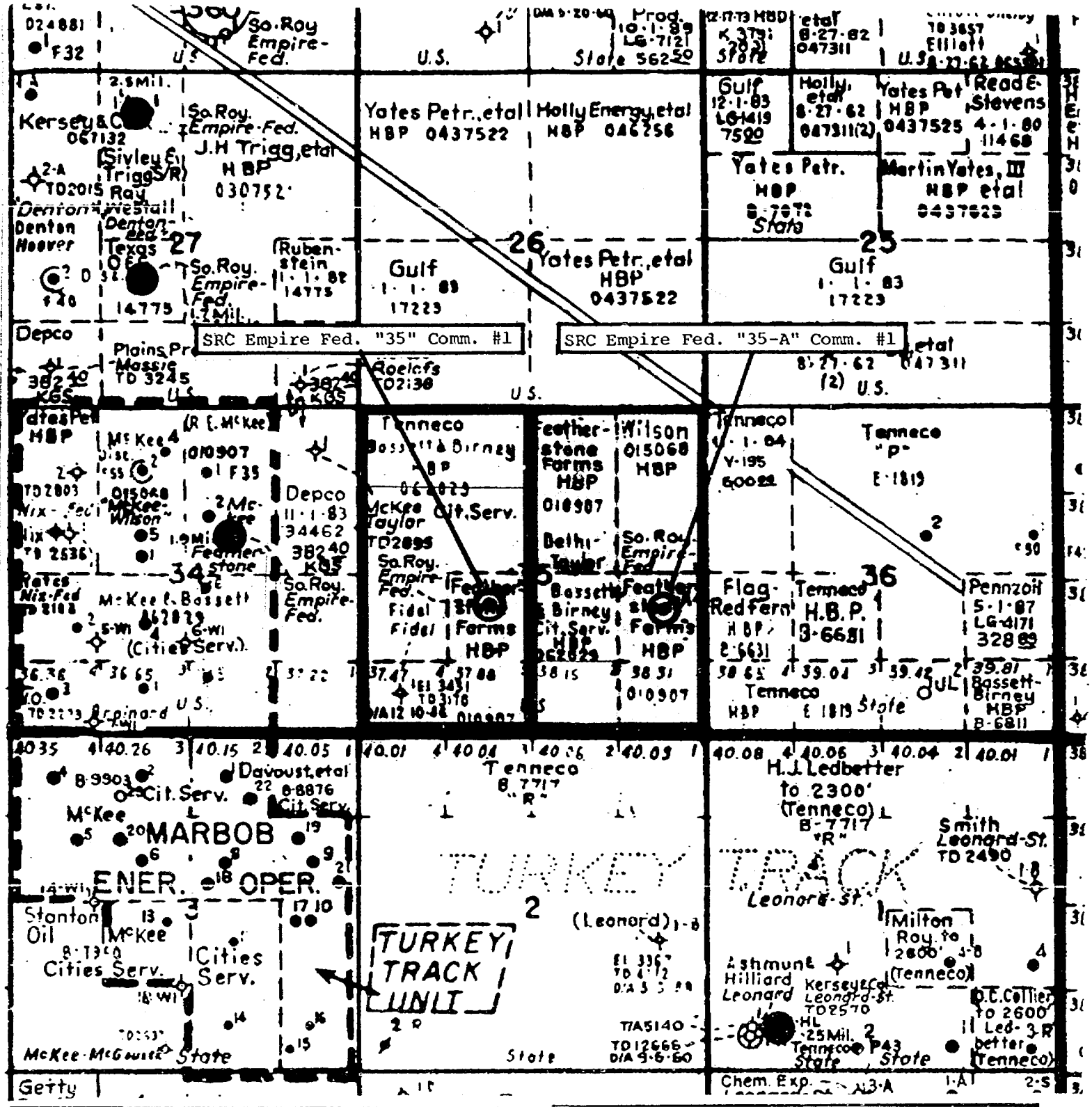
5. 2% overriding royalty on, among other lands, Lot 2 (SW/4 SE/4) Section 34, and N/2 NW/4 Section 35, reserved in an assignment dated October 22, 1943, recorded Book 22, Page 94, from Julia Brainard et vir to Robert E. McKee.

6. Operating rights from surface to base of the Queen formation underlying, among other lands, Lot 2 (SW/4 SE/4), NW/4 SW/4 Section 34, conveyed by assignment dated November 1, 1959, recorded Book 109, Page 274, from Robert E. McKee General Contractor, Inc. to Stanton Oil, Ltd.

7. Operating rights from surface to 2,373 feet, underlying Lot 4 (SW/4 SW/4) Section 34, conveyed by assignment dated August 19, 1964, unrecorded but approved October 7, 1964, from Robert E. McKee General Contractor, Inc. to Stanton Oil, Ltd.

8. Operating rights, without depth limitation, underlying Lot 2 (SW/4 SE/4), N/2 NW/4 Section 35, conveyed by assignment dated March 9, 1960, recorded Book 105, Page 468, from Robert E. McKee General Contractor, Inc. and Bassett-Birney Oil Corporation to Leonard Oil Company.

9. A production payment of $750 per acre, payable out of 1/16th of 7/8ths, but reduced by 1/2 of the then existing overriding royalty burdens from the lands described in 8 above, created by production payment agreement dated March 9, 1960, recorded Book 105, Page 399, from Leonard Oil Company to Robert E. McKee General Contractor, Inc., and presently owned by and reserved to Robert E. McKee General Contractor, Inc.



REMARKS

FARMIN SUPPORT, OWNED 100% BY SRC
(Obligation date for well: 11-05-80

FARMIN SUPPORT, OWNED 50% BY SRC
(Obligation date for well: 11-05-80

DEDICATED PRORATION UNIT TO WELL

MORROW OR ATOKA PRODUCER

Southland Royalty Company
SOUTHWESTERN DISTRICT
MIDLAND, TEXAS

EMPIRE (SOUTH) PROSPECT
EDDY COUNTY, NEW MEXICO

September 8, 1980

Flag-Redfern Oil Company
1200 Wall Towers West
Midland, Texas 79701

Re: New Mexico Oil Conservation Division
Case 7024

Gentlemen:

Enclosed is a copy of the docket for the September 17, 1980 Oil Conservation Division Examiner Hearing.

You may have an interest that will be affected by the above-referenced case.

Very truly yours,

William F. Carr

WFC:lr

Enclosure

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

BEFORE EXAMINER STAMETS
OIL CONSERVATION DIVISION
SRC EXHIBIT NO. 2
CASE NO. 7025
Submitted by DON DAVIS
Hearing Date 9/17/80

P11 [illegible]
RECEIPT FOR CERTIFIED MAIL
NO INSURANCE COVERAGE PROVIDED—
NOT FOR INTERNATIONAL MAIL
(See Reverse)

SENT TO Flag-Redfern Oil Co
P.O., STATE AND ZIP CODE

POSTAGE $
CERTIFIED FEE
SPECIAL DELIVERY
RESTRICTED DELIVERY
SHOW TO WHOM AND DATE DELIVERED
SHOW TO WHOM, DATE, AND ADDRESS OF DELIVERY
RETURN RECEIPT SERVICE
OPTIONAL SERVICES
CONSULT POSTMASTER FOR FEES
TOTAL POSTAGE AND FEES $
POSTMARK OR DATE
9/8/80

Southland Royalty - Case 7024

PS Form 3811, Jan. 1979

SENDER: Complete items 1, 2, and 3.
Add your address in the "RETURN TO" space on reverse.

1. The following service is requested (check one.)
   - ☒ Show to whom and date delivered..... ¢
   - ☐ Show to whom, date and address of delivery.... ¢
   - ☐ RESTRICTED DELIVERY
     Show to whom and date delivered..... ¢
   - ☐ RESTRICTED DELIVERY.
     Show to whom, date, and address of delivery.$

(CONSULT POSTMASTER FOR FEES)

2. ARTICLE ADDRESSED TO:
Flag-Redfern Oil Company
1200 Wall Towers West
Midland, Texas 79701

3. ARTICLE DESCRIPTION:

REGISTERED NO.	CERTIFIED NO.	INSURED NO.
	7144036	

(Always obtain signature of addressee or agent)

I have received the article described above.
SIGNATURE ☐Addressee ☐Authorized agent

4. DATE OF DELIVERY

POSTMARK

5. ADDRESS (Complete only if requested)

6. UNABLE TO DELIVER BECAUSE:

CLERK'S INITIALS

☆GPO: 1979-300-459

RETURN RECEIPT, REGISTERED, INSURED AND CERTIFIED MAIL

September 8, 1980

Tenneco Oil Exploration and
Production Company
6800 Park Ten Boulevard
Suite 200 North
San Antonio, Texas 78213

Re: New Mexico Oil Conservation Division
Case 7024

Gentlemen:

Enclosed is a copy of the docket for the September 17, 1980 Oil Conservation Division Examiner Hearing.

You may have an interest that will be affected by the above-referenced case.

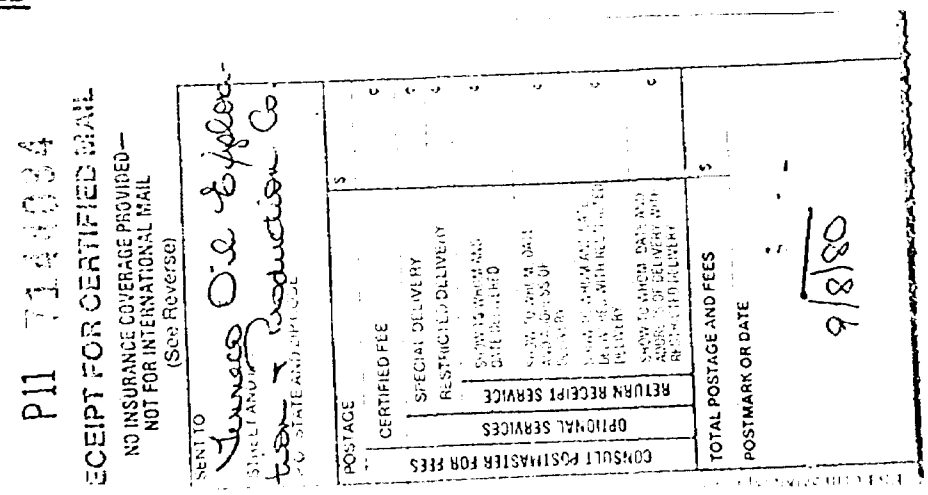
Very truly yours,

William F. Carr

WFC:lr

Enclosure

CERTIFIED MAIL
RETURN RECEIPT REQUESTED



Southland Royalty - Case 7024

PS Form 3811, Jan. 1973

SENDER: Complete items 1, 2, and 3.
Add your address in the "RETURN TO" space on reverse.

1. The following service is requested (check one.)
- ☑ Show to whom and date delivered.....¢
- ☐ Show to whom, date and address of delivery....¢
- ☐ RESTRICTED DELIVERY
  Show to whom and date delivered.....¢
- ☐ RESTRICTED DELIVERY.
  Show to whom, date, and address of delivery.$

(CONSULT POSTMASTER FOR FEES)

2. ARTICLE ADDRESSED TO:
Tenneco Oil Exploration Co.
6800 Park Ten Blvd., St. 200
San Anotnio, TX 78213

3. ARTICLE DESCRIPTION:

REGISTERED NO.	CERTIFIED NO.	INSURED NO.
	7144034	

(Always obtain signature of addressee or agent)

I have received the article described above.
SIGNATURE ☐Addressee ☐Authorized agent

4. Everett Reynolds

DATE OF DELIVERY: SEP 12 1980

POSTMARK: SEP 12 1980

5. ADDRESS (Complete only if requested)

6. UNABLE TO DELIVER BECAUSE:

CLERK'S INITIALS

☆GPO : 1979-300 459

RETURN RECEIPT, REGISTERED, INSURED AND CERTIFIED MAIL

September 8, 1980

Bassett-Birney Oil Corporation
202 South 4th Street
Artesia, New Mexico 88210

Re: New Mexico Oil Conservation Division
Case 7024

Gentlemen:

Enclosed is a copy of the docket for the September 17, 1980 Oil Conservation Division Examiner Hearing.

You may have an interest that will be affected by the above-referenced case.

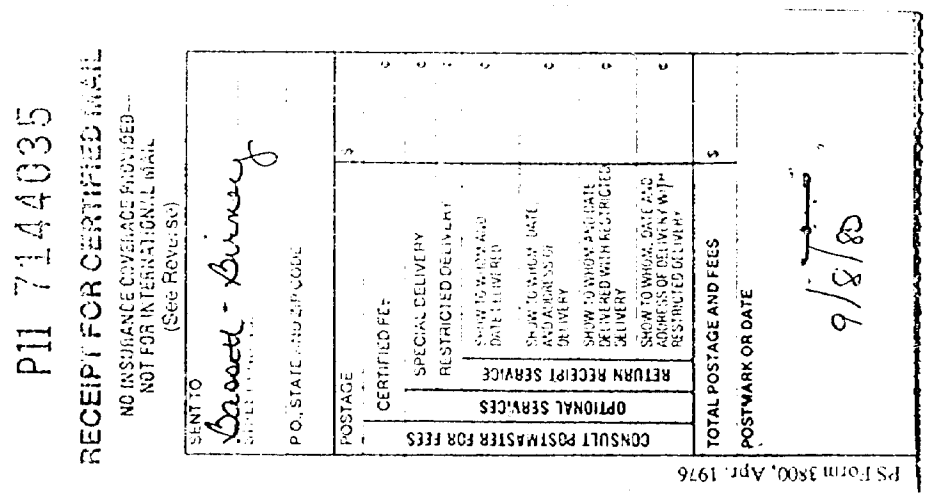
Very truly yours,

William F. Carr

WFC:lr

Enclosure

CERTIFIED MAIL
RETURN RECEIPT REQUESTED



Southland Royalty - Case 7024

PS Form 3811, Jun. 1979

SENDER: Complete items 1, 2, and 3. Add your address in the "RETURN TO" space on reverse.

1. The following service is requested (check one.)
- [x] Show to whom and date delivered.....—¢
- [ ] Show to whom, date and address of delivery...—¢
- [ ] RESTRICTED DELIVERY
  Show to whom and date delivered.....—¢
- [ ] RESTRICTED DELIVERY.
  Show to whom, date, and address of delivery.$—

(CONSULT POSTMASTER FOR FEES)

2. ARTICLE ADDRESSED TO:
Bassett-Birney Oil Corp.
202 South 4th Street
Artesia, NM 88210

3. ARTICLE DESCRIPTION:

REGISTERED NO.	CERTIFIED NO.	INSURED NO.
	7144035	

(Always obtain signature of addressee or agent)

I have received the article described above.
SIGNATURE ☐Addressee ☒Authorized agent

Dana Cole

4. DATE OF DELIVERY — POSTMARK: ARTESIA, N.M. SEP 10 1980

5. ADDRESS (Complete only if requested)

6. UNABLE TO DELIVER BECAUSE: — CLERK'S INITIALS

RETURN RECEIPT, REGISTERED, INSURED AND CERTIFIED MAIL

☆GPO : 1979-300-459

Southland Royalty Company

February 26, 1980

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: Farmout Request
Portions of Sections 33, 34 & 35
T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

Gentlemen:

Reference is made to your leasehold located in the above subject tracts. Southland Royalty Company is presently attempting to secure support from the leasehold owners under these sections for the drilling of several Morrow wells.

A check of the records indicates that Bassett & Birney Oil Corporation owns a 50% working interest in a lease covering the deep rights in the following tracts of land:

Section	W.I.	Gross Acres	Net Acres
Section 33: N½SE¼, SE¼SW¼	50%	120	60
Section 34: Lots 1, 2, 4 & NW¼SW¼	50%	160	80
Section 35: Lot 2, NW¼ NW¼SW¼, NW¼SE¼	50%	280	140
Totals		560	280

Southland requests your support for the project by granting of a Farmout of your acreage under the following general terms:

1. Bassett-Birney deliver its leasehold interest in the E½ of Section 34 to Southland Royalty Company for the drilling of a Morrow well. Southland Royalty Company will have a period of ninety (90) days in which to commence drilling this well. Upon obtaining production from this well, Southland Royalty Company will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled. The remainder of Bassett-Birney's leasehold in Sections 33, 34 and 35,

BEFORE EXAMINER STAMETS
OIL CONSERVATION DIVISION
SRC EXHIBIT NO. 3
CASE NO. 7025
Submitted by DON DAVIS
Hearing Date 9/17/80

out side the drilled proration unit will fall under a 120-day continuous development program.

2. Under the terms of this Agreement, Bassett & Birney will retain a 1/16th of 8/8ths ORRI convertible to a 50% working interest at payout on the initial well.

Upon receiving approval for this proposal, Southland will be happy to prepare a Farmout Agreement containing the above provisions. If instead, you choose to join in this well, an AFE and Joint Operating Agreement will be forwarded to you at once.

If there are any questions concerning the above, please do not hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am

Southland Royalty Company

March 24, 1980

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: SRC-Empire Federal Comm. "35" #1
1,980' FN&WL Section 35,
T-18-S, R-29-E,
Eddy County, New Mexico
Empire, South Prospect #1873
F/O 382, F/O 399

Gentlemen:

Reference is made to the proposed well and to a Farmout request mailed to Bassett & Birney Oil Corporation dated February 26, 1980. In this letter, Southland Royalty Company requested a farmout of your acreage in Sections 33, 34 and 35.

Southland Royalty Company is now prepared to drill a Morrow well in the W½ of Section 35, and by this letter, request your support for the well.

A check of the records indicates that Bassett & Birney Oil Corporation owns a 50% working interest in a lease covering the deep rights in the S½ of the NW¼ and the NW¼ of the SW¼ of Section 35. Southland requests a farmout of your acreage under the following general terms:

1. Bassett & Birney deliver its leasehold interest in the W½ of Section 35 for the drilling of the SRC Empire Federal Comm. "35" #1 well. Southland will have a ninety (90) day period in which to commence the drilling of this well. Upon obtaining production from this well, Southland will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below total depth drilled.

2. Under the terms of this Agreement, Bassett & Birney will retain a 1/16th of 8/8ths overriding royalty interest convertible to a 50% working interest at payout, proportionately reduced.

Upon receiving approval for this proposal, Southland Royalty Company will be happy to prepare a Farmout Agreement containing the above provisions.

If instead, Bassett & Birney Oil Corporation chooses to join in this well, upon approval, please execute the three (3) enclosed AFEs, returning two (2) originals to Southland Royalty Company's Midland office, while retaining one (1) original for your files. At such time as we have received the signed AFEs, a Joint Operating Agreement and Communitization Agreement will be forwarded for your approval.

If there are any questions regarding the above, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am

Southland Royalty Company

June 19, 1980

Tenneco Oil Exploration and Production
6800 Park Ten Blvd., Suite 200 North
San Antonio, Texas 78213

Attn: Mr. Steve D. King,
Landman

RE: Proposed SRC Empire Fed. Comm.
"35" #1 Well
W/2 Section 35, T18S, R29E
Eddy County, New Mexico
Empire, South #1873
F/O 382, 399 J/O 500342

Gentlemen:

Reference is made to your response of June 4, 1980, to Southland Royalty Company's proposal for the drilling of the SRC Empire Federal Comm. "35" #1 well. Although Southland Royalty Company would look favorably toward the formation of a one section working interest unit encompassing all of section 35, T18S, R29E, and would agree to offer Tenneco any farmin acreage received in support of the "35" #1 well; Southland Royalty Company, at this time, does not feel that any acreage received in support of our initial test well should be offered to partners in the "35" well.

Southland Royalty Company acquired farmin support in Sections 33, 34 and 35, in October of 1979, some nine months ago, in support of our proposed SRC Empire Federal Comm. #1 test well. This well, which was drilled and completed in the S/2 of Section 27, was not offsetting any Morrow production, and was quite risky. Had SRC not received the farmin support we did, this initial well, which has prompted the current development and activity in this immediate area, would not have been drilled. Also, although SRC is aware of Tenneco's geological expertise in this area, Southland Royalty Company has also been successful in the drilling of numerous Morrow wells in the area.

I look forward to hearing from you concerning the formation of a unit. If there are any questions concerning this matter, please feel free to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd

1100 WALL TOWERS WEST (915) 682-8641 MIDLAND, TEXAS 79701

Southland Royalty Company

July 8, 1980

Bassett-Birney Oil Corporation
207 South Fourth Street
Artesia, New Mexico 88210

Attn: Mr. Jack McCaw

Empire, S.

RE: SRC-Empire Fed. Comm. "35" #1
1980' FSL & 1980' FWL, Sec. 35
T18S, R29E, Eddy Co, New Mexico
F/O 382 and 399 500340 J/O

Gentlemen:

Reference is made to my letters of February 26th, 1980 and March 24, 1980, concerning the above proposed well. In the letter of March 24th, 1980, Southland proposed the drilling of the subject well at a location of 1980' FNL and 1980' FWL of Sec. 35. Southland has now moved the location of this well to 1980' FSL and 1980' FWL, and once again requests your support for the subject well.

Enclosed, please find three original AFE's,along with a Joint Operating Agreement which contains three sets of signature pages for the 35 #1 well. At such time as these instruments meet with your approval, please have the appropriate company officer execute all AFE's and signature pages, returning two executed originals of each to our Midland Office for further handling. If instead, you choose to Farmout your interest under this well, Southland will be happy to prepare a Farmout Agreement which will contain the provisions mentioned in my prior two letters.

If you have any questions concerning this matter, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd
Encl.

1100 WALL TOWERS WEST (915) 682-8641 MIDLAND, TEXAS 79701

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 Wall Towers West Midland, Texas 79701

COMPANY NO 01

AFE NUMBER 022E

ADD A CHANGE ___ DELETE ___ PROPERTY NUMBER 0-5003 12-___

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "35" No. 1

ORIGINAL 0 SUPPLEMENTAL ___ PRODUCER ___ DRY HOLE ___ SRC OPERATOR X MANUAL ___

AUTHORITY IS REQUESTED TO:

WILDCAT ___ DEV. X

Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980 FSL 1980 FWL Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE			ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
		TANGIBLE - 249		
	01	Conductor or Drive Pipe	$ -	$ -
350	02	Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	03	8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	04	4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	05	4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	06	4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	07	4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	08		-	-
11,450'	09	Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	10	Wellhead & Safety Equipment	26,000	2,000
	11	Packer & Special Equipment	4,500	-
	12	Artificial Lift	-	-
	13	Tank Battery and process equip.	36,000	-
	14	Other Equipment	7,530	3,040
	15	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16	Bassett-Birney .19026479	$ 43,534	$ 8,467
		INTANGIBLE - 248		
	17	Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	18	Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	19	Rig Moving Costs	-	-
	20	Completion Rig 10 Days @ $ 1200 /day	12,000	-
	21	Roustabout & Miscellaneous Labor	4,000	2,000
	22	Auto, Trucking, Barge, Tug	4,500	2,000
	23	Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	24	Mud, Oil, Water, Chemicals	45,000	40,000
	25	Drill Stem Tests	5,000	5,000
	26	Electric Logs & Bond Logs	35,000	35,000
	27	Cement, Centralizer, Scratchers, Service	45,000	40,000
	28	Bits, Fuel	20,000	20,000
	29	Rental Equipment & tubular inspection	25,000	12,000
	30	Core & Analyses	-	-
	31	Bottle Tests & Sidewall Cores	-	-
	32	Perforate	10,000	-
	33	Acid & Frack Variable	25,000	-
	34	Geological & Engineering	5,000	2,500
	35	Mud Logger	20,000	20,000
	36	Cost of Control Insurance (SRC Only) .468	5,400	5,400
	37	Miscellaneous & Unforseen	24,800	10,100
	38	District & Overhead Expense	3,000	2,000
	39	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40	Bassett-Birney .19026479	$ 102,400	$ 84,382
	41	GRAND TOTAL COSTS	$ 767,010	$ 488,000
	42	Bassett-Birney .19026479	$ 145,934	$ 92,849

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: _____

BY: _____

DATE: _____

BEFORE THE OIL CONSERVATION DIVISION

OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE APPLICATION OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO	:	CASE NOS. ~~7024 and~~ 7025

MEMORANDUM IN OPPOSITION TO APPLICATIONS OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING

Section 70-2-17, N.M.S.A. 1978, provides in part as follows . . .

> C. When two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof, ~~embraced~~ within such spacing or proration unit, the owner or owners thereof may validly pool their interests and develop their lands as a unit. Where, however, such owner or owners have not agreed to pool their interests, and where one such separate owner, or owners, who has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply, the division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interests or both in the spacing or proration unit as a unit.

As a matter of simple construction of the above statute, the division has authority to subject interests to compulsory pooling only when "such owner or owners have not agreed to pool their interests."

As expressly stated in the authorizing statute for this division, and as recognized by the Supreme Court of New Mexico in Sims v. Mechem, 72 N.M. 186, 382 P.2d 183, the authority of the division to pool arises only when such pooling has not been voluntarily agreed to by the parties. In this case, Bassett-Birney has agreed to pool its interests with the other leasehold owners in the spacing units.

The controversy between Southland and Bassett-Birney involves disputed title to interests in a Federal Oil and Gas Lease upon the lands affected by Southland's application herein, to which both Southland and Bassett-Birney claim title. As stated by Bassett-Birney in its Exhibit No. 1, "Bassett-Birney is willing to pool its interests" in the wells proposed to be drilled by Southland. Also, as made clear in such Exhibit, Bassett-Birney's objection to the operating agreements and AFE's furnished by Southland arises from the erroneous interests credited to Bassett-Birney by Southland in those instruments, and not with regard to any lack of agreement of Bassett-Birney to voluntarily pool its interests under the proposed wells. Bassett-Birney should not be required to assume the cost of a dry hole attributable to the disputed interests, in the face of Southland's denial of its title.

By its applications in these proceedings Southland attempts to accomplish by compulsory pooling what it can only accomplish by litigation. As reflected by Bassett-Birney Exhibit No. 2, the underlying title dispute between Southland and Bassett-Birney is presently the subject of litigation in the United States District Court for the District of New Mexico. In this suit, or in such other court to which this litigation may ultimately be transferred, the underlying title dispute between Southland and Bassett-Birney will ultimately be resolved.

As recognized in Williams and Meyers, Oil and Gas Law, §941.3, compulsory pooling statutes do not have any effect upon the underlying titles of the interest owners. In Monsanto Chemical Company v. Southern Natural Gas Company, 234 La. 939, 102 So.2d 223, 9 O&GR 1110, the court held that it was beyond the authority of the regulatory commission to determine who was entitled to production under the terms of voluntary agreements affecting the title to the premises, and further found that the only authority of the agency was to allocate to each tract a

pro rata share of the unit production. To the same effect is Arkansas-Louisana Gas Company v. Southwest Natural Production Company, 221 La. 608, 60 So.2d 9, 1 O&GR 1186, in which it was held that it was beyond the constitutional and legislative authority of the Commissioner of Conservation of the State of Louisiana to determine the title to the mineral ownership itself. In Texas it has also been held that orders of the Railroad Commission do not effect a transfer of title. Nale v. Carroll, 155 Tex. 555, 289 S.W.2d 743, 5 O&GR 1379, in which it was stated: "Rules and regulations of the Railroad Commission cannot effect a change or transfer of property rights. A Rule 37 Permit cannot be made the basis for a claim of title."

As stated above, only the courts have the power to determine the title to this disputed interest in real estate. The courts also will determine the rights of Southland and Bassett-Birney once the title dispute has been resolved, with regard to such questions as drainage caused during the pendency of the dispute, for any decrease in the speculative value of the land by reason of the drilling of a dry hole and other such measures. Williams and Meyers, supra, §231.4.

As shown by its Exhibits, Bassett-Birney is willing to pool its interests and to participate in the wells proposed by Southland, but is not willing to execute AFE's and operating agreements not recognizing the leasehold interests claimed by Bassett-Birney. For these reasons, the policies behind enactment of compulsory pooling statutes in virtually all of the oil producing states, that being the prevention of waste and the furtherance of spacing rules regulating the size of the drilling units, have no application to the dispute between Southland and Bassett-Birney. Further, the fact that the prevailing party in the litigation will be made whole for any damages suffered by it as a result of the title dispute assures that no waste can be prevented by the applications of Southland in these proceedings. Southland is free to drill its proposed wells, and

Bassett-Birney has elected to participate therein to the full extent of its interests. The title to any production resulting will also be determined in the litigation.

For the reasons stated above, the division has no authority to subject the interests of Bassett-Birney to compulsory pooling under these circumstances, and the applications of Southland should therefore be denied.

BASSETT-BIRNEY OIL CORPORATION

By: Chad Dickerson
Chad Dickerson

LOSEE, CARSON & DICKERSON, P.A.
P. O. Drawer 239
Artesia, New Mexico 88210

Attorneys for Bassett-Birney Oil Corporation

Southland Royalty Company

July 15, 1980

Tenneco Oil Exploration
and Production
6800 Park Ten Boulevard
Suite 200 North
San Antonio, Texas 78213

Attention: Mr. Steve King

RE: SRC Empire Federal Comm "35" #1
1980' FSL & 1980' FWL - Sec. 35,
T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873
F/O 382 and F/O 399 J/O 500340

Dear Steve:

Reference is made to our telephone conversation of even date concerning our original proposal to drill a Morrow test in the W/2 of Section 35, and our most recent attempts to form a one section working interest unit encompassing all of section 35. Due to the conflict concerning R. E. McKee's interest in section 35, Bassett-Birney Corporation has refused to join in a working interest unit.

Therefore, Southland Royalty Company, once again proposes its original well to be drilled in the W/2 of Section 35. Although this well is to be drilled in a W/2 proration unit as was our first proposal, there has been a footage location change. The subject well has been moved to 1980' FSL and 1980' FWL of Section 35.

Enclosed, please find three original AFE's, along with a Joint Operating Agreement which contains three sets of signature pages for the subject well. At such time as this well is approved by Tenneco, please have the appropriate company officer execute all AFE's and signature pages, returning two executed originals of each to our Midland Office for further handling.

As we discussed in our telephone conversation, Southland Royalty Company is also preparing to propose a Morrow test to be drilled in the E/2 of Section 35. The location of 660' FSL and 1980' FEL of Section 35 was wrong, and our proposed location for this well will be 1980' FSL and 660' FEL of Section 35, T18S, R29E. As we hope to spud these wells in the very near future, I anxiously await your reply.

If you have any questions, or if I can be of any assistance concerning this matter, please do not hesitate to give me a call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 WALL TOWERS WEST MIDLAND, TEXAS 79701

COMPANY NO ___ AFE NUMBER ___

ADD A CHANGE ___ DELETE ___ PROPERTY NUMBER ___

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "35" No. 1

ORIGINAL 0 SUPPLEMENTAL ___ PRODUCER ___ DRY HOLE ___ SRC OPERATOR ___ MANUAL ___

AUTHORITY IS REQUESTED TO: Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

WILDCAT ___ DEV. X

LOCATION: 1980 FNL 1980 FWL Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249		
	01 Conductor or Drive Pipe	$ --	$ -
350	02 Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	03 8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	04 4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	05 4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	06 4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	07 4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	08	-	-
11,450'	09 Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	10 Wellhead & Safety Equipment	26,000	2,000
	11 Packer & Special Equipment	4,500	-
	12 Artificial Lift	-	-
	13 Tank Battery and process equip.	36,000	-
	14 Other Equipment	7,530	3,040
	15 TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16 Tenneco .25368638	$ 58,046	$ 11,289
	INTANGIBLE - 248		
	17 Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	18 Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	19 Rig Moving Costs	-	-
	20 Completion Rig 10 Days @ $ 1200 /day	12,000	-
	21 Roustabout & Miscellaneous Labor	4,000	2,000
	22 Auto, Trucking, Barge, Tug	4,500	2,000
	23 Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	24 Mud, Oil, Water, Chemicals	45,000	40,000
	25 Drill Stem Tests	5,000	5,000
	26 Electric Logs & Bond Logs	35,000	35,000
	27 Cement, Centralizer, Scratchers, Service	45,000	40,000
	28 Bits, Fuel	20,000	20,000
	29 Rental Equipment & tubular inspection	25,000	12,000
	30 Core & Analyses	-	-
	31 Bottle Tests & Sidewall Cores	-	-
	32 Perforate	10,000	-
	33 Acid & Frack Variable	25,000	-
	34 Geological & Engineering	5,000	2,500
	35 Mud Logger	20,000	20,000
	36 Cost of Control Insurance (SRC Only) .468	5,400	5,400
	37 Miscellaneous & Unforseen	24,800	10,100
	38 District & Overhead Expense	3,000	2,000
	39 TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40 Tenneco .25368638	$ 136,534	$ 112,510
	41 GRAND TOTAL COSTS	$ 767,010	$ 488,000
	42 Tenneco .25368638	$ 194,579	$ 123,799

AUTHORIZATION REQUESTED

K M Hallin

AUTHORIZATION APPROVED

COMPANY: _____

BY: _____

DATE: _____

Southland Royalty Company

March 24, 1980

Tenneco Oil Exploration & Production
6800 Park Ten Blvd. - Suite 200 North
San Antonio, Texas 78213

Attention: Michael M. Hinze

Re: SRC-Empire Federal Comm "35" #1
1980' FNL & 1980' FWL Section 35,
T-18-S, R-29-E,
Eddy County, New Mexico
Empire, South Prospect #1873
F/O 382, F/O 399

Gentlemen:

Reference is made to the proposed well to be drilled in Section 35, Township 18 South, Range 29 East. Southland Royalty Company is at this time preparing to drill a Morrow well in the W½ of Section 35, and by this letter, request your support for the well.

A check of the records indicates that Tenneco Oil Exploration & Production owns a 100% working interest in a lease covering the deep rights in the N½ of the NW¼ of Section 35. Southland requests a farmout of your acreage under the following general terms:

1. Tenneco deliver its leasehold interest in the W½ of Section 35 for the drilling of the SRC-Empire Federal "35" #1 well. Southland will have a ninety (90) day period in which to commence the drilling of this well. Upon obtaining production from this well, Southland will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled.

2. Under the terms of this Agreement, Tenneco will retain a 1/16th of 8/8ths overriding royalty interest convertible to a 50% working interest at payout, proportionately reduced.

Upon receiving approval for this proposal, Southland Royalty Company will be more than happy to prepare a Farmout Agreement containing the above provisions. If instead, Tenneco chooses to join in this well, upon approval,

please execute the three (3) enclosed AFEs, returning two (2) originals to Southland Royalty Company's Midland Office, while retain one (1) original for your files. At such time as we have received the signed AFEs, a Joint Operating Agreement and Communitization Agreement will be forwarded for your approval.

If there are any questions concerning the above, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am
Enclosures

Southland Royalty Company

July 25, 1980

Bassett-Birney Oil Corp.
207 South Fourth Street
Artesia, New Mexico 88210

Attention: Mr. Jack McCaw

Re: SRC Empire Fed. "35" Comm. #1 &
SRC Empire Fed. "35-A" Comm. #1
Sec. 35, T18S, R29E
Eddy County, New Mexico
SRC 500340 J/O; 500422 J/O
F/O 382; F/O 399

Dear Mr. McCaw:

Reference is made to my earlier letters concerning the proposed SRC Empire Fed. "35" Comm. No. 1, and to our most recent telephone conversation concerning my attempts to form a one section working interest unit encompassing all of Section 35, T18S, R29E. In that telephone conversation, you indicated that at this time, Bassett-Birney would not join in any well drilled on this acreage.

Due to the tight rig situation, and obligation dates SRC has under our support agreements in Section 35, SRC must attempt to acquire support for two Morrow tests under Section 35 on a well-to-well basis. Enclosed are three original AFE's along with a Joint Operating Agreement which contains three extra sets of signature pages for the newly proposed SRC Empire Fed. "35-A" Comm. No. 1. This well is proposed to be drilled 1980' FSL & 660' FEL of Section 35, in a E/2 proration unit. If you choose to join in this well, please execute all AFE's and signature pages to the Joint Operating Agreement, returning two originals of each to our Midland Office. If, instead, you decide to farmout under this well, SRC will be happy to prepare a farmout agreement which will provide you with a 1/16th of 8/8ths overriding royalty interest with the option to convert this override to a 50% working interest at payout (proportionately reduced).

If you have any questions concerning this matter, please don't hesitate calling.

Yours very truly,

Don Davis

Don W. Davis
Landman

DWD:lh

Southland Royalty Company
1100 Wall Towers West Midland Texas 79701

AUTHORIZATION FOR EXPENDITURE

COMPANY NO C1

AFE NUMBER 0228

ADD A CHANGE DELETE PROPERTY NUMBER C-5 0 0 3 1 2-

AFE DATE 3 / 17 / 80 NAME SRC Empire Fed. "35-A" Comm. No. 1

ORIGINAL 0 SUPPLEMENTAL PRODUCER DRY HOLE SRC OPERATOR MANUAL

AUTHORITY IS REQUESTED TO:

WILDCAT DEV. (D)

Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980' FSL & 660' FEL, Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE			ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
		TANGIBLE - 249		
	01 01	Conductor or Drive Pipe	$ -	$ -
350	01 02	Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	03	8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	04	4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	05	4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	06	4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	07	4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	08		-	-
11,450'	02 09	Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,860	-
	33 10	Wellhead & Safety Equipment	26,000	2,000
	04 11	Packer & Special Equipment	4,500	-
	04 12	Artificial Lift	-	-
	05 13	Tank Battery and process equip.	36,000	-
	10 14	Other Equipment	7,530	3,040
	15	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16	Bassett-Birney .063199	$ 14,461	$ 2,812
		INTANGIBLE - 243		
	01 17	Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	01 18	Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	01 19	Rig Moving Costs	-	-
	01 20	Completion Rig 10 Days @ $ 1200 /day	12,000	-
	02 21	Roustabout & Miscellaneous Labor	4,000	2,000
	03 22	Auto, Trucking, Barge, Tug	4,500	2,000
	04 23	Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	05 24	Mud, Oil, Water, Chemicals	45,000	40,000
	06 25	Drill Stem Tests	5,000	5,000
	06 26	Electric Logs & Bond Logs	35,000	35,000
	07 27	Cement, Centralizer, Scratchers, Service	45,000	40,000
	08 28	Bits, Fuel	20,000	20,000
	38 29	Rental Equipment & tubular inspection	25,000	12,000
	09 30	Core & Analyses	-	-
	09 31	Bottle Tests & Sidewall Cores	-	-
	09 32	Perforate	10,000	-
	09 33	Acid & Frack Variable	25,000	-
	09 34	Geological & Engineering	5,000	2,500
	09 35	Mud Logger	20,000	20,000
	10 36	Cost of Control Insurance (SRC Only) .468	5,400	5,400
	10 37	Miscellaneous & Unforseen	24,800	10,100
	11 12 38	District & Overhead Expense	3,000	2,000
	39	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40	Bassett-Birney .063199	$ 34,014	$ 28,029
	41	GRAND TOTAL COSTS	$ 767,010	$ 488,000
	42	Bassett-Birney .063199	$ 48,474	$ 30,841

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY:

BY:

DATE:

Southland Royalty Company

July 29, 1980

Flag-Redfern Oil Company
1200 Wall Towers West
Midland, Texas 79701

Attention: Mr. John Smart

RE: SRC-Empire Federal "35-A" Comm #1
1980' FSL & 660' FEL Section 35
T18S, R29E, Eddy County, New Mexico
Empire South Prospect #1873
J/O 500422

Dear John:

Reference is made to our recent conversations concerning SRC's original proposal to drill a Morrow test in the W/2 of Section 35, and our most recent attempts to form a one section working interest unit encompassing all of section 35. As I related to you earlier, due to the conflict concerning R. E. McKee's interest in Section 35, Bassett-Birney Corporation has refused to join in a working interest unit.

Therefore, Southland Royalty Company, once again, is proceeding with its plans to drill two wells in Section 35 on a well by well basis. Enclosed, are three original AFE's along with a Joint Operating Agreement which contains three extra signature pages, for the newly proposed SRC-Empire Federal "35-A" Comm. #1 well to be drilled 1980' FSL & 660' FEL of Section 35, T18S, R29E. The well will encompass an E/2 proration unit.

At such time as this well is approved by Flag-Redfern,please have the appropriate company officers execute all AFE's and signature pages, returning two executed originals of each to our Midland Office for our further handling. If instead, Flag-Redfern chooses to farmout to this well, Southland Royalty Company will be happy to prepare a Farmout Agreement which will provide for a 1/16th override convertible to a 50% working interest at payout.

If there are any questions, or if I can be of assistance concerning this matter, please don't hesitate calling.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd

Southland Royalty Company
1100 MAIN TOWERS ALEE MIDLAND TEXAS 79701

AUTHORIZATION FOR EXPENDITURE

COMPANY NO C'

AFE NUMBER 022E

ADD A CHANGE DELETE PROPERTY NUMBER 0-5003 10-

AFE DATE 3 / 17 / 80 NAME SRC Empire Fed. "35-A" Comm. No. 1

ORIGINAL 0 SUPPLEMENTAL PRODUCER DRY HOLE SRC OPERATOR MANUAL

AUTHORITY IS REQUESTED TO:

WILDCAT DEV. #D Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980' FSL & 660' FEL, Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE		TANGIBLE - 249	ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	01 01	Conductor or Drive Pipe	$ -	$ -
350	01 02	Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	03	8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	04	4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	05	4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	06	4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	07	4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	08		-	-
11,450'	09 09	Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	10 10	Wellhead & Safety Equipment	26,000	2,000
	11 11	Packer & Special Equipment	4,500	-
	12 12	Artificial Lift	-	-
	13 13	Tank Battery and process equip.	36,000	-
	14 14	Other Equipment	7,530	3,040
	15	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16	Flag-Redfern .252797	$ 57,842	$ 11,249
		INTANGIBLE - 243		
	01 17	Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	01 18	Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	01 19	Rig Moving Costs	-	-
	01 20	Completion Rig 10 Days @ $ 1200 /day	12,000	-
	02 21	Roustabout & Miscellaneous Labor	4,000	2,000
	03 22	Auto, Trucking, Barge, Tug	4,500	2,000
	04 23	Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	05 24	Mud, Oil, Water, Chemicals	45,000	40,000
	06 25	Drill Stem Tests	5,000	5,000
	06 26	Electric Logs & Bond Logs	35,000	35,000
	07 27	Cement, Centralizer, Scratchers, Service	45,000	40,000
	08 28	Bits, Fuel	20,000	20,000
	28 29	Rental Equipment & tubular inspection	25,000	12,000
	09 30	Core & Analyses	-	-
	09 31	Bottle Tests & Sidewall Cores	-	-
	09 32	Perforate	10,000	-
	29 33	Acid & Frack Variable	25,000	-
	09 34	Geological & Engineering	5,000	2,500
	09 35	Mud Logger	20,000	20,000
	10 36	Cost of Control Insurance (SRC Only) .468	5,400	5,400
	10 37	Miscellaneous & Unforseen	24,800	10,100
	11222 38	District & Overhead Expense	3,000	2,000
	39	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40	Flag-Redfern .252797	$ 136,055	$ 112,115
	41	GRAND TOTAL COSTS	$ 767,010	$ 488,000
	42	Flag-Redfern .252797	$ 193,898	$ 123,365

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: _____

BY: _____

DATE: _____

BASSETT-BIRNEY OIL CORPORATION

Oil Producers and Operators

ARTESIA, NEW MEXICO 88210

YATES BUILDING — 207 SOUTH FOURTH

PHONE: (505) 748-1331

September 4, 1980

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis, Landman

Re: Proposed Southland Royalty Company Empire
Federal "35" Com. No. 1 and "35-A" Com. No. 1
Wells, W/2 and E/2 Sec. 35, T-18-S, R-29-E,
Eddy County, New Mexico

Gentlemen:

This acknowledges receipt of your letters of July 8 and July 25, 1980, together with joint operating agreements and AFEs covering the proposed drilling of the subject wells.

The joint operating agreement dated July 8 covering W/2 Section 35 and the AFE for your No. "35" Com. No. 1, credits our company with a 19.026479% (60/315.35) interest, when in fact we own a 38.052957% (120/315.35) interest. The joint operating agreement dated July 17, 1980 covering E/2 Section 35 and the AFE for your No. "35-A" Com. No. 1, credits our company with a 6.3199% (20/316.46) interest, when in fact we own a 12.6398% (40/316.46) interest. Southland Royalty has instituted a suit against, among other parties, Bassett-Birney Oil Corporation, in the United States District Court for the District of New Mexico, Case No. CIV-80-0614 HB, contesting a portion of our title to the working interest underlying the proposed wells. In view of the incorrect statements in your operating agreements and AFEs as to our ownership in the proposed wells and the pending lawsuit, we are unable to approve either the AFEs or joint operating agreements.

Bassett-Birney is willing to pool its interests in the W/2 of Section 35 and in the E/2 of Section 35 for the drilling of the "35" Com. No. 1 Well and the "35-A" Com. No. 1 Well.

RECEIVED
SEP 5 1980
SOUTHLAND ROYALTY CO.
MIDLAND, TEXAS

If you have any questions, please do not hesitate to call me.

Very truly yours,

BASSETT-BIRNEY OIL CORPORATION

By: Jack W. McCaw

Jack W. McCaw,
Vice President

DRAFT

dr/

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

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

CASE NO. 7025

Order No. R- 6498

APPLICATION OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 9 a.m. on September 17, 1980, at Santa Fe, New Mexico, before Examiner Richard L. Stamets.

NOW, on this _____ day of September, 1980, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

FINDS:

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

(2) That the applicant, Southland Royalty Company, seeks an order pooling all mineral interests in the Pennsylvanian formation underlying the W/2 of Section 35, Township 18 South, Range 29 East, NMPM, _____, Eddy County, New Mexico.

(3) That the applicant has the right to drill and proposes to drill a well at a standard location thereon.

(4) That the applicant and another interest owner in the proposed proration unit are involved in litigation to determine the true ownership of the S/2 NW/4 and NW/4 SW/4 of said Section 35.

(5) That said owners would, except for such litigation, agree to voluntarily pool their interests and pay their proportionate share for the drilling of the proposed well.

(6) That because of said litigation

plus an additional 20 percent thereof as a reasonable charge for the risk involved in the drilling of the well.

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

(12) ~~(10)~~ That following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs should pay to the operator any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(13) ~~(11)~~ That $ 3000 ^{00} per month while drilling and $ 300 ^{00} per month while producing should be fixed as reasonable charges for supervision (combined fixed rates); that the operator should be authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator should be authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are reasonable, attributable to each non-consenting working interest.

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

(15) ~~(13)~~ That upon the failure of the operator of said pooled unit to commence drilling of the well to which said unit is dedicated on or before January 15, 1981, the order pooling said unit should become null and void and of no effect whatsoever.

IT IS THEREFORE ORDERED:

(1) That all mineral interests, whatever they may be, in the Pennsylvanian formation underlying the W/2 of Section 35, Township 18 South, Range 29 East, NMPM, _____, Eddy County, New Mexico, are hereby pooled to form a standard 320 - acre gas spacing and proration unit to be dedicated to a well to be drilled at a standard location thereon

PROVIDED HOWEVER, that the operator of said unit shall commence the drilling of said well on or before the 15th day of January, 1981, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test the Pennsylvanian formation;

PROVIDED FURTHER, that in the event said operator does not commence the drilling of said well on or before the 15th day of January, 1981, Order (1) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division for good cause shown.

PROVIDED FURTHER, that should said well not be drilled to completion, or abandonment, within 120 days after commencement thereof, said operator shall appear before the Division Director and show cause why Order (1) of this order should not be rescinded.

(2) That Southland Royalty Company is hereby designated the operator of the subject well and unit.

(3) That after the effective date of this order and within 90 days prior to commencing said well, the operator shall furnish the Division and each known working interest owner in the subject unit an itemized schedule of estimated well costs.

(4) That within 30 days from the date the schedule of estimated well costs is furnished to him, any non-consenting working interest owner shall have the right to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production, and that any such owner who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(5) That the operator shall furnish the Division and each known working interest owner an itemized schedule of actual well costs within 90 days following completion of the well; that if no objection to the actual well costs is received by the Division and the Division has not objected within 45 days following receipt of said schedule, the actual well costs shall be the reasonable well costs; provided however, that if there is an objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

(6) That within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs in advance as provided

above shall pay to the operator his pro rata share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator his pro rata share of the amount that estimated well costs exceed reasonable well costs.

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

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

(B) As a charge for the risk involved in the drilling of the well, 20 percent of the pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

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

(9) That $ 3000 oe per month while drilling and $ 300 oe per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rates); that the operator is hereby authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating such well, not in excess of what are reasonable, attributable to each non-consenting working interest.

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

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

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

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

DONE at Santa Fe, New Mexico, on the day and year herein-above designated.

CAMPBELL AND BLACK, P.A.
LAWYERS

JACK M. CAMPBELL
BRUCE D. BLACK
MICHAEL B. CAMPBELL
WILLIAM F. CARR

POST OFFICE BOX 2208
JEFFERSON PLACE
SANTA FE, NEW MEXICO 87501
TELEPHONE (505) 988-4421

RECEIVED
NOV 06 1980
OIL CONSERVATION DIVISION
SANTA FE

November 4, 1980

Mr. Joe D. Ramey
Oil Conservation Commission
New Mexico Department of
Energy & Minerals
Post Office Box 2088
Santa Fe, New Mexico 87501

Re: Application for Hearing De Novo in Case 7025:
Application of Southland Royalty Company for
Compulsory Pooling, Eddy County, New Mexico

Dear Mr. Ramey:

Enclosed in triplicate is the application for hearing de novo of Southland Royalty Company in the above-referenced matter.

The applicant requests that this matter be set for hearing before the full Commission at the earliest possible date.

Very truly yours,

William F. Carr

WFC:lr

Enclosures

cc: Mr. Chad D. Dickerson

NOV 0 6 1980
OIL CONSERVATION COMMISSION
SANTA FE

BEFORE THE

OIL CONSERVATION COMMISSION

NEW MEXICO DEPARTMENT OF ENERGY AND MINERALS

IN THE MATTER OF THE APPLICATION OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

Case 7025
Order No. R-6498

APPLICATION FOR HEARING DE NOVO

Comes now SOUTHLAND ROYALTY COMPANY, by and through its undersigned attorneys, Campbell and Black, P.A., and pursuant to Commission Rule 1220, hereby applies to the Commission for a hearing de novo in the above-captioned case.

CAMPBELL AND BLACK, P.A.

By William F. Carr

William F. Carr
Post Office Box 2208
Santa Fe, New Mexico 87501
Attorneys for Applicant

Certificate of Mailing

I hereby certify that a copy of the foregoing Application for Hearing De Novo has been mailed to Chad D. Dickerson, Esq., Attorney for Bassett-Birney Oil Corporation, Post Office Box 239, Artesia, New Mexico, 88210 this 4th day of November, 1980.

William F. Carr

RECEIVED
NOV 06 1980
OIL CONSERVATION DIVISION
SANTA FE

BEFORE THE

OIL CONSERVATION COMMISSION

NEW MEXICO DEPARTMENT OF ENERGY AND MINERALS

IN THE MATTER OF THE APPLICATION OF SOUTHLAND ROYALTY COMPANY FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

Case 7025
Order No. R-6498

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F/O 382; F/O 399

A.A.P.L. FORM 610 - 1977

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

July 8, 19 80,

OPERATOR SOUTHLAND ROYALTY COMPANY

CONTRACT AREA W/2 Section 35, T18S, R29E

COUNTY ~~OR PARISH~~ OF Eddy STATE OF New Mexico

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between SOUTHLAND ROYALTY COMPANY, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators",

WITNESSETH:

WHEREAS, the parties to this agreement are owners of oil and gas leases and/or oil and gas interests in the land identified in Exhibit "A", and the parties hereto have reached an agreement to explore and develop these leases and or oil and gas interests for the production of oil and gas to the extent and as hereinafter provided:

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.
DEFINITIONS

As used in this agreement, the following words and terms shall have the meanings here ascribed to them:

A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.

B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.

D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".

E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.

F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.

G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.

H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II.
EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

[X] A. Exhibit "A", shall include the following information:
- (1) Identification of lands subject to agreement,
- (2) Restrictions, if any, as to depths or formations,
- (3) Percentages or fractional interests of parties to this agreement,
- (4) Oil and gas leases and/or oil and gas interests subject to this agreement,
- (5) Addresses of parties for notice purposes.

[X] B. Exhibit "B", Form of Lease.

[X] C. Exhibit "C", Accounting Procedure.

[X] D. Exhibit "D", Insurance.

[X] E. Exhibit "E", Gas Balancing Agreement.

[X] F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.

If any provision of any exhibit, except Exhibit "E", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

ARTICLE III.
INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an unleased oil and gas interest in the Contract Area, that interest shall be treated for the purpose of this agreement and during the term hereof as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B". As to such interest, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the lessee interest.

B. Interest of Parties in Costs and Production:

Exhibit "A" lists all of the parties and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and material acquired in operations on the Contract Area shall be owned by the parties as their interests are shown in Exhibit "A". All production of oil and gas from the Contract Area, subject to the payment of lessor's royalties ~~which will be borne by the Joint Account~~, shall also be owned by the parties in the same manner during the term hereof; provided, however, this shall not be deemed an assignment or cross-assignment of interests covered hereby.

ARTICLE IV.
TITLES

A. Title Examination:

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including Federal Lease Status Reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

~~[ ] Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be a part of the administrative overhead as provided in Exhibit "C" and shall not be a direct charge, whether performed by Operator's staff attorneys or by outside attorneys.~~

[X] Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Exhibit "A".* Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection with leases or oil and gas interests contributed by such party. The Operator shall be responsible for the preparation and recording of Pooling Designations or Declarations as well as the conduct of hearings before Governmental Agencies for the securing of spacing or pooling orders. This shall not prevent any party from appearing on its own behalf at any such hearing.

No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to participate in the drilling of the well.

B. Loss of Title:

1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A", this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests, and

(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development

*except when such costs are incurred in connection with an operation conducted under Article VI B.2 in which event such costs are to be borne by the drilling parties in the proportions elected by such parties.

or operating costs which it may have theretofore paid, but there shall be no monetary liability on its part to the other parties hereto for drilling, development, operating or other similar costs by reason of such title failure; and

(b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract Area by the amount of the interest lost; and

(c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract Area is increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such interests (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well; and

(d) Should any person not a party to this agreement, who is determined to be the owner of any interest in the title which has failed, pay in any manner any part of the cost of operation, development, or equipment, such amount shall be paid to the party or parties who bore the costs which are so refunded; and

(e) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be borne by the party or parties whose title failed in the same proportions in which they shared in such prior production; and

(f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in connection therewith.

2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, is not paid or is erroneously paid, and as a result a lease or interest therein terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new lease covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties shall be revised on an acreage basis, effective as of the date of termination of the lease involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the lease or interest which has terminated. In the event the party who failed to make the required payment shall not have been fully reimbursed, at the time of the loss, from the proceeds of the sale of oil and gas attributable to the lost interest, calculated on an acreage basis, for the development and operating costs theretofore paid on account of such interest, it shall be reimbursed for unrecovered actual costs theretofore paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost interest, on an acreage basis, up to the amount of unrecovered costs;

(b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an acreage basis, of that portion of oil and gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such lease termination, would be attributable to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said portion of the oil and gas to be contributed by the other parties in proportion to their respective interests; and

(c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall not be considered failure of title but shall be joint losses and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of the Contract Area.

ARTICLE V.
OPERATOR

A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:

SOUTHLAND ROYALTY COMPANY shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operator, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the Parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed, shall be determined by Operator, and all such employees shall be the employees of Operator.

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the 8th day of October, 1980, Operator shall commence the drilling of a well for oil and gas at the following location:

1980' FSL & 1980' FWL, Section 35, T18S, R29E, Eddy County, New Mexico

and shall thereafter continue the drilling of the well with due diligence to

11,600' or a depth sufficient to test the Morrow formation

unless granite or other practically impenetrable substance or condition in the hole, which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E.1. hereof.

B. Subsequent Operations:

1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday or legal holidays. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or response given by telephone shall be promptly confirmed in writing.

2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, within sixty (60) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period where the drilling rig is on location, as the case may be) actually commence work on the proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest of the parties approving such operation, and (b) its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A", or (b) carry its proportionate part of Non-Consenting Parties' interest.* The proposing party, at its election, may withdraw such proposal if there is insufficient participation, and shall promptly notify all parties of such decision. *and failure so to advise the proposing party shall constitute an election under (b).

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a producer of oil and or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk, and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or market value thereof if such share is not sold (after deducting production taxes, royalty, overriding royalty and other interests existing on the effective date hereof, payable out of or measured by the production from such well accruing with respect to such interest until it reverts) shall equal the total of the following:

(a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to each Non-Consenting Party had it participated in the well from the beginning of the operation; and

(b) 300% of that portion of the costs and expenses of drilling, reworking, deepening, or plugging back, testing and completing, after deducting any cash contributions received under Article VIII.C., and

300 % of that portion of the cost of newly acquired equipment in the well (to and including the well-head connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's election, shall be sold to its purchaser, if available, under the terms of its existing gas sales contract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from such sale direct to the Consenting Parties until the amounts provided for in this Article are recovered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not contracted for sale of its gas at the time such gas is available for delivery, or has not made the election as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-Consenting Party's share of gas as hereinabove provided during the recoupment period.

During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production.

In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.

Within sixty (60) days after the completion of any operation under this Article, the party conducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas produced during any month, Consenting Parties shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs of the work done and of the equipment purchased, in determining when the interest of such Non-Consenting Party shall revert to it as above provided; and if there is a credit balance, it shall be paid to such Non-Consenting party.

If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent of all parties, no wells shall be completed in or produced from a source of supply from which a well located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such source of supply.

The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b) to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article VI.A.

C. Right to Take Production in Kind:

Each party shall have the right to take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating oil for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any

party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment direct from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate commerce, of any other party's share of gas production without first giving such other party thirty (30) days prior written notice of such intended sale.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any Gas Balancing Agreement between the parties hereto, whether such Agreement is attached as Exhibit "E", or is a separate Agreement.

D. Access to Contract Area and Information:

Each party shall have access to the Contract Area at all reasonable times, at its sole risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the information.

E. Abandonment of Wells:

1. Abandonment of Dry Holes: Except for any well drilled pursuant to Article VI.B.2., any well which has been drilled under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling of such well. Any party who objects to the plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well which has been drilled or reworked pursuant to Article VI.B.2. hereof for which the Consenting Parties have not been fully reimbursed as therein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of such well, all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one year and so long thereafter as oil and or gas is produced from the interval or inter-

vals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentages of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interest in the remaining portion of the Contract Area.

Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned well.

ARTICLE VII.
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.

B. Liens and Payment Defaults:

Each Non-Operator grants to Operator a lien upon ~~its oil and gas rights in the Contract Area, and~~ a security interest in its share of oil and or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon at the rate provided in the Accounting Procedure attached hereto as Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the State, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's share of oil and or gas until the amount owed by such Non-Operator, plus interest has been paid. Each purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.

If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.

C. Payments and Accounting:

Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in the Accounting Procedure attached hereto as Exhibit "C". Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Limitation of Expenditures:

1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this Agreement, it being understood that the consent to the drilling or deepening shall include:

~~[ ] Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and equipping of the well, including necessary tankage and or surface facilities.~~

[X] Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its authorized depth, and all tests have been completed, Operator shall give immediate notice to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion attempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, including necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less than all parties.

2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agreement, it being understood that the consent to the reworking or plugging back of a well shall include consent to all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage and/or surface facilities.

3. Other Operations: Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Twenty-Five Thousand and no/100--- Dollars ($ 25,000.00) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares "Authority for Expenditures" for its own use, Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project costing in excess of Twenty-Five Thousand and no/100-------- Dollars ($ 25,000.00).

E. Royalties, Overriding Royalties and Other Payments:

Each party shall pay or deliver, or cause to be paid or delivered, all royalties to the extent of one-fourth (1/4) due on its share of production and shall hold the other parties free from any liability therefor. If the interest of any party in any oil and gas lease covered by this agreement is subject to any royalty, overriding royalty, production payment, or other charge over and above the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account for or cause to be accounted for, such interest to the owners thereof.

No party shall ever be responsible, on any price basis higher than the price received by such party, to any other party's lessor or royalty owner; and if any such other party's lessor or royalty owner should demand and receive settlements on a higher price basis, the party contributing such lease shall bear the royalty burden insofar as such higher price is concerned.

F. Rentals, Shut-in Well Payments and Minimum Royalties:

Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.2.

Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sunday and holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments

of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

G. Taxes:

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. Operator shall bill other parties for their proportionate share of all tax payments in the manner provided in Exhibit "C".

If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final determination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint account, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as provided in Exhibit "C".

Each party shall pay or cause to be paid all production, severance, gathering and other taxes imposed upon or with respect to the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.

H. Insurance:

At all times while operations are conducted hereunder, Operator shall comply with the Workmen's Compensation Law of the State where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be an amount equivalent to the premium which would have been paid had such insurance been obtained. Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the Workmen's Compensation Law of the State where the operations are being conducted and to maintain such other insurance as Operator may require.

In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's fully owned automotive equipment.

ARTICLE VIII.
ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

A. Surrender of Leases:

The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole or in part unless all parties consent thereto.

However, should any party desire to surrender its interest in any lease or in any portion thereof, and other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not desiring to surrender it. If the interest of the assigning party includes an oil and gas interest, the assigning party shall execute and deliver to the party or parties not desiring to surrender an oil and gas lease covering such oil and gas interest for a term of one year and so long thereafter as oil and/or gas is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B". Upon such assignment, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the acreage assigned and the operation of any well thereon, and the assigning party shall have no further interest in the lease assigned and its equipment and production other than the royalties retained in any lease made under the terms of this Article. The parties assignee shall pay to the party assignor the reasonable salvage value of the latter's interest in any wells and equipment on the assigned acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. If the assignment is in favor of more than one party, the assigned interest shall

be shared by the parties assignee in the proportions that the interest of each bears to the interest of all parties assignee.

Any assignment or surrender made under this provision shall not reduce or change the assignor's or surrendering parties' interest, as it was immediately before the assignment, in the balance of the Contract Area; and the acreage assigned or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this agreement.

B. Renewal or Extension of Leases:

If any party secures a renewal of any oil and gas lease subject to this Agreement, all other parties shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area.

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this agreement.

The provisions in this Article shall apply also and in like manner to extensions of oil and gas leases.

C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash toward the drilling of a well or any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. If all parties hereto are Drilling Parties and accept such tender, such acreage shall become a part of the Contract Area and be governed by the provisions of this agreement. If less than all parties hereto are Drilling Parties and accept such tender, such acreage shall not become a part of the Contract Area. Each party shall promptly notify all other parties of all acreage or money contributions it may obtain in support of any well or any other operation on the Contract Area.

If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Subsequently Created Interest:

Notwithstanding the previsions of Article VIII.E. and VIII.G., if any party hereto shall, subsequent to execution of this agreement, create an overriding royalty, production payment, or net proceeds interest, which such interests are hereinafter referred to as "subsequently created interest", such subsequently created interest shall be specifically made subject to all of the terms and provisions of this agreement, as follows:

1. If non-consent operations are conducted pursuant to any provision of this agreement, and the party conducting such operations becomes entitled to receive the production attributable to the interest out of which the subsequently created interest is derived, such party shall receive same free and clear of such subsequently created interest. The party creating same shall bear and pay all such subsequently created interests and shall indemnify and hold the other parties hereto free and harmless from any and all liability resulting therefrom.

2. If the owner of the interest from which the subsequently created interest is derived (1) fails to pay, when due, its share of expenses chargeable hereunder, or (2) elects to abandon a well under provisions of Article VI.E. hereof, or (3) elects to surrender a lease under provisions of Article VIII.A. hereof, the subsequently created interest shall be chargeable with the pro rata portion of all expenses hereunder in the same manner as if such interest were a working interest. For purposes of collecting such chargeable expenses, the party or parties who receive assignments as a result of (2) or (3) above shall have the right to enforce all provisions of Article VII.B. hereof against such subsequently created interest.

E. Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or

2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the right of the other parties.

If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such party's interests within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds hereof.

F. Waiver of Right to Partition:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

~~**G. Preferential Right to Purchase:**~~

~~Should any party desire to sell all or any part of its interests under this agreement, or its rights and~~ interests in the Contract Area, it shall promptly give written notice to the other parties, ~~with full~~ information concerning its proposed sale, which shall include the name and address of ~~the~~ prospective purchaser (~~who must be ready~~, willing and able to purchase), the purchase ~~price~~, and all other terms of the offer. The other parties shall then have an optional prior ~~right~~, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there ~~shall be~~ no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or ~~substantially~~ all of its assets to a subsidiary or parent company or to a subsidiary of a parent ~~company, or to any company in which any one party owns a majority of the stock~~.

ARTICLE IX.
INTERNAL REVENUE CODE ELECTION

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No

such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from Operations hereunder can be adequately determined without the computation of partnership taxable income.

ARTICLE X.
CLAIMS AND LAWSUITS

Operator may settle any single damage claim or suit arising from operations hereunder if the expenditure does not exceed Five Thousand and no/100---------- Dollars ($ 5,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, the party shall immediately notify Operator, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

ARTICLE XI.
FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure. The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

ARTICLE XII.
NOTICES

All notices authorized or required between the parties, and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by United States mail or Western Union telegram, postage or charges prepaid, or by teletype, and addressed to the party to whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed, and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid, or when sent by teletype. Each party shall have the right to change its address at any time, and from time to time, by giving written notice hereof to all other parties.

ARTICLE XIII.
TERM OF AGREEMENT

This agreement shall remain in full force and effect as to the oil and gas leases and or oil and gas interests subjected hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any lease, or oil and gas interest contributed by any other party beyond the term of this agreement.

~~[ ] Option No. 1: So long as any of the oil and gas leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise, and/or so long as oil and/or gas production continues from any lease or oil and gas interest.~~

[X] Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of 90 days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling or reworking a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and or gas from the Contract Area, this agreement shall terminate unless drilling or reworking operations are commenced within 60 days from the date of abandonment of said well.

It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

ARTICLE XIV.
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the conservation laws of the state in which the committed acreage is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and orders.

B. Governing Law:

The essential validity of this agreement and all matters pertaining thereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state where most of the land in the Contract Area is located shall govern.

ARTICLE XV.
OTHER PROVISIONS

SALE OF ROYALTY GAS

It is recognized by the parties hereto that in addition to each party's share of working interest production, such party shall have the right, subject to existing contracts, to market the royalty gas attributable to each lease which it contributes to the unit area and to receive payments due for such royalty gas produced from or allocated to such lease or leases. It is agreed that, regardless of whether each party markets or contracts for its share of gas, including the royalty gas under the leases which it contributed to the Unit, such party agrees to pay or cause to be paid to the royalty owners under its lease or leases the proceeds attributable to their respective royalty interest and to hold all other parties hereto harmless for its failure to do so.

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of _____ day of _____, 19____.

OPERATOR

SOUTHLAND ROYALTY COMPANY

_____ By: C. E. Mear

DD RWP KWH

NON-OPERATORS

TENNECO OIL EXPLORATION & PRODUCTION

_____ By: _____

BASSETT-BIRNEY OIL CORPORATION

_____ By: _____

FEATHERSTONE FARMS, LTD.

_____ BY: _____

ROBERT E. McKEE COMPANY

_____ BY: _____

CORPORATION ACKNOWLEDGMENT

THE STATE OF Texas

COUNTY OF Midland

BEFORE ME, the undersigned authority, on this day personally appeared _____ C. E. Mear, known to me to be the person whose name is subscribed to the foregoing instrument, as Attorney-in-Fact of _____ Southland Royalty Company, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the 18th day of July A.D. 1980.

My Commission Expires:
Oct. 31, 1980

Linda Harell
Notary Public in and for Midland County, Texas

CORPORATION ACKNOWLEDGMENT

THE STATE OF

COUNTY OF

BEFORE ME, the undersigned authority, on this day personally appeared _____ _____, known to me to be the person whose name is subscribed to the foregoing instrument, as _____ of _____ _____, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the _____ day of _____ A.D. 19____.

My Commission Expires:

_____
Notary Public in and for _____ County,

CORPORATION ACKNOWLEDGMENT

THE STATE OF

COUNTY OF

BEFORE ME, the undersigned authority, on this day personally appeared _____ _____, known to me to be the person whose name is subscribed to the foregoing instrument, as _____ of _____ _____, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the _____ day of _____ A.D. 19____.

My Commission Expires:

_____
Notary Public in and for _____ County,

W/2 Section 35, T18S, R29E
Eddy County, New Mexico

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of _____ day of _____, 19____.

OPERATOR

SOUTHLAND ROYALTY COMPANY

By: C. E. Mear

DD Rwp Field

NON-OPERATORS

TENNECO OIL COMPANY

ATTEST:

D L Mottloch

D. L. Motloch, Asst. Secretary

By: D S Taylor

D.S.TAYLOR, Vice-President

SDK mmm 4HM

BASSETT-BIRNEY OIL CORPORATION

By: _____

FEATHERSTONE FARMS, LTD.

BY: _____

ROBERT E. McKEE COMPANY

BY: _____

CORPORATION ACKNOWLEDGMENT

THE STATE OF Texas

COUNTY OF Midland

BEFORE ME, the undersigned authority, on this day personally appeared C. E. Mear, known to me to be the person whose name is subscribed to the foregoing instrument, as Attorney-in-Fact of Southland Royalty Company, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the 18th day of July A.D. 1980.

My Commission Expires:
Oct. 31, 1980

Linda Harrell
Notary Public in and for Midland County, Texas

CORPORATION ACKNOWLEDGMENT

THE STATE OF Texas

COUNTY OF Bexar

BEFORE ME, the undersigned authority, on this day personally appeared C. S. Taylor, known to me to be the person whose name is subscribed to the foregoing instrument, as Vice President of Tennessee Gas Company, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the 15 day of August A.D. 1980.

My Commission Expires:
CAROLYN WRIGHT
Notary Public, Bexar County, Texas
My Commission Expires 9-15-80

Carolyn Wright
Notary Public in and for Bexar County,

CORPORATION ACKNOWLEDGMENT

THE STATE OF

COUNTY OF

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing instrument, as _____ of _____, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the _____ day of _____ A.D. 19____.

My Commission Expires:

_____
Notary Public in and for _____ County,

EXHIBIT "A"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration and Production and Bassett-Birney Oil Corporation, Non-Operators.

LANDS SUBJECT TO AGREEMENT:

W/2 of Section 35, T18S, R29E, Eddy County, New Mexico, below the base of the San Andres formation.;

NE/4SW/4, of Section 35, T18S, R29E, Eddy County, New Mexico, insofar as it covers the depths from the surface of the earth to the base of the San Andres formation.

ADDRESSES AND INTERESTS OF PARTIES:

	WI (BPO)	WI (APO)
Southland Royalty Company 1100 Wall Towers West Midland, Texas 79701	.55604883	.27802442
Tenneco Oil Exploration & Production 6800 Park Ten Blvd., Suite 200 North San Antonio, Texas 78213	.25368638	.25368638
Bassett-Birney Oil Corporation 202 South Fourth Street Artesia, New Mexico 88210	.19026479	.19026479
Robert E. McKee Co. P. O. Box 20562 El Paso, Texas 79998	-0-	.09513239
Featherstone Farms, Ltd. 1717 W. Second Street Roswell, New Mexico 88201	-0-	.18289202
	1.000000	1.00000000

EXHIBIT "B"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

OIL AND GAS LEASE

THIS AGREEMENT made this _____ day of _____ 19___, between _____

_____

as Lessor, and _____ as Lessee, WITNESSETH:

1. Lessor in consideration of Ten and No/100 Dollars ($10.00) in hand paid of the royalties herein provided, and of the agreements of Lessor herein contained, hereby grants, leases and lets exclusively unto Lessee for the purpose of investigating, exploring, producing, drilling and mining for and producing oil and gas, laying pipe lines, building roads, tanks, power stations, telephone lines and other structures thereon to produce, care, take care of, treat, transport, and own said products, the following

described land in _____ County, Texas, to-wit:

and containing _____ acres, more or less. In the event a resurvey of said lands shall reveal the existance of excess and/or vacant lands lying adjacent to the lands above described and the Lessor, his heirs, or assigns, shall by virtue of its ownership of the lands above described, have preference right to acquire said excess and/or vacant lands, then in that event this lease shall cover and include all such excess and/or vacant lands which the Lessor, its successors or assigns, shall have the preference right to acquire by virtue of its ownership of the lands above described as and when acquired by the Lessor; and the Lessee shall pay the Lessor for such excess and/or vacant lands at the same rate per acre as the cash consideration paid for the acreage hereinabove mentioned.

2. Subject to the other provisions herein contained, this lease shall be for a term of _____ from this date (called "primary term") and as long thereafter as oil or gas is produced from said land hereunder.

3. The royalties to be paid Lessor are: (a) on oil one-fourth (1/4) of that produced and saved from said land, the same to be delivered at the wells or to the credit of Lessor into the pipe line to which the wells may be connected; Lessee may from time to time purchase any royalty oil in its possession, paying the market price therefor prevailing for the field where produced on the date of purchase; and (b) on gas, including cashinghead gas or other gaseous substance, produced from said land and sold or used off the premises or in the manufacture of gasoline or other products therefrom, the market value at the well of one-fourth (1/4) of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-fourth (1/4) of the amount realized from such sale; where gas from a well producing gas only is not sold or used, Lessee may pay as annual royalty, commencing ninety (90) days after such well is first shut in, the sum of _____ per well per year, and upon such payment it will be considered that gas is being produced within the meaning of Paragraph 2 hereof; provided, however, that such shut in payments shall not continue this lease in force for any consecutive period of more than _____ years. Lessee shall have free use of oil, gas and water from said land, except water from Lessor's wells, for all operations hereunder, and the royalty on oil, gas or water shall be computed after deducting any so used.

4. If prior to discovery of oil or gas on said land, Lessee should drill a dry hole or holes thereon, or if after discovery of oil or gas, the production thereof should cease from any cause, this lease shall not terminate if Lessee commences additional drilling or re-working operations within sixty (60) days thereafter. If at the expiration of the primary term, oil or gas is not being produced on said land, but Lessee is then engaged in drilling or re-working operations thereon, the lease shall remain in force so long as operations on said well or for drilling or re-working of any additional well are prosecuted with no cessation of more than sixty (60) consecutive days and if they result in the production of oil or gas so long thereafter as oil or gas is produced from said land. In the event a well or wells producing oil or gas in paying quantities should be brought in on adajacent land and draining the leased premises, Lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.

5. Lessee shall have the right at any time until six months after the expiration of this lease to remove all property and fixtures placed by Lessee on said land, including the right to draw and remove all casing. When required by Lessor, Lessee will bury all pipe lines below ordinary plow depth, and no well shall be drilled within two hundred (200) feet of any residence or barn now on said land without Lessor's consent.

6. The rights of either party hereunder may be assigned in whole or in part and the provisions hereof shall extend to the heirs, successors and assigns, but no change or division in ownership of the land, or royalties, however accomplished, shall operate to enlarge the obligations or diminish the rights of Lessor. No sale or enlargement by either party shall be binding on the other party hereto until such party shall have been furnished with a certified copy of recorded instrument evidencing same. If six or more parties become entitled to royalty hereunder, Lessee may withhold payment thereof unless and until furnished with a recordable instrument executed by all such parties designating an agent to receive payment for all.

7. Lessor herein makes no warranty of title, either express or implied. Lessor hereby agrees that Lessee at its option may discharge any tax, mortgage or other lien upon said land and in the event Lessee does so, it shall be subrogated to such lien with the right to enforce same and apply royalties accruing hereunder toward satisfying same. It is agreed that if Lessor owns an interest in said land less than the entire fee simple, then the royalties to be paid Lessor shall be reduced proportionately.

8. If any operations permitted or required hereunder or the performance by Lessee of any covenant, agreement or requirement hereof is delayed or interrupted directly or indirectly by any past or future acts, orders, regulations, or requirements of the Government of the United States or of any state or other governmental body, or any agent, officer, representative or authority of any of them, the period of such Delay or interruption shall not be counted against the Lessee, and the primary term of this lease shall automatically be extended after the expiration of the primary term set forth in Section 2 above so long as the cause or causes for such delay or interruption continue and for a period of six (6) months thereafter; and such extended term shall constitute and shall be considered for the purposes of this lease as a part of the primary term hereof. The Lessee shall not be liable to Lessor in damages for failure to perform any operation permitted or required hereunder or to comply with any covenant, agreement or requirement hereof during the time Lessee is relieved from the obligations to comply with such covenants, agreements, or requirements.

IN WITNESS WHEREOF, this instrument is executed on the date first above written.

_____

601, BOX 800 TULSA OK 74101

COPAS — 1974
Recommended by the Council of Petroleum Accountants Societies of North America

COPAS

EXHIBIT "C"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

ACCOUNTING PROCEDURE
JOINT OPERATIONS

I. GENERAL PROVISIONS

1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

2. Statement and Billings

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

3. Advances and Payments by Non-Operators

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

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

4. Adjustments

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

5. Audits

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

6. Approval by Non-Operators

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

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. **Rentals and Royalties**

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

2. **Labor**

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

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

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

   B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II. Such costs under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 2A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.

   C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II.

   D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II.

3. **Employee Benefits**

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

4. **Material**

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

5. **Transportation**

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

   A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by the Parties.

   B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.

   C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking cost of $200 or less excluding accessorial charges.

6. **Services**

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

7. **Equipment and Facilities Furnished by Operator**

   A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on investment not to exceed eight per cent (8%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.

   B.. In lieu of charges in Paragraph 7A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

8. **Damages and Losses to Joint Property**

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

9. **Legal Expense**

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

10. Taxes

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

11. Insurance

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

12. Other Expenditures

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

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

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

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

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

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

A. Overhead - Fixed Rate Basis

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

Drilling Well Rate $ 3,000.00
Producing Well Rate $ 300.00

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

(a) Drilling Well Rate

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

[2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days

[3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

[1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.

[2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.

[3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.

[4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.

[5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

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

~~B. Overhead - Percentage Basis~~

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

(a) Development

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

(b) Operating

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

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

2. Overhead - Major Construction

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess of $ 25,000.00 :

A. 5.0 % of total costs if such costs are more than $ 25,000.00 but less than $ 100,000.00 ; plus
B. 2.0 % of total costs in excess of $ 100,000.00 but less than $1,000,000; plus
C. 2.0 % of total costs in excess of $1,000,000.

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

3. Amendment of Rates

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

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

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

1. Purchases

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

2. Transfers and Dispositions

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

A. New Material (Condition A)

(1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.

(2) Line Pipe

(a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.

(b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.

(3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

B. Good Used Material (Condition B)

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

(1) Material moved to the Joint Property

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

(2) Material moved from the Joint Property

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

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

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

C. Other Used Material (Condition C and D)

(1) Condition C

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

(2) Condition D

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

D. Obsolete Material

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

E. Pricing Conditions

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

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

3. Premium Prices

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

4. Warranty of Material Furnished by Operator

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

V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

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

3. Special Inventories

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

4. Expense of Conducting Periodic Inventories

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

EXHIBIT "D"

INSURANCE

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

(a) Operator shall at all times during the terms of this Agreement carry insurance to protect the parties hereto as follows:

(1) Workmen's compensation and occupational disease insurance as required by the laws of the state or states in which operations will be conducted and employer's liability insurance with a limit of not less than $100,000.

(2) Comprehensive general public liability insurance, excluding products liability insurance, with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident and $100,000 aggregate limit applicable to all loss of or damage to property during the policy period.

(3) Automotive public liability insurance covering all automotive equipment used in performance of work under this Agreement with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident.

(b) Operator shall require all contractors performing work under this Agreement to carry the following insurance:

(1) Workmen's compensation and occupational disease insurance as required by the laws of the state or states in which operations will be conducted and employers' liability insurance with a limit of not less than $100,000.

(2) Comprehensive general liability insurance with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident and $100,000 aggregate limit applicable to all loss of or damage to property during the policy period.

(3) Automotive public liability insurance covering all automotive equipment used in performance of work under this Agreement with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident.

EXHIBIT "E"

GAS BALANCING AGREEMENT

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

The parties to the Operating Agreement to which this agreement is attached, own working interest in the gas rights underlying the Unit Area covered by such Operating Agreement in accordance with the percentages of participation as set forth in Exhibit "A" to said Agreement.

In accordance with the terms of the Operating Agreement, each party thereto has the right to take in kind its share of gas produced from the Unit Area and market or otherwise dispose of same. In the event any party hereto is not at any time taking or marketing its share of gas, or has contracted to sell its share of gas produced from the Unit Area to a purchaser which does not at any time take the full share of gas attributable to the interest of such party, the terms of this agreement shall automatically become operative.

During the period when any party hereto is not marketing or otherwise disposing of its share of gas produced from any proration unit within the Unit Area, the other parties hereto shall be entitled to produce, in addition to their own share of production, that portion of such other party's share of production which said party is unable to market or otherwise dispose of and shall be entitled to take such gas production and deliver same to its or their purchaser(s). All parties hereto shall share in and own the liquid hydrocarbons recovered from such gas by lease equipment in accordance with their respective interests, and subject to the aforesaid Operating Agreement, but the party or parties taking such gas shall own all of such gas delivered to its or their purchaser(s).

An account shall be established for each party not marketing or otherwise disposing of its share of the gas produced, which account shall be credited with an amount of gas equal to such party's full share of the gas produced, less its share of gas used in lease operations, vented or lost, and less that portion marketed or otherwise disposed of by such party. The Operator will maintain a current over and under account of the gas balance between the parties and will furnish all parties hereto monthly statements showing the total quantity of gas produced, the amount used in lease operations, vented or lost, the total quantity of liquid hydrocarbons recovered therefrom, and the monthly and cumulative over and under account of each party.

Each party hereto will make settlement with the royalty owners to whom it is accountable, just as if such party were marketing or otherwise disposing of its share, and its share only, of such gas production. Each party hereto agrees to hold each other harmless from any and all claims for royalty payments asserted by royalty owners to whom each party is accountable. The term "royalty owner" shall include owners of royalty, overriding royalties, production payments and similar interests.

After notice to the Operator, any party at any time may begin marketing or otherwise disposing of its share of the gas produced from a proration unit with respect to which it has an under account balance. In addition to such share, said party, until it has balanced the gas account as to its interest, shall be entitled to take a share of gas determined by multiplying thirty-three and one-third percent (33 1/3%) of the interest in the current gas production of the party or parties having an over account balance by a fraction, the numerator of which is the interest in the proration unit of such party with the under account balance and the denominator of which is the total percentage interest in such proration unit of all parties having an under account balance and who are currently marketing or otherwise disposing of a portion of their under account balance in addition to their share of gas.

Each party marketing or otherwise disposing of gas shall pay the production taxes due on such gas.

Nothing herein shall be construed to deny any party the right, from time to time, to produce and deliver to its purchaser its full share of the allowable gas production to meet the deliverability tests required by its purchaser.

Should production of gas from a proration unit be permanently discontinued before the gas account is balanced, settelement will be made between those parties credited with under account and over account balances. In making such settlement, the party or parties credited with an under account balance will be paid by the party or parties credited with an over account balance a sum of money equal to that received attributable to such over account, less applicable taxes theretofore paid. For gas sold or delivered into intrastate commerce said sum shall be computed at the price received for sale of the gas. For gas sold or delivered into interstate commerce said sum shall be computed at the rate collected, not subject to possible refund, as provided by the Federal Energy Regulatory Commission, plus any additional collected amount which is ultimately not required to be refunded, such additional collected amount to be accounted for at such time as final determination is made with respect thereto.

Nothing herein shall change or affect each party's obligation to pay its proportionate share of all costs and liabilities incurred, as provided in the aforesaid Operating Agreement.

This agreement shall constitute a separate agreement as to each proration unit within the Unit Area. It shall inure to the benefit of and be binding upon the parties hereto, their successors, legal representatives and assigns. It shall become effective in accordance with its terms and shall remain in force and effect as long as the Operating Agreement to which it is attached remains in effect.

EXHIBIT "F"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

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 origin 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 relevent 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 non-discrimination 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 orders 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 (EE01) 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.

September 4, 1980

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis, Landman

Re: Proposed Southland Royalty Company Empire
Federal "35" Com. No. 1 and "35-A" Com. No. 1
Wells, W/2 and E/2 Sec. 35, T-18-S, R-29-E,
Eddy County, New Mexico

Gentlemen:

This acknowledges receipt of your letters of July 8 and July 25, 1980, together with joint operating agreements and AFEs covering the proposed drilling of the subject wells.

The joint operating agreement dated July 8 covering W/2 Section 35 and the AFE for your No. "35" Com. No. 1, credits our company with a 19.026479% (60/315.35) interest, when in fact we own a 38.052957% (120/315.35) interest. The joint operating agreement dated July 17, 1980 covering E/2 Section 35 and the AFE for your No. "35-A" Com. No. 1, credits our company with a 6.3199% (20/316.46) interest, when in fact we own a 12.6398% (40/316.46) interest. Southland Royalty has instituted a suit against, among other parties, Bassett-Birney Oil Corporation, in the United States District Court for the District of New Mexico, Case No. CIV-80-0614 HB, contesting a portion of our title to the working interest underlying the proposed wells. In view of the incorrect statements in your operating agreements and AFEs as to our ownership in the proposed wells and the pending lawsuit, we are unable to approve either the AFEs or joint operating agreements.

Bassett-Birney is willing to pool its interests in the W/2 of Section 35 and in the E/2 of Section 35 for the drilling of the "35" Com. No. 1 Well and the "35-A" Com. No. 1 Well.

Case Nos. 7024 and 7025
N.M. Oil Conservation Div.
Examiner Hearing of 9/17/80
Bassett-Birney Oil Corp.
Exhibit No. 1

If you have any questions, please do not hesitate to call me.

Very truly yours,

BASSETT-BIRNEY OIL CORPORATION

By: Jack W. McCaw

Jack W. McCaw,
Vice President

COPY

FILED
UNITED STATES DISTRICT COURT
SANTA FE, NEW MEXICO
JUL 23 1980
BY _____ DEP. CLERK

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW MEXICO

SOUTHLAND ROYALTY COMPANY,

Plaintiff,

vs.

ROBERT E. McKEE, INC., BASSETT-BIRNEY OIL CORPORATION and the UNITED STATES DEPARTMENT OF THE INTERIOR, BUREAU OF LAND MANAGEMENT,

Defendants.

CIV 80-0514HB
No.

C O M P L A I N T

COMES NOW the Plaintiff, SOUTHLAND ROYALTY COMPANY, by and through its attorneys, and for its Complaint against Defendants states:

The Parties - Jurisdiction - Venue

1. Plaintiff, Southland Royalty Company ("Southland") is a corporation, incorporated by the State of Delaware, having its principal place of business in the State of Texas.

2. Defendant Robert E. McKee, Inc., ("McKee") is a corporation, incorporated by the State of Nevada, having, upon information and belief, its principal place of business in the State of California.

3. Defendant Bassett-Birney Oil Corporation ("Bassett-Birney") is a corporation, incorporated by the State of New Mexico, having its principal place of business in the State of New Mexico.

4. Defendant United States Department of the Interior, Bureau of Land Management, is charged by statute with the administration and supervision of federal oil and gas leases and is the lessor of certain oil and gas properties as more particularly alleged herein.

Case Nos. 7024 and 7025
N.M. Oil Conservation Div.
Examiner Hearing of 9/17/80
Bassett-Birney Oil Corp.
Exhibit No. 2

5. This is a suit to adjudicate a disputed title to real estate in which the United States claims an interest and the Court has jurisdiction over the subject matter herein by reason of 28 U.S.C. 1346 (f) and 28 U.S.C. 2409 (a).

6. Venue in the District of New Mexico is proper by reason of 28 U.S.C. 1402 (d).

General Allegations

7. The real estate to which title is disputed is certain acreage specified in Federal Oil and Gas Lease No. LC-062029, dated May 1, 1942, more particularly described as follows:

Township 18 South, Range 29 East, Eddy County, New Mexico:

(a) Section 33 - N1/2 SE1/4
- SE1/4 SW1/4

(b) Section 34 - Lots 1 and 2 (S1/2 SE1/4) and 4 (SW1/4 SW1/4)
- NW1/4 SW1/4

(c) Section 35 - NW1/4 SW1/4
- S1/2 NW1/4
- NW1/4 SE1/4

hereinafter referred to as the "Disputed Acreage."

8. In late 1979, Southland initiated a program to drill and to develop an oil and gas well on a 320 acre proration unit in the eastern half (E1/2) of Section 34, T18S, R29E, Eddy County, New Mexico, hereinafter referred to as "The Tract." Ownership of oil and gas interests in The Tract was divided in varying proportions among several individuals and entities, and included a portion of the Disputed Acreage.

9. In order to develop an oil and gas tract, the ownership of which is divided among several individuals and entities, appropriate parties contract and agree among themselves regarding relevant rights, duties, and obligations, with respect to the tract. Two of the most common forms of such agreement are a) a Farmout Agreement, and b) an Operating Agreement:

a) Farmout Agreement - In the usual and customary practice of the oil and gas industry, a Farmout Agreement is a contract between operators whereby the owner of a lease not desirous of drilling at the time agrees to assign the lease to another operator who is desirous of drilling the tract. The primary characteristic of a farmout is the obligation of the assignee to drill a well on the assigned acreage as a prerequisite to the formal assignment of interests. In exchange for the assignment of interests, the assignor is usually granted an overriding royalty interest in production from the tract.

b) Operating Agreement - In the usual and customary practice of the oil and gas industry, an Operating Agreement is a contract between owners of leases in a tract who are desirous of drilling a well. The owners agree to name an Operator to drill the well, designate their specific acreage interest in the tract, and agree to divide costs in the well and interest in production.

10. In late 1979, Southland conducted a title search to determine ownership of oil and gas interest in the Tract. Such title search revealed that McKee and Bassett-Birney each possessed a one-half (1/2) working interest in Lots 1 and 2 (S1/2 SE1/4) of the Tract and that McKee and Bassett-Birney each possessed a one-half (1/2) working interest in the remainder of the Disputed Acreage.

11. By letter dated September 27, 1979, Southland informed McKee that the title seach revealed McKee's one-half (1/2)

working interest in Lots 1 and 2 (S1/2 SE1/4) of the Tract and one-half (1/2) working interest in the remainder of the Disputed Acreage and requested McKee to execute a Farmout of the Disputed Acreage in favor of Southland, such letter is attached hereto and incorporated herein as Exhibit "A."

12. On October 15, 1979, McKee formally executed a Farmout Agreement of the Disputed Acreage in favor of Southland, such Farmout Agreement is attached hereto and incorporated herein as Exhibit "B."

13. Under the terms of the Farmout Agreement, McKee promised to assign to Southland its one-half (1/2) working interest in the Disputed Acreage in the event Southland, at its sole risk and expense, was successful in drilling a natural gas well. In exchange for such assignment, McKee was granted a 1/16 of 8/8 overriding royalty interest in production from the Disputed Acreage with the option to convert to a 50% working interest at payout.

14. By executing the Farmout Agreement, McKee acknowledged and represented that it possessed a one-half (1/2) working interest in Lots 1 and 2 of the Tract and one-half (1/2) working interest in the remainder of the Disputed Acreage.

15. By letter dated February 26, 1980, Southland informed Bassett-Birney that the title search revealed Bassett-Birney's one-half (1/2) working interest in Lots 1 and 2 (S1/2 SE1/4) of the Tract and one-half (1/2) working interest in the remainder of the Disputed Acreage and requested Bassett-Birney to execute either a Farmout of the Disputed Acreage in favor of Southland or an Operating Agreement for the Tract, such letter is attached hereto and incorported herein as Exhibit "C."

16. By letter dated March 21, 1980, Southland again informed Bassett-Birney that the title seach revealed

Bassett-Birney's one-half (1/2) working interest in Lots 1 and (S1/2 SE1/4) of the Tract and again requested Basset-Birney to execute either a Farmout of Lots 1 and 2 of the Tract or an Operating Agreement for the Tract, such letter is attached here and incorporated herein as Exhibit "D."

17. By letter dated April 8, 1980, and pursuant to a request by Bassett-Birney, Southland forwarded to Bassett-Birney a xerox copy of the formal Title Opinion on the Disputed Acreage, such letter and Title Opinion are attached hereto and incorporated herein as Exhibit "E."

18. By letter dated April 22, 1980, and after complete review of the Title Opinion showing as its only ownership a one-half (1/2) working interest in the Disputed Acreage, Bassett-Birney executed an Authorization for Expenditure (AFE) and an Operating Agreement for the Tract, which letter, AFE and Operating Agreement are attached hereto and incorporated herein as Exhibit "F," "F(1)," and "F(2)," respectively.

19. Under the terms of the Operating Agreement, Bassett-Birney agreed that Southland would drill and operate an 11,000 foot Morrow natural gas well on the Tract.

20. By executing the AFE after complete review of the Title Opinion, Bassett-Birney acknowledged and represented that it possessed only a one-half (1/2) working interest in Lots 1 and 2 of the Tract and only a one-half (1/2) working interest in the remainder of the Disputed Acreage.

21. By executing the Operating Agreement after complete review of the Title Opinion, Bassett-Birney acknowledged and represented that it possessed only a one-half (1/2) working interest in Lots 1 and 2 of the Tract and only a one-half (1/2) working interest in the remainder of the Disputed Acreage.

22. At 10:00 a.m. on May 11, 1980, on the basis of and in reliance on the Title Opinion concerning the Disputed Acreage, the execution of the Farmout Agreement by McKee, and the execution of the AFE and Operating Agreement by Bassett-Birney, Southland initiated the drilling of a natural gas well on the Tract. The natural gas well, desginated as the Southland Royalty Company Federal Comm. "34" #1 Well, has been completed as a commercial producing gas well on the Tract.

23. On May 23, 1980, after Southland initiated drilling on the Tract, Bassett-Birney informed Southland that Bassett-Birney claimed an ownership interest in the Tract and the remainder of Disputed Acreage in an amount greater that its ownership interest as specified in the Title Opinion, the Farmout Agreement with McKee and the AFE and Operating Agreement with Bassett-Birney.

24. On the basis of an unrecorded Operating Agreement between Bassett-Birney and McKee, Bassett-Birney claims ownership of one-hundred percent (100%) of the working interest in Lots 1 and 2 of the Tract and one-hundred percent (100%) of the working interest in the remainder of the Disputed Acreage, such Operating Agreement as was supplied to Southland by Bassett-Birney is attached hereto and incorporated herein as "Exhibit G."

25. On June 6, 1980, on demand by Bassett-Birney, McKee executed an Assignment to Bassett-Birney of fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and fifty percent (50%) of the working interest in the remainder of the Disputed Acreage, such Assignment is attached hereto and incorporated herein as "Exhibit H."

FIRST CAUSE OF ACTION

26. Southland adopts and incorporates herein by reference the allegations contained in Paragraphs 1 through 25.

27. On the basis of the Farmout Agreement with McKee, Southland owns a fifty percent (50%) working interest in Lots 1

and 2 of the Tract and a fifty percent (50%) working interest in the remainder of the Disputed Acreage.

28. Bassett-Birney's claim that it owns one-hundred percent (100%) of the working interest in Lots 1 and 2 of the Tract and one-hundred percent (100%) working interest in the remainder of the Disputed Acreage is adverse to Southland and Bassett-Birney owns only fifty percent (50%) of such working interest.

29. Bassett-Birney's adverse claim is based on an Operating Agreement ("Exhibit G"), which is invalid and unenforceable on grounds of laches, waiver, and estoppel.

30. The Assignment from McKee to Bassett-Birney ("Exhibit H") constitutes a cloud on Southland's title to fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and fifty percent (50%) of the working interest in the remainder of the Disputed Acreage.

WHEREFORE, Southland requests judgment against McKee and Bassett-Birney as follows:

A. Declaring that the Operating Agreement ("Exhibit G") between McKee and Bassett-Birney is invalid and unenforceable on grounds of laches, waiver and estoppel;

B. Cancelling the Assignment ("Exhibit H") from McKee to Bassett-Birney;

C. Quieting title in fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and fifty percent (50%) of the working interest in the remainder of the Disputed Acreage in Southland and against McKee and Bassett-Birney; and

D. For such other relief as the Court deems just and proper.

SECOND CAUSE OF ACTION

31. Southland adopts and incorporates herein by reference the allegations contained in Paragraphs 1 through 28.

32. The Operating Agreement ("Exhibit G") under which Bassett-Birney claims an interest adverse to Southland's was not recorded as required by law and was not in the record chain of title of the Disputed Acreage.

33. With respect to fifty percent (50%) of the working interest in the Disputed Acreage, Southland is a good-faith, innocent purchaser for value without notice or knowledge of the adverse claim by Bassett-Birney.

WHEREFORE, Southland requests judgment against McKee and Bassett-Birney as follows:

A. Declaring that with respect to the Disputed Acreage, Southland is an innocent purchaser for value without notice or knowledge of the adverse claim by Bassett-Birney.

B. Cancelling the Assignment ("Exhibit H") from McKee to Bassett-Birney.

C. Quieting title in fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and 50% of the working interest in the remainder of the Disputed Acreage in Southland and against Mckee and Bassett-Birney; and

D. For such other relief as ther Court deems just and proper.

THIRD CAUSE OF ACTION

34. Southland adopts and incorporates by reference herein the allegations contained in Paragraphs 1 through 28.

35. At the time McKee executed the Farmout Agreement and at the time Bassett-Birney executed the Operating Agreement, McKee and Bassett-Birney knew or reasonably should have known of the existence and terms of the Operating Agreement ("Exhibit H") under which the parties claim an interest in the Disputed Acreage adverse to Southland.

36. At the time McKee executed the Farmout Agreement and at the time Bassett-Birney executed the Operating Agreement, the

parties made no claims to an interest in the Disputed Acreage adverse to Southland.

37. By executing the Farmout Agreement and Operating Agreement, McKee and Bassett-Birney waived any claims to an interest in the Disputed Acreage adverse to Southland and are now barred by estoppel from asserting such claims.

WHEREFORE, Southland requests judgment against McKee and Bassett-Birney as follows:

A. Declaring that with respect to the Disputed Acreage, McKee and Bassett-Birney have waived any claims to an interest in the Disputed Acreage adverse to Southland and are now estopped from asserting such claims; and

B. Cancelling the Assignment ("Exhibit H") from McKee to Bassett-Birney.

C. Quieting title in fifty percent (50%) of the working interest in Lots 1 and 2 of the Tract and 50% of the working interest in the remainder of the Disputed Acreage in Southland and against Mckee and Bassett-Birney; and

D. For such other relief as the Court deems just and proper.

FOURTH CAUSE OF ACTION

38. Southland adopts and incorporates by reference herein the allegations contained in Paragraphs 1 through 25.

39. Under the terms and conditions of the Farmout Agreement between Southland and McKee, McKee promised to assign to Southland its one-half (1/2) working interest in the Disputed Acreage upon Southland's drilling and completion of a well capable of producing gas in paying quantities.

40. By drilling and completing the Federal Comm. "34" #1 Well, Southland has performed its drilling obligations under the

Farmout Agreement with McKee and has performed and is in compliance with all other terms and conditions of the Farmout Agreement.

41. Pursuant to the terms and conditions of the Farmout Agreement, Southland has made demand on McKee for an assignment of its one-half (1/2) working interest in the Disputed Acreage, but McKee has refused to tender such assignment and McKee has instead unlawfully and without authority assigned such interests to Bassett-Birney.

42. The actions of McKee in refusing to assign to Southland its one-half (1/2) working interest in the Disputed Acreage and instead assigning such interests to Bassett-Birney constitutes a breach of the Farmout Agreement between Southland and McKee.

43. As a direct and proximate result of McKee's breach of the terms and conditions of the Farmout Agreement, Southland has suffered damages in an amount as yet unascertainable, but in no event less than $10,000.

WHEREFORE, Southland requests judgment against McKee as follows:

A. Declaring that McKee has breached the Farmout Agreement with Southland.

B. Awarding Southland actual damages incurred as a result of McKee's breach of the Farmout Agreement.

C. For such other relief as the Court deems just and proper.

Respectfully submitted,

CAMPBELL & BLACK, P.A.

By _____
Michael B. Campbell
Attorney for Plaintiff, Southland Royalty Company
Post Office Box 2208
Santa Fe, NM 87501
Telephone: (505) 988-4421

Southland Royalty Company

September 27, 1979

Robert E. McKee Co.
P. O. Box 20562
El Paso, Texas 79998

Attention: Mr. Jerry Watkins

Re: Portions of T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

Gentlemen:

SRC is presently attempting to secure support from the leasehold owners under portions of T18S, R29E, Eddy County, New Mexico. With adequate support SRC plans to drill a Morrow test well at a legal offset location to your leasehold.

Due to the diverse ownership in this area, a successful attempt to explore a deep formation like the Morrow will require the cooperation of numerous parties. Before SRC can attempt such a risky venture, we must acquire a substantial amount of support through option farmouts, allowing SRC the opportunity to earn additional acreage through drilling and producing.

A check of the records indicates that Robert E. McKee Co. owns a leasehold under the following tract(s) of land:

SECTION	W.I.	GROSS ACRES	NET ACRES
Sec. 33: N/2SE/4, SE/4SW/4	50%	120	60
Sec. 34: Lots 1,2,4 & NW/4SW/4	50%	160	60
Sec. 35: Lot 2, NW/4, NW/4SW/4, NW/2SE/4	50%	280	140
	Total:	560	280

Upon verfication that our information on your ownership is correct, SRC requests your support by granting a Farmout of your leasehold interest under the following general terms:

1. Ninety days from the completion of an offset well, Southland will commence a well at a legal location on your leasehold in Section 33, 34, or 35, or on land unitized herewith.
2. Upon completion of a well capable of producing oil and/or gas in commercial quantities Robert E. McKee will assign 100% of its leasehold interest to SRC, subject to a 1/16 of 8/8 overriding royalty interest with an option

EXHIBIT A

to convert said interest to a 50% working interest at payout, both proportionately reduced, in the proration unit drilled. Also, SRC will have the option to drill on the balance of your acreage in Section 33, 34, and 35, under a 90 day continuous development provision, with a clause providing for a depth severance of 100' below the deepest producing interval on proration unit basis, as well as the ipso facto termination of any undeveloped proration units not drilled under the continuous development provision.

3. Upon completion or abandonment of an offset well, Southland will have a 120 day option to commence a subsequent well in the drilled proration unit.

Upon receiving approval for this proposal, Southland will be happy to prepare a Farmout Agreement containing the above provisions.

Should you have any questions regarding the above, please do not hesitate contacting me at (915) 682-8641, Ext. 27. Your earliest attention concerning this proposal will be greatly appreciated.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:lh

FARMOUT AGREEMENT F/O 382

Date: October 9, 1979

Robert E. McKee Co.
P. O. Box 20562
El Paso, Texas 79998

Attention: Bob Hazelton

Re: Farmout Agreement
Portions of T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

This letter when accepted by you as "Farmor", shall evidence Southland Royalty Company's, hereinafter called "SRC", right to earn from Robert E. McKee Co., hereinafter called "McKee", an assignment of an interest in the leases described in Exhibit "A" attached hereto, hereinafter called "said leases", upon SRC fulfilling the requirements, conditions, and obligations contained herein.

I. DRILLING REQUIREMENTS: The drilling and completion requirements FARMOUTEE must satisfy, as a condition for earning, are as follows:

TEST WELL: A. This agreement shall terminate unless on or before ninety (90) days from the date hereof, FARMOUTEE shall commence, at FARMOUTEE's sole cost, risk and expense, the actual drilling of a well, hereafter called "Test Well", at a location in the S/2 of Section 27, T18S, R29E, Eddy County, New Mexico.

Once timely commenced, Test Well shall be drilled with due diligence to the "Objective Depth" described as 11,500 feet or a depth sufficient to test the Morrow formation, XXXXXXXXXXXXXXXXXXXX (as to all of which drilling and testing the decision of McKee shall be conclusive) and shall thereafter be completed as a well capable of producing oil and/or gas in paying quantities or shall be plugged and abandoned as a dry hole.

B. By timely commencing and drilling Test Well to the Objective Depth and completing same as a well capable of producing oil and/or gas in paying quantities, FARMOUTEE shall not earn the assignment provided for below.

C. If Test Well is completed as a dry hole, FARMOUTEE shall not earn the assignment provided for below.

SUCCESSIVE WELL: (Applicable only if FARMOUTEE has not earned said assignment by the drilling of the Test Well).

CONTINUOUS DEVELOPMENT: A. If the Successive Well is timely commenced and drilled to the Objective Depth and is capable of producing oil and/or gas in paying quantities, SRC thereby earns an assignment of McKee's interest in the acreage as it appears in Exhibit "A" attached hereto. SRC shall be required to continuously develop "said leases" to the extent of one gas well to 320 acres, one oil well to 80 acres, or as prescribed by the New Mexico Oil Conservation Commission. SRC shall have 120 days from completion or abandonment to commence operations on each subsequent well. If not sooner terminated by the provisions contained herein, Farmee's right to earn additional acreage hereunder shall ipso facto terminate in the absence of drilling in compliance with the continuous drilling obligation above and each proration unit upon which there is not located a well capable of producing oil and/or gas in paying quantities shall be reassigned to Farmor.

II. GEOLOGICAL INFORMATION, NOTICES, AND REPORTS: FARMOUTEE agrees to furnish to McKee the notices and reports provided for in Exhibit "B" attached hereto and to conduct the tests and surveys provided for therein. McKee shall be afforded an opportunity to witness such tests and surveys and the results thereof. (Please attach your requirements).

III. ADDITIONAL COVENANTS, CONDITIONS, AND OBLIGATIONS: FARMOUTEE agrees to comply with the additional covenants, conditions, and obligations provided for in Exhibit "C" attached hereto and shall reimburse McKee upon billing by McKee for 100% of the delay rentals paid in accordance with Paragraph 9 thereof. FARMOUTEE is not obligated to drill any well hereunder, however, FARMOUTEE shall comply with all of

EXHIBIT B

the obligations of this agreement that accrue during the period FARMOUTEE has the right to earn and all obligations arising from, related to, or based upon the drilling operations which FARMOUTEE conducts hereunder.

IV. ASSIGNMENT: In the event that Test Well or Successive Well (if Successive Well is provided for) is drilled to the Objective Depth and is completed with the results required herein for earning an assignment, hereafter called "Earning Well", and FARMOUTEE has otherwise complied with the requirements, conditions, and obligations hereof, McKee shall assign to FARMOUTEE, in the form attached hereto as Exhibit "D", 100% of McKee's interest in said leases described in Exhibit "A", reserving to McKee 1/16 of 8/8 overriding royalty interest with the option to convert to a 50% working interest at payout. Such assignment shall be effective as of the date hereof; shall be limited to oil and gas rights under said leases; shall provide for continuous development, and shall be limited in depth to 100 feet below the deepest depth drilled.

V. OTHER PROVISIONS: A. If not sooner terminated by other provisions hereof, this Agreement and FARMOUTEE's right to earn said assignment shall terminate at such time as FARMOUTEE fails to earn said assignment under either paragraph B or C of the Drilling requirements for Test Well or Successive Well (if Successive Well is provided for).

B. If the assignment earned by FARMOUTEE covers less than all of McKee's interest in said leases and McKee retains a working interest therein, the form of the Operating Agreement to be entered into by the parties covering operation of said leases or any part thereof in which McKee and FARMOUTEE concurrently own an undivided interest, is attached hereto as Exhibit "E", and said Operating Agreement shall be effective with said assighment. A Special Agreement relating to revenue from the Earning Well is attached to said Operating Agreement as Exhibit "E".

C. If any of said leases is a federal lease, the parties hereto agree to comply with the provisions of Exhibit "F" attached hereto. Reference to contractor therein means any and all parties performing work under this agreement.

If this letter correctly sets forth your understanding of our agreement, please signify your acceptance in the space provided below and return two (2) executed copies to SRC at 1100 Wall Towers West, Midland, Texas, 79701, within fifteen (15) days from the date hereof.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

By C. E. Mear
Asst. Vice Pres. Attorney-In-Fact

AGREED TO AND ACCEPTED this 15th day of October, 1979.

By: C. D. McKee, President

For: Robert E. McKee, Inc.

EXHIBIT "A"

To Farmout Agreement dated October 9, 1979, between Robert E. McKee Co. as Farmor and Southland Royalty Company as Farmoutee.

LANDS SUBJECT TO THIS AGREEMENT:

N½SE¼; SE¼SW¼ of Section 33, Township 18 South, Range 29 East, Eddy County, New Mexico (below the San Andres formation).

Lots 1, 2, 4; NW¼SW¼ of Section 34, Township 18 South, Range 29 East, Eddy County, New Mexico (below the San Andres formation).

Lot 2; NW¼; NW¼SW¼; W/½SE¼ of Section 35, Township 18 South, Range 29 East, Eddy County, New Mexico (below the San Andres formation).

EXHIBIT "B"

Attached to and made a part of Farmout Agreement dated October 9, 1979, between Southland Royalty Company, and Robert E. McKee Co.

GEOLOGICAL REQUIREMENTS AND NOTICES:

EXHIBIT "C"

Attached to and made a part of Farmout Agreement dated October 9, 1979, by and between Southland Royalty Company and Robert E. McKee Co.

THERE IS NO EXHIBIT "C"

Southland Royalty Company

February 26, 1980

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: Farmout Request
Portions of Sections 33, 34 & 35
T18S, R29E
Eddy County, New Mexico
Empire, South Prospect #1873

Gentlemen:

Reference is made to your leasehold located in the above subject tracts. Southland Royalty Company is presently attempting to secure support from the leasehold owners under these sections for the drilling of several Morrow wells.

A check of the records indicates that Bassett & Birney Oil Corporation owns a 50% working interest in a lease covering the deep rights in the following tracts of land:

Section	W.I.	Gross Acres	Net Acres
Section 33: N½SE¼, SE¼SW¼	50%	120	60
Section 34: Lots 1, 2, 4 & NW¼SW¼	50%	160	80
Section 35: Lot 2, NW¼ NW¼SW¼, NW¼SE¼	50%	280	140
Totals		560	280

Southland requests your support for the project by granting of a Farmout of your acreage under the following general terms:

1. Bassett-Birney deliver its leasehold interest in the E½ of Section 34 to Southland Royalty Company for the drilling of a Morrow well. Southland Royalty Company will have a period of ninety (90) days in which to commence drilling this well. Upon obtaining production from this well, Southland Royalty Company will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled. The remainder of Bassett-Birney's leasehold in Sections 33, 34 and 35,

EXHIBIT C

out side the drilled proration unit will fall under a 120-day continuous development program.

2. Under the terms of this Agreement; Bassett & Birney will retain a 1/16th of 8/8ths ORRI convertible to a 50% working interest at payout on the initial well.

Upon receiving approval for this proposal, Southland will be happy to prepare a Farmout Agreement containing the above provisions. If instead, you choose to join in this well, an AFE and Joint Operating Agreement will be forwarded to you at once.

If there are any questions concerning the above, please do not hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am

Southland Royalty Company

March 21, 1980

Empire Federal "34" #1

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: SRC-Empire Federal Comm. 34 #1
1980' FNL & 1980' FEL, Section 34,
T-18-S, R29-E,
Eddy County, New Mexico
Empire, South Prospect #1873
F/O 382, F/O 399

Gentlemen:

Reference is made to the proposed well and to a Farmout request mailed to Bassett & Birney Oil Corporation dated February 26, 1980. In this letter, Southland Royalty Company requested a Farmout of your acreage in Sections 33, 34 and 35.

Southland Royalty Company is now prepared to drill a Morrow well in the E½ of Section 34, and by this letter, requests your support for the well.

A check of the records indicates that Bassett & Birney Oil Company owns a 50% working interest in a lease covering the deep rights in the S½SE¼ (Lots 1 and 2) of Section 34. Southland requests a Farmout of your acreage under the following general terms:

1. Bassett & Birney deliver its leasehold interest in the E½ of Section 34 for the drilling of the SRC-Empire Federal Comm. 34 #1 well. Southland will have a ninety (90) day period in which to commence the drilling of this well. Upon obtaining production from this well, Southland will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled.

2. Under the terms of this agreement, Bassett & Birney will retain a 1/16th of 8/8ths ORRI convertible to a 50% working interest at payout, proportionately reduced.

Upon receiving approval for this proposal, Southland Royalty Company will be happy to prepare a Farmout Agreement containing the above provisions.

If instead, Bassett & Birney Oil Company chooses to join in this well, upon approval, please execute the three (3) enclosed AFEs, returning two (2) originals to Southland Royalty Company's Midland office, while retaining one (1) original for your files. At such time as we have received the signed AFEs, a Joint Operating Agreement and Communitization Agreement will be forwarded for your approval.

If there are any questions concerning the above, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am
Enclosures

April 8, 1980

Bassett-Birney Oil Corporation
207 South Fourth Street
Artesia, New Mexico 88210

Attention: Jack McCall

Re: SRC Empire Fed. Comm. "34" #1
1980' FNL & 1980' FEL,
Section 34, T18S, R29E
Eddy County, New Mexico
Empire South Prospect #1873
F/O 382; F/O 399

Gentlemen:

Reference is made to our telephone conversation of even date concerning the subject well. Enclosed are the following:

1. Complete set of logs for the SRC Empire Fed. Comm. #1 well.

2. Xerox copy of an original Title Opinion by Stubbeman, McRae, Sealy, Laughlin & Browder dated February 21, 1980.

3. Operating Agreement for the proposed SRC Empire Fed. Comm. "34" #1, along with two extra signature pages.

I hope this information will aid you in making your decision to either join or farmout in the subject well. If you choose to join, please have the appropriate company officer execute the signature pages to the Operating Agreement, returning the two extra signature pages to our Midland office, along with two original signed AFE's which were mailed to you earlier. If instead, you choose to farmout, a Farmout Agreement will be prepared to cover your interest.

As time is of the essence in this matter, your immediate attention will be greatly appreciated. If you have any questions, or any further information is needed, please don't hesitate calling.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:lh

EXHIBIT E

STUBBEMAN, MCRAE, SEALY, LAUGHLIN & BROWDER
ATTORNEYS AT LAW

MIDLAND, TEXAS
MIDLAND SAVINGS BUILDING-ZIP CODE 79701
300 WEST WALL STREET
P. O. BOX 1540-ZIP CODE 79702
A.C. 915 682-1616

AUSTIN, TEXAS
1500 AMERICAN BANK TOWER-ZIP CODE 78701
221 WEST 6TH STREET
P. O. BOX 2288-ZIP CODE 78768
A.C. 512 478-3502

JAMES W. WILSON
OF COUNSEL

FRANK STUBBEMAN (1908-1974)
HAMILTON E. MCRAE
TOM SEALY
BOYD LAUGHLIN
FRED M. CASSIDY
WM. P. BROWDER JR.
WALTER C. HERSOSLEY
W. F. PENNEBAKER
DUDLEY M. GOODLOE
JAMES L. PARQUE
JAMES G. HOLLAND
ROBERT J. COMAN
MILTON L. RANNSTON
WALTER K. BOYD, JR.
MARRELL PELOT
SMITH MAY
J. P. WOOD
J. J. BOWDEN
NICHOLAS C. TAYLOR
T. R. WRIGHT
JOE D. MERONEY
ALVIN WALWOORD JR.
RODNEY M. SATTERWHITE
HAL L. KEMP
JOE R. GREENHILL JR.
THOS. L. LOWRY
JAMES V. HANNETT, JR.
DANIEL W. HERD
JOSEPH V. CRAWFORD
JO ANNE CHRISTIAN
PATRICIA A. ENGLISH
GREGORY D. HOOSER
AL W. SCHORRE, JR.
JAMES CHRISMAN PHILLIPS
MARK R. LEAMERTON
KAREN PARKER
RANDAL M. KIRK
JACK D. LADD
MICHAEL B. STOLTZ
J. STOCKTON WILLIAMS, JR.
WOFFORD DENIUS
BRAD CUMMINS

February 21, 1980

ADDRESS REPLY TO:

Midland

Empire, S. Prospect
F/O 382 & 399

SOUTHLAND ROYALTY COMPANY
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis

Re: ORIGINAL TITLE OPINION
Federal Oil and Gas Lease LC-062029
insofar as it covers Lots 1, 2, 3, 4,
N/2 S/2 of Section 34, and Lot 2,
NW/4, NW/4 SE/4 and NW/4 SW/4 of
Section 35, Township 18 South,
Range 29 East, N.M.P.M., Eddy
County, New Mexico, containing
585.31 acres, more or less
(Empire, South Prospect #1873).

Gentlemen:

At your request, we have examined title to the captioned land as reflected by the following:

ABSTRACTS

1. Abstract No. 32209 certified by Federal Abstract Company covering, among other land, the captioned land based on the Records of the Bureau of Land Management from Inception of the Records to February 5, 1980 at 10:00 A.M., containing 279 pages.

2. Abstract No. 80,008 certified by Currier Abstract Company covering, among other land, the mineral interest in the captioned land from Inception of the Records to January 22, 1980 at 8:00 A.M., containing 692 pages.

INSTRUMENTS

Letter dated December 27, 1979 by Mr. Don W. Davis.

Based upon our examination of the foregoing and subject to the requirements hereinafter set forth, we find that title to the captioned land is vested as follows:

I. Lessee of Record:

A. Lot 3, NE/4 SW/4, N/2 SE/4 of Section 34 (156.65 acres):

Bassett-Birney Oil Corporation	1/2
Carper Drilling Company, Inc.	1/2
Total	2/2

B. Lots 1, 2, 4, NW/4 SW/4 of Section 34 and Lot 2, NW/4, NW/4 SW/4 and NW/4 SE/4 of Section 35 (428.66 acres):

Bassett-Birney Oil Corporation	1/2
Robert E. McKee General Contractor, Inc.	1/2
Total	2/2

II. Ownership of Production:

A. Lot 3, Section 34 from the surface to the base of the Queen Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI

Robert E. McKee General Contractor, Inc.	1/2 of 30% of 85.5% or	.1282500	WI
Mack Chase, Inc.	1/4 of 85% of 85.5% or	.1816875	WI#**
Marbob Energy Corporation	1/4 of 85% of 85.5% or	.1816875	WI#**
Harlan Oil Company, a Limited Partnership	1/4 of 85% of 85.5% or	.1816875	WI#**
Stevenson-Roach Tank Company, Inc.	1/4 of 85% of 85.5% or	.1816875	WI#**
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#This interest shall bear and pay 1/4 of a .062438 to .0 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .0085 to .0 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 85% of 85.5% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964,

recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

B. NW/4 SW/4 of Section 34 from the surface to the base of the Queen Formation, or 2,505 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI#
Robert E. McKee General Contractor, Inc.	30% of 79.25% or	.2377500	WI
Mack Chase, Inc.	1/4 of 70% of 79.25% or	.1386875	WI§**
Marbob Energy Corporation	1/4 of 70% of 79.25% or	.1386875	WI§**
Harlan Oil Company, a Limited Partnership	1/4 of 70% of 79.25% or	.1386875	WI§**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 79.25% or	.1386875	WI§**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of

oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

§This interest shall bear and pay 1/4 of a .049875 to .0 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 79.25% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

C. NE/4 SW/4 of said Section 34 from the surface to the base of the Queen Formation, or 2,200 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Robert E. McKee General Contractor, Inc.	30% of 85.5% or	.2565000	WI

Mack Chase, Inc.	1/4 of 70% of 85.5% or	.1496250	WI#**
Marbob Energy Corporation	1/4 of 70% of 85.5% or	.1496250	WI#**
Harlen Oil Company, a Limited Partnership	1/4 of 70% of 85.5% or	.1496250	WI#**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 85.5% or	.1496250	WI#**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#This interest shall bear and pay 1/4 of a .049875 to .0089446 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0005963 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 85.5% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

D. Lot 2 of said Section 34 from the surface to the base of the Queen Formation, or 2,543 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI=
Robert E. McKee General Contractor, Inc.	30% of 79.25% or	.2377500	WI
Mack Chase, Inc.	1/4 of 70% of 79.25% or	.1386875	WI§**
Marbob Energy Corporation	1/4 of 70% of 79.25% or	.1386875	WI§**
Harlan Oil Company, a Limited Partnership	1/4 of 70% of 79.25% or	.1386875	WI§**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 79.25% or	.1386875	WI§**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

§This interest shall bear and pay 1/4 of a .049875 to .0 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 79.25% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

E. NW/4 SE/4 of said Section 34 from the surface to the base of the Queen Formation, or 2,200 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI

Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Robert E. McKee General Contractor, Inc.	30% of 85.5% or	.2565000	WI
Mack Chase, Inc.	1/4 of 70% of 85.5% or	.1496250	WI#**
Marbob Energy Corporation	1/4 of 70% of 85.5% or	.1496250	WI#**
Harlan Oil Company, a Limited Partnership	1/4 of 70% of 85.5% or	.1496250	WI#**
Stevenson-Roach Tank Company, Inc.	1/4 of 70% of 85.5% or	.1496250	WI#**
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#This interest shall bear and pay 1/4 of a .049875 to .0089446 Net Profits interest owned by Joe L. Stanton, and wife, Virginia Stanton, as determined by Stipulation Concerning Interest dated December 10, 1963, recorded in Volume 59, Page 271, Miscellaneous Records, and 1/4 of a .00665 to .0005963 Net Profits interest owned by James Noel, and wife, Virginia Noel, determined by Stipulation Concerning Interest dated December 2, 1963, recorded in Volume 59, Page 292, Miscellaneous Records.

**Also subject to bearing and paying 1/4 of obligation to convey 20% of 70% of 85.5% Working Interest to Arthur R. Kneibler, Jr., and Quasar, Incorporated under Acknowledgment of Contractural Obligation dated June 5, 1964, recorded in Book 174, Page 168, Miscellaneous Records, when $835,000.00 plus certain "add ons" are paid out of gross proceeds.

F. NW/4 SE/4 and NE/4 SW/4 of Section 34 from the base of the Queen Formation to the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Mack Chase, Inc.	1/4 of 85.5% or	.2137500	WI**
Marbob Energy Corporation	1/4 of 85.5% or	.2137500	WI**
Harlan Oil Company, a Limited Partnership	1/4 of 85.5% or	.2137500	WI**
Stevenson-Roach Tank Company, Inc.	1/4 of 85.5% or	.2137500	WI**
Total		1.0000000	

Note: For rights above the base of the Queen Formation, see Paragraph E, and for rights below the top of the San Andres Formation, see Paragraph G.

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35% to 25% of 70% of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

G. Lot 3 of said Section 34 from the base of the Queen Formation to the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Mack Chase, Inc.	1/4 of 1/2 of 85.5% or	.1068750	WI#

Marbob Energy Corporation	1/4 of 1/2 of 85.5% or	.1068750	WI#
Harlan Oil Company, a Limited Partnership	1/4 of 1/2 of 85.5% or	.1068750	WI#
Stevenson-Roach Tank Company, Inc.	1/4 of 1/2 of 85.5% or	.1068750	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 1/2 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35%-25% of 1/2 of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

H. NE/4 SE/4 of Section 34 from the surface down to 750 feet:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Cities Service Company	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

I. NE/4 SE/4 of Section 34 from 750 feet down to the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Mack Chase, Inc.	1/4 of 85.5% or	.2137500	WI#
Marbob Energy Corporation	1/4 of 85.5% or	.2137500	WI#
Harlan Oil Company, a Limited Partnership	1/4 of 85.5% or	.2137500	WI#
Stevenson-Roach Tank Company, Inc.	1/4 of 85.5% or	.2137500	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35% to 25% of 70% of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

J. NE/4 SE/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Cities Service Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying a Production Payment of $1,000.00 a net acre payable out of 3% of 85.5% from all formations below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.

K. NW/4 SE/4 and NE/4 SW/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI

J. NE/4 SE/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Cities Service Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying a Production Payment of $1,000.00 a net acre payable out of 3% of 85.5% from all formations below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.

K. NW/4 SE/4 and NE/4 SW/4 of Section 34 lying below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI

Meryl Story Tatman	1% or	.0100000	ORI
Cities Service Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying a Production Payment of $1,000.00 a net acre payable out of 3% of 85.5% from all formations below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.

L. Lot 3 of said Section 34 below the top of the San Andres Formation:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Cities Service Company	1/2 of 85.5% or	.4275000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying 1/4 of 1/2 of 3% of 85.5% of Production Payment until $1,000.00 per net acre is paid from production below 3,500 feet which is owned by Robert E. McKee General Contractor, Inc.; upon payment this interest will revert to the working interest owners; and also subject to bearing and paying 1/4 of Production Payment dated March 28, 1968 and recorded in Book 60, Page 236, Miscellaneous Records, payable out of 35%-25% of 1/2 of 85.5% which is owned by December, Inc. (Amount of Production Payment not shown because the instrument was briefed.)

M. Lot 2 of said Section 34 below the base of the Queen Formation, or 2,543 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Jimmie Marie Joy, Trustee of the Sandra Leigh Worley Trust Dated November 16, 1972	1/3 of 1% or	.0033333	ORI
Billie L. Kruse, Trustee of the Barbara Frankenfield Trust Dated October 20, 1966	1/3 of 1% or	.0033333	ORI
Jimmie Marie Joy, Trustee of the Susan Lynn Terry Trust Dated November 16, 1972	1/3 of 1% or	.0033334	ORI
Meryl Story Tatman	1% or	.0100000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

N. NW/4 SW/4 of Section 34 below the base of the Queen Formation, or 2,505 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

O. Lot 4 of said Section 34 from the surface down to the base of the Queen Formation, or 2,373 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	6.25% or	.0625000	ORI#
Robert E. McKee General Contractor, Inc.	79.25% or	.7925000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

P. Lot 4 of said Section 34 below the base of the Queen Formation, or 2,373 feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
R. E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

Q. Lot 1 of said Section 34 from the surface to the base of the Queen Formation, or _____ feet, whichever is the lesser:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI

Bassett-Birney Oil Corporation	6.25% or .0625000	ORI#
Robert E. McKee General Contractor, Inc.	79.25% or .7925000	WI
Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#To be reduced to 3% ORI or convert to a working interest of 8.522725% if 15-10 barrels of oil and 10.22725% if less than 10 barrels of oil. The interest of the working interest owners will be increased or reduced as the ORI is reduced or converts.

R. Lot 1 of said Section 34 below the base of the Queen Formation, or feet, whichever is the lesser:

United States of America	1/8 or .1250000	RI*
Featherstone Farms, Ltd.	2% or .0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or .4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or .4275000	WI
Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

S. NW/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
Julia Brainard Estate	2% or	.0200000	ORI
Tenneco Oil Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying (1) a $750.00 per acre Production Payment payable out of 1/16 of 7/8 less 1/2 of 2%, subject to suspension when oil production is 15 barrels or less of oil as to excess over 17-1/2% total burdens and royalty, which is owned by Robert E. McKee General Contractor, Inc., and (2) a $3,000,000.00 Production Payment payable out of 3/32 of the production from said land and others which is owned by Robert J. Leonard, Patrick J. Leonard and Timothy T. Leonard.

T. NE/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
C. Melvin Neal	2.5% or	.0250000	ORI
Tenneco Oil Company	85% or	.8500000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying (1) a $750.00 per acre Production Payment payable out of 1/16 of 7/8 less 1/2 of 2-1/2%, subject to suspension when oil production is 15 barrels or less of oil as to excess over 17-1/2% total burdens and royalty, which is owned by Robert E. McKee General Contractor, Inc., and (2) a $3,000,000.00 Production Payment payable out of 3/32 of the production from said land and others which is owned by Robert J. Leonard, Patrick J. Leonard and Timothy T. Leonard.

U. SW/4 SE/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
Featherstone Farms, Ltd.	2% or	.0200000	ORI
Tenneco Oil Company	85.5% or	.8550000	WI#
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

#Subject to bearing and paying (1) a $750.00 per acre Production Payment payable out of 1/16 of 7/8 less 1/2 of 2%, subject to suspension when oil production is 15 barrels or less of oil as to excess over 17-1/2% total burdens and royalty, which is owned by Robert E. McKee General Contractor, Inc., and (2) a $3,000,000.00 Production Payment payable out of 3/32 of the production from said land and others which is owned by Robert J. Leonard, Patrick J. Leonard and Timothy T. Leonard.

V. SW/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*

Julia Brainard Estate	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.42750000	WI
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

W. SE/4 NW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
C. Melvin Neal	2.5% or	.0250000	ORI
Bassett-Birney Oil Corporation	1/2 of 85% or	.4250000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85% or	.4250000	WI
	Total	1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

X. NW/4 SE/4 of Section 35:

United States of America	1/8 or	.1250000	RI*

Featherstone Farms, Ltd.	2% or	.0200000	ORI
Bassett-Birney Oil Corporation	1/2 of 85.5% or	.4275000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 85.5% or	.4275000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

Y. NW/4 SW/4 of Section 35:

United States of America	1/8 or	.1250000	RI*
Neil B. Watson	5% or	.0500000	ORI
Bassett-Birney Oil Corporation	1/2 of 82.5% or	.4125000	WI
Robert E. McKee General Contractor, Inc.	1/2 of 82.5% or	.4125000	WI
Total		1.0000000	

*The royalty is a step scale of 12.5% to 25% on oil and 12-1/2% to 16-2/3% on gas. We have assumed that royalty will be paid at the 12-1/2% rate. As royalty increases, the working interest decreases by an equal amount.

OIL AND GAS LEASE

Form:	4-208F (January 1943).
Serial No.:	LC 062029 (Consolidated).
Date:	May 1, 1942.
Recorded:	Unrecorded, however recording is not necessary.
Lessor:	United States of America.
Lessee:	Robert E. McKee and C. N. Bassett.
Land Covered:	Township 18 South, Range 29 East, N.M. Section 33: Lots 1,2,3, NE/4 SW/4, N/2 SE/4 Section 34: Lots 1,2,3,4, N/2 S/2 Section 35: Lot 2, NW/4, NW/4 SW/4, NW/4 SE/4 containing 812.67 acres, more or less.
Term:	5 years and usual thereafter clause.
Royalty:	

On Oil

When the average production for the calendar month in barrels per well per day is

not over					50,	the royalty shall be		12.5	percent;		
over	50	but not	over		60,	"	"	"	"	13	"
"	60	"	"	"	70,	"	"	"	"	14	"
"	70	"	"	"	80,	"	"	"	"	15	"
"	80	"	"	"	90,	"	"	"	"	16	"
"	90	"	"	"	110,	"	"	"	"	17	"
"	110	"	"	"	130,	"	"	"	"	18	"
"	130	"	"	"	150,	"	"	"	"	19	"
"	150	"	"	"	200,	"	"	"	"	20	"
"	200	"	"	"	250,	"	"	"	"	21	"
"	250	"	"	"	300,	"	"	"	"	22	"
"	300	"	"	"	350,	"	"	"	"	23	"
"	350	"	"	"	400,	"	"	"	"	24	"
"	400	"	"	"	450,	"	"	"	"	25	"
"	450	"	"	"	500,	"	"	"	"	26	"
"	500	"	"	"	750,	"	"	"	"	27	"
"	750	"	"	"	1,000,	"	"	"	"	28	"
"	1,000	"	"	"	1,250,	"	"	"	"	29	"
"	1,250	"	"	"	1,500,	"	"	"	"	30	"
"	1,500	"	"	"	2,000,	"	"	"	"	31	"
"	2,000	"	"	"		"	"	"	"	32	"

On Gas

When the average production of gas per well per day for the calendar month does not exceed 5,000,000 cubic feet, 12-1/2 percent; and when said production of gas exceeds 5,000,000 cubic feet,

16-2/3 percent of the amount or value of the gas and liquid products produced, said amount or value of such liquid products to be net after an allowance for the cost of manufacture; Provided, That the allowance for cost of manufacture may exceed two-thirds of the amount or value of any product only on approval by the Secretary of the Interior; and that said value of gas and of liquid products shall be as determined by said Secretary.

Delay Rentals: No longer applicable. Lease is on a producing status.

PATENT INFORMATION AND SURVEYING DATA

The captioned land is public domain. The following lots contain the following land:

Section 34:

Lot	Land
1	37.22
2	36.93
3	36.65
4	36.36

Section 35:

Lot	Land
1	38.31
2	38.15
3	37.83
4	37.47

ENCUMBRANCES

1. Deed of Trust dated April 1, 1968, recorded in Book 247, Page 703, by December, Inc. to First City National Bank of Houston, Texas, covering a $745,000.00 Production Payment reserved by Aurora Corporation of Illinois to secure a $745,000.00 note. (This instrument has been briefed).

2. Deed of Trust dated December 21, 1976, recorded in Volume 284, Page 100, by D. R. Clary, et ux, to Wilbur A. Yeager, Jr. covering his interest in the captioned land (which is now owned by Mack C. Chase, et al) to secure payment of a $60,000.00 note to The First National Bank of Midland.

EASEMENTS

The Plat shows a pipeline (NM 28526) as crossing the NW/4 of Section 35.

CASINGHEAD GAS CONTRACTS

Casinghead Gas Contract dated January 16, 1978, recorded in Volume 153, Page 592, by Marbob Energy Corporation to Phillips Petroleum Company covering the NE/4 SW/4, SE/4 SW/4, SW/4 SE/4 of Section 34. There is no depth limitation in this instrument.

TITLE REQUIREMENTS

I.

Certain of the tracts above are limited in depth to the base of the Queen Formation or a specific footage depth. In each instance, we have assumed that the footage depth is below the base of the Queen Formation. In the event this is not true, then we should be furnished with the footage depths of the base of the Queen Formation under each quarter/quarter section of land at which time we will advise you of the ownership of the zone lying between the footage depth and the base of the Queen Formation.

REQUIREMENT NO. 1: As stated.

II.

Bassett-Birney Oil Corporation owned a 1/2 interest in the operating rights in the NE/4 SW/4 and NW/4 SE/4 of Section 34. R. E. McKee General Contractor, Inc. owned the other 1/2 interest in the operating rights. R. E. McKee General Contractor, Inc. assigned its 1/2 interest in the operating rights to Stanton Oil Company. The Assignment purported to cover all of the operating rights. The Assignment of Operating Rights from R. E. McKee General Contractor, Inc. to Stanton Oil Company was approved as to only a 1/2 interest in such operating rights. Stanton Oil Company, in turn, assigned its interest in the operating rights to Richard D. Davoust. This Assignment was approved for a 1/2 interest in the operating rights insofar as it covers the NE/4 SW/4 and NW/4 SE/4 of said Section 34. Richard D. Davoust, et ux, in turn, assigned his interest to Texas City Refining Co., Inc. This conveyance was approved as covering all of the operating rights. We have examined no instrument whereby Bassett-Birney Oil Corporation conveyed its 1/2 interest in the operating rights in said NW/4 SE/4 and NE/4 SW/4 of Section 34. The Brainard No. 4 and No.

6 Wells are located on this land, and we assume that they are completed in the zone lying between the base of the Queen Formation and the top of the San Andres Formation.

REQUIREMENT NO. 2: We should be furnished with information as to how Stanton Oil Company or Richard D. Davoust acquired the 1/2 interest in the operating rights of Bassett-Birney Oil Corporation, and also we should be furnished with the complete well history of the Brainard No. 4 and No. 6 wells, and especially information showing where said wells were completed.

III.

The Stipulation Concerning Interest between Joe L. Stanton and Stanton Oil Company, Ltd. indicates that Bassett-Birney Oil Corporation has an option to acquire a paid-up working interest in the NW/4 SW/4, Lot 2 and Lot 4 of said Section 34, insofar as their interest covers from the surface down to depth limitation or the base of the Queen Formation, whichever is the lesser depth.

REQUIREMENT NO. 3: We have not examined the instrument whereby this option was reserved.

IV.

The abstract does not contain the instruments in the case file for NM 010907 and LC-056845 out of which LC-062029 was consolidated. LC 061439, LC 061440, LC 062076 and LC 060629 were also included in this consolidation. It would be helpful to examine each of these old case files which have been sent to the Dead Record Center in Denver. Since we have not been able to examine the case files on NM-010907 and LC-056845, there is a possibility that Bassett-Birney Oil Corporation conveyed a 1/2 interest in certain tracts and depths which we have credited with above to Robert E. McKee General Contractor, Inc. This possibility appears to be heightened by the fact that in a number of instances Robert E. McKee General Contractor, Inc. stated that their net interest covered the full working interest, when we credited them with only 1/2. You should investigate further into this possibility in the event you desire to acquire the shallow interests which we have credited to Bassett-Birney Oil Corporation.

REQUIREMENT NO. 4: None. Advisory only.

V.

Under Paragraphs Q and R we have left the depth limitation blank as we have seen no evidence as to the depth to which the required well was drilled. The Operating Agreement dated June 29, 1956 by Bassett-Birney Oil Corporation to Robert E. McKee, General Contractor, Inc. covering said Lot 4 required a continuous drilling program until all of the land is developed. The Affidavit dated June 10, 1957 by Bassett-Birney Oil Corporation specified the depths limit on all of the land covered by the Operating Agreement dated June 29, 1956, except as to Lot 4. We have assumed that a well was drilled on Lot 4 and Robert E. McKee, General Contractor, Inc. earned Bassett-Birney Oil Corporation's 1/2 interest down to total depth plus 100 feet or the base of the Queen Formation, whichever is the lesser.

REQUIREMENT NO. 5: Submit evidence that a well was timely commenced on said Lot 4 and that Robert E. McKee, General Contractor, Inc. earned said 1/2 interest in the shallow operating rights, together with evidence as to the depth to which said well was drilled.

VI.

Under Paragraphs S and V of Ownership, we have shown the Julia Brainard Estate as having a 2% Overriding Royalty Interest. These Overriding Royalty Interests were not listed in her Estate. In the event that you acquire these two properties, inquiries should be made concerning the ownership of this Overriding Royalty Interest.

REQUIREMENT NO. 6: As stated.

VII.

In the event you acquire an interest in any of the captioned land, it would be helpful for us to examine the Division Orders and lease files of your Seller in order to verify the ownership of the captioned land. This Opinion is based solely on the data examined, and there are numerous questions and ambiguities reflected by this information. As a result, we have made certain assumptions which need to be clarified.

REQUIREMENT NO. 7: Advisory.

VIII.

We have examined no information showing that the lease is in good standing and that the wells located thereon have been drilled and operated in accordance with the rules and regulations of the New Mexico Oil Conservation Division, the United States Geological Survey and any other governmental agency having jurisdiction over the captioned land. You should satisfy yourself concerning these matters.

REQUIREMENT NO. 8: As stated.

COMMENTS

1. This opinion cannot cover such matters as area, boundaries, location on the ground or other matters that can be determined by an actual on-the-ground survey.

2. This opinion does not cover matters concerning regulations by the Federal Energy Regulatory Commission and other governmental agencies.

We return herewith the material furnished.

Respectfully submitted,

STUBBEMAN, McRAE, SEALY, LAUGHLIN & BROWDER

By ORIGINAL SIGNED BY J. J. BOWDEN
J. J. Bowden

JJB/bb

Enclosures

BASSETT-BIRNEY OIL CORPORATION

ARTESIA, NEW MEXICO — *OIL PRODUCERS AND OPERATORS* — EL PASO, TEXAS

ARTESIA, NEW MEXICO

April 22, 1980

RECEIVED
LAND DEPT.
APR 23 1980
SOUTHLAND ROYALTY CO.
MIDLAND, TEXAS

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Don W. Davis

Re: SRC Empire Fed. Comm. "34" #1
Township 18 South, Range 29 East, NMPM
Section 34
Eddy County, New Mexico

Gentlemen:

We enclose 2 executed copies of the AFE and 2 copies of the signature pages for the Operating Agreement on the captioned well.

We have executed the Operating Agreement with the understanding there will be no charge to us for the Drilling Title Opinion.

Very truly yours,

Randy G. Patterson
Land Department

By: Jack W. McCaw

JWM/kc
Enclosures

EXHIBIT F

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
FIDELITY UNION TOWER BUILDING MIDLAND, TEXAS 79701

COMPANY NO ____ RECORD ID 112

AFE NUMBER ____

ADD A CHANGE ____ DELETE ____ PROPERTY NUMBER ____

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "34" No. 1

ORIGINAL O SUPPLEMENTAL ____ PRODUCER ____ DRY HOLE ____ SRC OPERATOR ____ MANUAL ____

AUTHORITY IS REQUESTED TO: Drill and complete to TD of 11,450' as gas well in

WILDCAT ____ DEV. X Morrow formation complete w/tank battery.

LOCATION: 1980 FEL 1980 FNL Sec. 34 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249	$ -	$ -
350	01 Conductor or Drive Pipe	5,860	5,860
3200'	02 Casing 11/3/4" 42# H-40 ST&C @ $16.75	33,600	33,600
1870'	03 8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	14,620	-
5470'	04 4 1/2" 13.5 #N-80 LT&C @ $7.82	36,760	-
3020'	05 4 1/2" 11.6# N-80 LT&C @ $6.72	15,250	-
1090'	06 4 1/2" 11.6# K-55 ST&C @ $5.05	7,810	-
11,450'	07 4 1/2" 11.6# N-80 Butt. @ $7.17	-	-
11,450'	08	40,880	-
	09 Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	26,000	2,000
	10 Wellhead & Safety Equipment	4,500	-
	11 Packer & Special Equipment	-	-
	12 Artificial Lift	36,000	-
	13 Tank Battery and process equip.	7,530	3,040
	14 Other Equipment	$ 228,810	$ 44,500
	15 TOTAL TANGIBLE 100%	$ 27,003	$ 5,252
	16 BASSETT & BIRNEY .11801687		
	INTANGIBLE - 248	$ 170,000	$170,000
	17 Drilling 10,000 ft. @ $ 17.00 /ft.	67,500	67,500
	18 Rig, Day Work 15 Days @ $ 4500 /day	-	-
	19 Rig Moving Costs	12,000	-
	20 Completion Rig 10 Days @ $ 1200 /day	4,000	2,000
	21 Roustabout & Miscellaneous Labor	4,500	2,000
	22 Auto, Trucking, Barge, Tug	12,000	10,000
	23 Roads, Canals, Location, Damages, Cleanup	45,000	40,000
	24 Mud, Oil, Water, Chemicals	5,000	5,000
	25 Drill Stem Tests	35,000	35,000
	26 Electric Logs & Bond Logs	45,000	40,000
	27 Cement, Centralizer, Scratchers, Service	20,000	20,000
	28 Bits, Fuel	25,000	12,000
	29 Rental Equipment & tubular inspection	-	-
	30 Core & Analyses	-	-
	31 Bottle Tests & Sidewall Cores	10,000	-
	32 Perforate	25,000	-
	33 Acid & Frack Variable	5,000	2,500
	34 Geological & Engineering	20,000	20,000
	35 Mud Logger	5,400	5,400
	36 Cost of Control Insurance (SRC Only) .468	24,800	10,100
	37 Miscellaneous & Unforseen	3,000	2,000
	38 39 District & Overhead Expense	$ 538,200	$ 443,500
	39 TOTAL INTANGIBLE 100%	$ 63,516	$ 52,340
	40 BASSETT & BIRNEY .11801687	$ 767,010	$ 488,000
	41 GRAND TOTAL COSTS	$ 90,520	$ 57,592
	42 BASSETT & BIRNEY .11801687		

AUTHORIZATION REQUESTED

K. W. Harden

AUTHORIZATION APPROVED

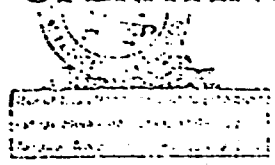
COMPANY: Bassett & Birney & Doyle

BY: [signature]

DATE: 4-10-80

A.A.P.L. FORM 610 - 1977

MODEL FORM OPERATING AGREEMENT



OPERATING AGREEMENT

DATED

April 8, 1980,

OPERATOR SOUTHLAND ROYALTY COMPANY

CONTRACT AREA E/2 Section 34, T18S, R29E, below the San Andres Formation

COUNTY ~~OR XXXXXXX~~ OF Eddy STATE OF New Mexico

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between SOUTHLAND ROYALTY COMPANY, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators",

WITNESSETH:

WHEREAS, the parties to this agreement are owners of oil and gas leases and/or oil and gas interests in the land identified in Exhibit "A", and the parties hereto have reached an agreement to explore and develop these leases and/or oil and gas interests for the production of oil and gas to the extent and as hereinafter provided:

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.
DEFINITIONS

As used in this agreement, the following words and terms shall have the meanings here ascribed to them:

A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.

B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.

D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".

E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.

F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.

G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.

H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II.
EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

☒ A. Exhibit "A", shall include the following information:
- (1) Identification of lands subject to agreement,
- (2) Restrictions, if any, as to depths or formations,
- (3) Percentages or fractional interests of parties to this agreement,
- (4) Oil and gas leases and/or oil and gas interests subject to this agreement,
- (5) Addresses of parties for notice purposes.

☒ B. Exhibit "B", Form of Lease.

☒ C. Exhibit "C", Accounting Procedure.

☒ D. Exhibit "D", Insurance.

☒ E. Exhibit "E", Gas Balancing Agreement.

☒ F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.

If any provision of any exhibit, except Exhibit "E", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

ARTICLE III.
INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an unleased oil and gas interest in the Contract Area, that interest shall be treated for the purpose of this agreement and during the term hereof as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B". As to such interest, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the lessee interest.

B. Interest of Parties in Costs and Production:

Exhibit "A" lists all of the parties and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and material acquired in operations on the Contract Area shall be owned by the parties as their interests are shown in Exhibit "A". All production of oil and gas from the Contract Area, subject to the payment of lessor's royalties which will be borne by the Joint Account, shall also be owned by the parties in the same manner during the term hereof; provided, however, this shall not be deemed an assignment or cross-assignment of interests covered hereby.

ARTICLE IV.
TITLES

A. Title Examination:

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including Federal Lease Status Reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

☐ ~~Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be a part of the administrative overhead as provided in Exhibit "C," and shall not be a direct charge, whether performed by Operator's staff attorneys or by outside attorneys.~~

☒ Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in gas royalty opinions, and division order title opinions) shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Exhibit "A". * Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection with leases or oil and gas interests contributed by such party. The Operator shall be responsible for the preparation and recording of Pooling Designations or Declarations as well as the conduct of hearings before Governmental Agencies for the securing of spacing or pooling orders. This shall not prevent any party from appearing on its own behalf at any such hearing.

~~No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to participate in the drilling of the well.~~

B. Loss of Title:

1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A", this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests, and

(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development except when such costs are incurred in connection with an operation conducted under Article VI in which event such costs are to be borne by the drilling parties in the proportions

or operating costs which it may have theretofore paid, but there shall be no monetary liability on its part to the other parties hereto for drilling, development, operating or other similar costs by reason of such title failure; and

(b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract Area by the amount of the interest lost; and

(c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract Area is increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such interests (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well; and

(d) Should any person not a party to this agreement, who is determined to be the owner of any interest in the title which has failed, pay in any manner any part of the cost of operation, development, or equipment, such amount shall be paid to the party or parties who bore the costs which are so refunded; and

(e) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be borne by the party or parties in the same proportions in which they shared in such prior production; and

(f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in connection therewith.

2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, is not paid or is erroneously paid, and as a result a lease or interest therein terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new lease covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties shall be revised on an acreage basis, effective as of the date of termination of the lease involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the lease or interest which has terminated. In the event the party who failed to make the required payment shall not have been fully reimbursed, at the time of the loss, from the proceeds of the sale of oil and gas attributable to the lost interest, calculated on an acreage basis, for the development and operating costs theretofore paid on account of such interest, it shall be reimbursed for unrecovered actual costs theretofore paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost interest, on an acreage basis, up to the amount of unrecovered costs;

(b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an acreage basis, of that portion of oil and gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such lease termination, would be attributable to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said portion of the oil and gas to be contributed by the other parties in proportion to their respective interests; and

(c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall not be considered failure of title but shall be joint losses and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of the Contract Area.

ARTICLE V.
OPERATOR

A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:

SOUTHLAND ROYALTY COMPANY shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operator, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the Parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed, shall be determined by Operator, and all such employees shall be the employees of Operator.

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the 1st day of June, 1980, Operator shall commence the drilling of a well for oil and gas at the following location:

1980' FNL & 1980' FEL of Section 34, T18S, R29E, Eddy County, New Mexico

and shall thereafter continue the drilling of the well with due diligence to

11,700' or a depth sufficient to test the Morrow formation

unless granite or other practically impenetrable substance or condition in the hole, which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E.1. hereof.

B. Subsequent Operations:

1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday or legal holidays. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or response given by telephone shall be promptly confirmed in writing.

2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, within sixty (60) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period where the drilling rig is on location, as the case may be) actually commence work on the proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest of the parties approving such operation, and (b) its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A", or (b) carry its proportionate part of Non-Consenting Parties' interest. The proposing party, at its election, may withdraw such proposal if there is insufficient participation, and shall promptly notify all parties of such decision.

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk, and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or market value thereof if such share is not sold (after deducting production taxes, royalty, overriding royalty and other interests existing on the effective date hereof, payable out of or measured by the production from such well accruing with respect to such interest until it reverts) shall equal the total of the following:

(a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to each Non-Consenting Party had it participated in the well from the beginning of the operation; and

(b) 300% of that portion of the costs and expenses of drilling, reworking, deepening, or plugging back, testing and completing, after deducting any cash contributions received under Article VIII.C., and

300 % of that portion of the cost of newly acquired equipment in the well (to and including the well-head connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's election, shall be sold to its purchaser, if available, under the terms of its existing gas sales contract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from such sale direct to the Consenting Parties until the amounts provided for in this Article are recovered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not contracted for sale of its gas at the time such gas is available for delivery, or has not made the election as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-Consenting Party's share of gas as hereinabove provided during the recoupment period.

During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production.

In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.

Within sixty (60) days after the completion of any operation under this Article, the party conducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas produced during any month, Consenting Parties shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs of the work done and of the equipment purchased, in determining when the interest of such Non-Consenting Party shall revert to it as above provided; and if there is a credit balance, it shall be paid to such Non-Consenting party.

If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent of all parties, no wells shall be completed in or produced from a source of supply from which a well located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such source of supply.

The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b) to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article VI.A.

C. Right to Take Production in Kind:

Each party shall have the right to take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating oil for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any

party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment direct from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate commerce, of any other party's share of gas production without first giving such other party thirty (30) days notice of such intended sale.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any Gas Balancing Agreement between the parties hereto, whether such Agreement is attached as Exhibit "E", or is a separate Agreement.

D. Access to Contract Area and Information:

Each party shall have access to the Contract Area at all reasonable times, at its sole risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the information.

E. Abandonment of Wells:

1. Abandonment of Dry Holes: Except for any well drilled pursuant to Article VI.B.2., any well which has been drilled under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling of such well. Any party who objects to the plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well which has been drilled or reworked pursuant to Article VI.B.2. hereof for which the Consenting Parties have not been fully reimbursed as therein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of such well, all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one year and so long thereafter as oil and or gas is produced from the interval or inter-

vals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentages of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interest in the remaining portion of the Contract Area.

Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned well.

ARTICLE VII.
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.

B. Liens and Payment Defaults:

Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share of oil and or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon at the rate provided in the Accounting Procedure attached hereto as Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the State, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's share of oil and or gas until the amount owed by such Non-Operator, plus interest has been paid. Each purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.

If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.

C. Payments and Accounting:

Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in the Accounting Procedure attached hereto as Exhibit "C". Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Limitation of Expenditures:

1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this Agreement, it being understood that the consent to the drilling or deepening shall include:

☐ Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and equipping of the well, including necessary tankage and or surface facilities.

☒ Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its authorized depth, and all tests have been completed, Operator shall give immediate notice to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion attempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, including necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less than all parties.

2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agreement, it being understood that the consent to the reworking or plugging back of a well shall include consent to all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage and/or surface facilities.

3. Other Operations: Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Twenty-Five Thousand and no/100--- Dollars ($ 25,000.00) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares "Authority for Expenditures" for its own use, Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project costing in excess of Twenty-Five Thousand and no/100------- Dollars ($ 25,000.00).

E. Royalties, Overriding Royalties and Other Payments:

Each party shall pay or deliver, or cause to be paid or delivered, all royalties to the extent of Lessor's royalty due on its share of production and shall hold the other parties free from any liability therefor. If the interest of any party in any oil and gas lease covered by this agreement is subject to any royalty, overriding royalty, production payment, or other charge over and above the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account for or cause to be accounted for, such interest to the owners thereof.

No party shall ever be responsible, on any price basis higher than the price received by such party, to any other party's lessor or royalty owner; and if any such other party's lessor or royalty owner should demand and receive settlements on a higher price basis, the party contributing such lease shall bear the royalty burden insofar as such higher price is concerned.

F. Rentals, Shut-in Well Payments and Minimum Royalties:

Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.2.

Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sunday and holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments

of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

G. Taxes:

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. Operator shall bill other parties for their proportionate share of all tax payments in the manner provided in Exhibit "C".

If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final determination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint account, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as provided in Exhibit "C".

Each party shall pay or cause to be paid all production, severance, gathering and other taxes imposed upon or with respect to the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.

H. Insurance:

At all times while operations are conducted hereunder, Operator shall comply with the Workmen's Compensation Law of the State where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be an amount equivalent to the premium which would have been paid had such insurance been obtained. Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the Workmen's Compensation Law of the State where the operations are being conducted and to maintain such other insurance as Operator may require.

In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's fully owned automotive equipment.

ARTICLE VIII.
ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

A. Surrender of Leases:

The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole or in part unless all parties consent thereto.

However, should any party desire to surrender its interest in any lease or in any portion thereof, and other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not desiring to surrender it. If the interest of the assigning party includes an oil and gas interest, the assigning party shall execute and deliver to the party or parties not desiring to surrender an oil and gas lease covering such oil and gas interest for a term of one year and so long thereafter as oil and/or gas is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B". Upon such assignment, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the acreage assigned and the operation of any well thereon, and the assigning party shall have no further interest in the lease assigned and its equipment and production other than the royalties retained in any lease made under the terms of this Article. The parties assignee shall pay to the party assignor the reasonable salvage value of the latter's interest in any wells and equipment on the assigned acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. If the assignment is in favor of more than one party, the assigned interest shall

be shared by the parties assignee in the proportions that the interest of each bears to the interest of all parties assignee.

Any assignment or surrender made under this provision shall not reduce or change the assignor's or surrendering parties' interest, as it was immediately before the assignment, in the balance of the Contract Area; and the acreage assigned or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this agreement.

B. Renewal or Extension of Leases:

If any party secures a renewal of any oil and gas lease subject to this Agreement, all other parties shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area.

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this agreement.

The provisions in this Article shall apply also and in like manner to extensions of oil and gas leases.

C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash toward the drilling of a well or any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. If all parties hereto are Drilling Parties and accept such tender, such acreage shall become a part of the Contract Area and be governed by the provisions of this agreement. If less than all parties hereto are Drilling Parties and accept such tender, such acreage shall not become a part of the Contract Area. Each party shall promptly notify all other parties of all acreage or money contributions it may obtain in support of any well or any other operation on the Contract Area.

If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Subsequently Created Interest:

Notwithstanding the provisions of Article VIII.E. and VIII.G., if any party hereto shall, subsequent to execution of this agreement, create an overriding royalty, production payment, or net proceeds interest, which such interests are hereinafter referred to as "subsequently created interest", such subsequently created interest shall be specifically made subject to all of the terms and provisions of this agreement, as follows:

1. If non-consent operations are conducted pursuant to any provision of this agreement, and the party conducting such operations becomes entitled to receive the production attributable to the interest out of which the subsequently created interest is derived, such party shall receive same free and clear of such subsequently created interest. The party creating same shall bear and pay all such subsequently created interests and shall indemnify and hold the other parties hereto free and harmless from any and all liability resulting therefrom.

2. If the owner of the interest from which the subsequently created interest is derived (1) fails to pay, when due, its share of expenses chargeable hereunder, or (2) elects to abandon a well under provisions of Article VI.E. hereof, or (3) elects to surrender a lease under provisions of Article VIII.A. hereof, the subsequently created interest shall be chargeable with the pro rata portion of all expenses hereunder in the same manner as if such interest were a working interest. For purposes of collecting such chargeable expenses, the party or parties who receive assignments as a result of (2) or (3) above shall have the right to enforce all provisions of Article VII.B. hereof against such subsequently created interest.

E. Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or

2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the right of the other parties.

If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such party's interests within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds hereof.

F. Waiver of Right to Partition:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

G. Preferential Right to Purchase:

~~Should any party desire to sell all or any part of its interests under this agreement, or its rights and~~ interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent ~~company, or to any company in which any one party owns a majority of the stock.~~

ARTICLE IX.
INTERNAL REVENUE CODE ELECTION

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No

such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from Operations hereunder can be adequately determined without the computation of partnership taxable income.

ARTICLE X.
CLAIMS AND LAWSUITS

Operator may settle any single damage claim or suit arising from operations hereunder if the expenditure does not exceed Five Thousand and no/100---------- Dollars ($ 5,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, the party shall immediately notify Operator, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

ARTICLE XI.
FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure. The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

ARTICLE XII.
NOTICES

All notices authorized or required between the parties, and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by United States mail or Western Union telegram, postage or charges prepaid, or by teletype, and addressed to the party to whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed, and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid, or when sent by teletype. Each party shall have the right to change its address at any time, and from time to time, by giving written notice hereof to all other parties.

ARTICLE XIII.
TERM OF AGREEMENT

This agreement shall remain in full force and effect as to the oil and gas leases and or oil and gas interests subjected hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any lease, or oil and gas interest contributed by any other party beyond the term of this agreement.

[illegible]

X: Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of 90 days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling or reworking a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and or gas from the Contract Area, this agreement shall terminate unless drilling or reworking operations are commenced within 60 days from the date of abandonment of said well.

It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

ARTICLE XIV.
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the conservation laws of the state in which the committed acreage is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and orders.

B. Governing Law:

The essential validity of this agreement and all matters pertaining thereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state where most of the land in the Contract Area is located shall govern.

ARTICLE XV.
OTHER PROVISIONS

SALE OF ROYALTY GAS

It is recognized by the parties hereto that in addition to each party's share of working interest production, such party shall have the right, subject to existing contracts, to market the royalty gas attributable to each lease which it contributes to the unit area and to receive payments due for such royalty gas produced from or allocated to such lease or leases. It is agreed that, regardless of whether each party markets or contracts for its share of gas, including the royalty gas under the leases which it contributed to the Unit, such party agrees to pay or cause to be paid to the royalty owners under its lease or leases the proceeds attributable to their respective royalty interest and to hold all other parties hereto harmless for its failure to do so.

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of 8th day of April, 19 80.

OPERATOR

SOUTHLAND ROYALTY COMPANY

_____

By: C. E. Mear
Attorney-in-Fact

NON-OPERATORS

ATTEST:

_____

DEPCO, INC.

By: _____

ATTEST:

_____

CITIES SERVICE COMPANY

By: _____

ATTEST:

_____
Secretary

BASSETT-BIRNEY

By: _____
Frank Yates, Attorney-In-Fact for
Martin Yates, III, Vice President

Form 3106-5
(March 1980)

UNITED STATES
DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT

FORM APPROVED
OMB NO. 42-R1599

Lease Serial No.
LC 062029

Lease effective date
May 1, 1942

FOR BLM OFFICE USE ONLY
New Serial No.

ASSIGNMENT AFFECTING RECORD TITLE TO OIL AND GAS LEASE

PART I

1. Assignee's Name

Bassett-Birney Oil Corporation

Address (include zip code)
207 South 4th Street
Artesia, New Mexico 88210

The undersigned, as owner of 50 percent of the record title of the above-designated oil and gas lease, hereby transfers and assigns to the assignee shown above, the record title interest in and to such lease as specified below.

2. Describe the lands affected by this assignment (43 CFR 3101.2-3)

Township 18 South, Range 29 East, N.M.P.M.

Section 33: Lot 3 ($SE\frac{1}{4}SW\frac{1}{4}$), $N\frac{1}{2}SE\frac{1}{4}$
Section 34: Lot 1 ($SE\frac{1}{4}SE\frac{1}{4}$), Lot 2 ($SW\frac{1}{4}SE\frac{1}{4}$),
Lot 4 ($SW\frac{1}{4}SW\frac{1}{4}$), $NW\frac{1}{4}SW\frac{1}{4}$
Section 35: Lot 2 ($SW\frac{1}{4}SE\frac{1}{4}$), $NW\frac{1}{4}SE\frac{1}{4}$, $NW\frac{1}{4}SW\frac{1}{4}$, $NW\frac{1}{4}$

containing 544.16 acres, more or less.

3. Specify interest or percent of assignor's record title interest being conveyed to assignee	All, bei 50% inte
4. Specify interest or percent of record title interest being retained by assignor, if any	None
5. Specify overriding royalty being reserved by assignor	None in Assignme
6. Specify overriding royalty previously reserved or conveyed, if any	Exhibit "A" attached shows ove riding royalties, operating ag ments and production payments heretofore reserved or conveyed
7. If any payments out of production have previously been created out of this lease, or if any such payments are being reserved under this assignment, attach statement giving full details as to amount, method of payment, and other pertinent terms as provided under 43 CFR 3106.	See Exhibit "A" attached.

It is agreed that the obligation to pay any overriding royalties or payments out of production of oil created herein, which, when added to overriding royalties or payments out of production previously created and to the royalty payable to the United States, aggregate in excess of 17½ percent, shall be suspended when the average production of oil per well per day averaged on the monthly basis is 15 barrels or less.

I CERTIFY That the statements made herein are true, complete, and correct to the best of my knowledge and belief and are made in good faith.

Executed this 6th day of June, 19 80
ROBERT E. McKEE GENERAL CONTRACTOR, INC.

By: [signature] President P. O. Box 20562
(Assignor's Signature) (Assignor's Address)

ATTEST: [signature]
Secretary El Paso, Texas 79998
(City) (State) (Zip Code)

STATE OF TEXAS)
: ss.
COUNTY OF EL PASO)

The foregoing instrument was acknowledged before me this 6th day of June, 1980, by C. D. McKee President of Robert E. McKee General Contractor, Inc., a Nevada corporation, on behalf of said corporation.

My commission expires:
[illegible]

[signature]
Notary Public

EXHIBIT "A"

1. 5% overriding royalty on NW/4 SW/4 Section 35, reserved in an assignment dated January 24, 1943, recorded Book 22, Page 171, from Neil B. Watson et ux to Robert E. McKee and C. N. Bassett.

2. 2-1/2% overriding royalty on E/2 NW/4 Section 35, reserved in an assignment dated May 8, 1943, recorded Book 21, Page 283, from C. Melvin Neal et ux to Paul Love.

3. 2% overriding royalty on, among other lands, Lot 3 (SE/4 SW/4) Section 33, Lot 1 (SE/4 SE/4), Lot 4 (SW/4 SW/4), NW/4 SW/4 Section 34, Lot 2 (SW/4 SE/4), NW/4 SE/4 Section 35, reserved in an assignment dated May 28, 1943, recorded Book 21, Page 329, from Martha Featherstone et vir to Robert E. McKee and C. N. Bassett.

4. 2% overriding royalty on, among other lands, N/2 SE/4 Section 33, reserved in an assignment dated June 5, 1943, recorded Book 21, Page 330, from Julia Brainard et vir to Robert E. McKee and C. N. Bassett.

5. 2% overriding royalty on, among other lands, Lot 2 (SW/4 SE/4) Section 34, and W/2 NW/4 Section 35, reserved in an assignment dated October 22, 1943, recorded Book 22, Page 94, from Julia Brainard et vir to Robert E. McKee.

6. Operating rights from surface to base of the Queen formation underlying, among other lands, Lot 2 (SW/4 SE/4), NW/4 SW/4 Section 34, conveyed by assignment dated November 1, 1959, recorded Book 109, Page 274, from Robert E. McKee General Contractor, Inc. to Stanton Oil, Ltd.

7. Operating rights from surface to 2,373 feet, underlying Lot 4 (SW/4 SW/4) Section 34, conveyed by assignment dated August 19, 1964, unrecorded but approved October 7, 1964, from Robert E. McKee General Contractor, Inc. to Stanton Oil, Ltd.

8. Operating rights, without depth limitation, underlying Lot 2 (SW/4 SE/4), N/2 NW/4 Section 35, conveyed by assignment dated March 9, 1960, recorded Book 106, Page 468, from Robert E. McKee General Contractor, Inc. and Bassett-Birney Oil Corporation to Leonard Oil Company.

9. A production payment of $750 per acre, payable out of 1/16th of 7/8ths, but reduced by 1/2 of the then existing overriding royalty burdens from the lands described in 8 above, created by production payment agreement dated March 9, 1960, recorded Book 106, Page 399, from Leonard Oil Company to Robert E. McKee General Contractor, Inc., and presently owned by and reserved to Robert E. McKee General Contractor, Inc.

Dockets Nos. 30-80 and 31-80 are tentatively set for October 1 and 15, 1980. Applications for hearing must be filed at least 22 days in advance of hearing date.

DOCKET: EXAMINER HEARING - WEDNESDAY - SEPTEMBER 17, 1980

9 A.M. - OIL CONSERVATION DIVISION CONFERENCE ROOM, STATE LAND OFFICE BUILDING, SANTA FE, NEW MEXICO

The following cases will be heard before Richard L. Stamets, Examiner, or Daniel S. Nutter, Alternate Examiner:

ALLOWABLE: (1) Consideration of the allowable production of gas for October, 1980, from fifteen prorated pools in Lea, Eddy, and Chaves Counties, New Mexico.

(2) Consideration of the allowable production of gas for October, 1980, from four prorated pools in San Juan, Rio Arriba, and Sandoval Counties, New Mexico.

CASE 7021: Application of Gulf Oil Corporation for simultaneous dedication, Lea County, New Mexico. Applicant, in the above-styled cause, seeks approval for the simultaneous dedication of a previously approved 477-acre non-standard gas proration unit comprising the N/2 and SE/4 of Section 19, Township 19 South, Range 37 East, Eumont Gas Pool, to its B. V. Culp (NCT-A) Wells Nos. 3 and 9 located in Units F and J, respectively, of said Section 19.

CASE 6961: (Continued from August 20, 1980, Examiner Hearing)

Application of Conoco Inc. for a dual completion and unorthodox well location, Lea County, New Mexico. Applicant, in the above-styled cause, seeks approval for the dual completion of its Meyer A-29 Well No. 11 to be drilled at an unorthodox location 990 feet from the North line and 660 feet from the East line of Section 29, Township 22 South, Range 36 East, to produce gas from the Langley-Devonian and -Ellenburger Pools thru parallel strings of tubing, the E/2 of said Section 29 to be dedicated to the well.

CASE 7022: Application of Texas Pacific Oil Company, Inc. for a non-standard proration unit and simultaneous dedication, Lea County, New Mexico. Applicant, in the above-styled cause, seeks approval for the simultaneous dedication of a 320-acre non-standard proration unit comprising the N/2 of Section 9, Township 22 South, Range 36 East, Jalmat Gas Pool, to its Wells Nos. 40 and 63 located in Units A and C, respectively, of said Section 9. Applicant further seeks approval to simultaneously dedicate its Wells Nos. 14, 36, 42, and 62 located in Units B, M, E, and K, respectively, of Section 11, Township 22 South, Range 36 East, to a standard proration unit to be comprised of all of said Section 11.

CASE 7008: (Continued from August 20, 1980, Examiner Hearing)

Application of Coronado Exploration Corp. for eight compulsory poolings, Chaves County, New Mexico. Applicant, in the above-styled cause, seeks an order pooling all mineral interests in the San Andres formation underlying eight 40-acre proration units, being the NE/4 NE/4 of Section 4 and the NW/4 NE/4 of Section 5, both in Township 12 South, Range 28 East, and the NW/4 SE/4 of Section 6, the NE/4 NW/4 of Section 23, the NE/4 SE/4 of Section 28, the SE/4 SE/4 of Section 29, the NE/4 NW/4 of Section 32, and the SE/4 NW/4 of Section 33, all in Township 11 South, Range 28 East, each to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said wells and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the wells, and a charge for risk involved in drilling said wells.

CASE 7004: (Continued from August 20, 1980, Examiner Hearing)

Application of Anadarko Production Company for compulsory pooling, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks an order pooling all mineral interests in the Wolfcamp-Morrow formations underlying the N/2 of Section 12, Township 19 South, Range 25 East, to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said well and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the well, and a charge for risk involved in drilling said well.

CASE 7023: Application of Shell Oil Company for pool creation and temporary special pool rules, Roosevelt County, New Mexico. Applicant, in the above-styled cause, seeks the creation of a new Pennsylvanian oil pool for its Askew Well No. 1 located in Unit L of Section 2, Township 5 South, Range 33 East, and the promulgation of special pool rules therefor, including a provision for 80-acre spacing.

CASE 7011: (Continued from August 20, 1980, Examiner Hearing)

Application of Amoco Production Company for downhole commingling, San Juan County, New Mexico. Applicant, in the above-styled cause, seeks approval for the downhole commingling of Fruitland and Blanco-Pictured Cliffs production in the wellbores of the following six wells: Elliott "C" No. 1, SE/4 of Section 9, Township 30 North, Range 9 West; Elliott "B" No. 8, NE/4 of Section 10; "A" Nos. 3 and 2, NE/4 and NW/4, Section 11; "D" No. 7, SW/4 of Section 11; and "E" No. 1, NW/4 of Section 14, all in Township 29 North, Range 9 West.

CASE 7019: (Continued from September 3, 1980, Examiner Hearing)

Application of Amoco Production Company for compulsory pooling, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks an order pooling all mineral interests in the Pennsylvanian formation underlying the W/2 of Section 30, Township 23 South, Range 25 East, to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said well and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the well, and a charge for risk involved in drilling said well.

CASE 6991: (Continued from September 3, 1980, Examiner Hearing)

Application of Amoco Production Company for salt water disposal, Lea County, New Mexico. Applicant, in the above-styled cause, seeks authority to dispose of produced salt water into the San Andres formation in a 100 foot perforated interval between 4400 feet and 4800 feet in its South Hobbs Unit Well No. 103 in Unit B of Section 15, Township 19 South, Range 38 East, Hobbs Grayburg-San Andres Pool.

CASE 7024: Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks an order pooling all mineral interests in the Pennsylvanian formation underlying the E/2 of Section 35, Township 18 South, Range 29 East, to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said well and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the well, and a charge for risk involved in drilling said well.

CASE 7025: Application of Southland Royalty Company for compulsory pooling, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks an order pooling all mineral interests in the Pennsylvanian formation underlying the W/2 of Section 35, Township 18 South, Range 29 East, to be dedicated to a well to be drilled at a standard location thereon. Also to be considered will be the cost of drilling and completing said well and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the well, and a charge for risk involved in drilling said well.

CASE 7005: (Continued from August 20, 1980, Examiner Hearing)

Application of Sol West III for an NGPA determination, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks a new onshore reservoir determination in the Morrow formation for his Turkey Track-Morrow Sand Well No. 1 in Unit I of Section 26, Township 18 South, Range 28 East.

CASE 6822: (Continued from September 3, 1980, Examiner Hearing)

In the matter of Case 6822 being reopened pursuant to the provisions of Order No. R-6293 which order created the West Double X-Wolfcamp Gas Pool as a retrograde gas condensate pool and set special production limitations therein. Operator(s) may appear and present evidence to establish the true nature of the reservoir and proper rates of withdrawal therefrom.

CASE 7026: Application of Bass Enterprises Production Company for pool creation, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks the creation of a new Bone Spring oil pool for its Big Eddy Unit Well No. 60 located in Unit J of Section 20, Township 21 South, Range 28 East, and the promulgation of special rules therefor including a gas-oil ratio limitation of 10,000 to one.

CASE 7027: Application of W. A. Moncrief, Jr. for an NGPA determination, Eddy County, New Mexico. Applicant, in the above-styled cause, seeks a new onshore reservoir determination in the Morrow formation for his Marathon State Com. Well No. 1 in Unit J of Section 11, Township 24 South, Range 24 East.

CASE 7028: In the matter of the hearing called by the Oil Conservation Division on its own motion for an order creating, deleting, and extending certain pools in Chaves, Eddy, and Lea Counties, New Mexico:

(a) CREATE a new pool in Lea County, New Mexico, classified as an oil pool for Wolfcamp production and designated as the North Bell Lake-Wolfcamp Pool. The discovery well is Amoco Production Company State HL Well No. 1 located in Unit L of Section 2, Township 23 South, Range 33 East, NMPM. Said pool would comprise:

TOWNSHIP 23 SOUTH, RANGE 33 EAST, NMPM
Section 2: W/2

(b) CREATE a new pool in Eddy County, New Mexico, classified as an oil pool for Delaware production and designated as the Golden Lane-Delaware Pool. The discovery well is Meadco Properties, Ltd. Hudson Federal Well No. 1 located in Unit C of Section 4, Township 21 South, Range 29 East, NMPM. Said pool would comprise:

TOWNSHIP 21 SOUTH, RANGE 29 EAST, NMPM
Section 4: Lots 3, 4, 5, 6, 11, and 12

(c) CREATE a new pool in Lea County, New Mexico, classified as a gas pool for Atoka production and designated as the McDonald-Atoka Gas Pool. The discovery well is Harvey E. Yates Company Heyco Betenbough Well No. 1 located in Unit C of Section 32, Township 13 South, Range 36 East, NMPM. Said pool would comprise:

TOWNSHIP 13 SOUTH, RANGE 36 EAST, NMPM
Section 32: N/2

(d) CREATE a new pool in Lea County, New Mexico, classified as an oil pool for Seven Rivers production and designated as the Pearsall-Seven Rivers Pool. The discovery well is Arrowhead Oil Corporation Hover Well No. 3 located in Unit D of Section 32, Township 17 South, Range 32 East, NMPM. Said pool would comprise:

TOWNSHIP 17 SOUTH, RANGE 32 EAST, NMPM
Section 32: NW/4

(e) CREATE a new pool in Lea County, New Mexico, classified as an oil pool for Wolfcamp production and designated as the West Tonto-Wolfcamp Pool. The discovery well is Inexco Oil Company Federal Com 7 Well No. 2 located in Unit E of Section 7, Township 19 South, Range 33 East, NMPM. Said pool would comprise:

TOWNSHIP 19 SOUTH, RANGE 33 EAST, NMPM
Section 7: NW/4

(f) CREATE a new pool in Eddy County, New Mexico, classified as an oil pool for Bone Spring production and designated as the Winchester-Bone Spring Pool. Further to assign approximately 38,955 barrels of discovery allowable to the discovery well, Marathon Oil Company Martinez "31" Federal Well No. 1 located in Unit F of Section 31, Township 19 South, Range 29 East, NMPM. Said pool would comprise:

TOWNSHIP 19 SOUTH, RANGE 29 EAST, NMPM
Section 31: NW/4

(g) CONTRACT the horizontal limits of the Mid Bell Lake-Devonian Gas Pool in Lea County, New Mexico, by the deletion of the following described area:

TOWNSHIP 23 SOUTH, RANGE 34 EAST, NMPM
Section 18: N/2 and SW/4

(h) CONTRACT the horizontal limits of the La Rica-Morrow Gas Pool in Lea County, New Mexico, by the deletion of the following described area:

TOWNSHIP 19 SOUTH, RANGE 34 EAST, NMPM
Section 2: All

(i) EXTEND the Airstrip-Upper Bone Spring Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 18 SOUTH, RANGE 34 EAST, NMPM
Section 35: NE/4
Section 36: NE/4

TOWNSHIP 18 SOUTH, RANGE 35 EAST, NMPM
Section 31: NW/4

(j) EXTEND the Airstrip-Lower Bone Spring Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 18 SOUTH, RANGE 34 EAST, NMPM
Section 23: SW/4
Section 26: NE/4

(k) EXTEND the Artesia Queen-Grayburg-San Andres Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 18 SOUTH, RANGE 27 EAST, NMPM
Section 22: E/2 NE/4

TOWNSHIP 18 SOUTH, RANGE 28 EAST, NMPM
Section 35: W/2 NW/4

TOWNSHIP 19 SOUTH, RANGE 27 EAST, NMPM
Section 2: NW/4 and N/2 SW/4

(l) EXTEND the Bough-San Andres Gas Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 9 SOUTH, RANGE 35 EAST, NMPM
Section 14: NE/4

(m) EXTEND the Buffalo-Pennsylvanian Gas Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 19 SOUTH, RANGE 33 EAST, NMPM
Section 8: E/2

(n) EXTEND the North Burton Flat-Wolfcamp Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 20 SOUTH, RANGE 28 EAST, NMPM
Section 29: N/2

(o) EXTEND the South Carlsbad-Morrow Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 22 SOUTH, RANGE 27 EAST, NMPM
Section 16: W/2

(p) EXTEND the Chaveroo-San Andres Pool in Chaves County, New Mexico, to include therein:

TOWNSHIP 8 SOUTH, RANGE 32 EAST, NMPM
Section 4: E/2 E/2

(q) EXTEND the South Culebra Bluff-Bone Spring Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 23 SOUTH, RANGE 28 EAST, NMPM
Section 24: S/2 NW/4 and N/2 S/2

(r) EXTEND the Eagle Creek Permo-Pennsylvanian Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 17 SOUTH, RANGE 25 EAST, NMPM
Section 31: All

(s) EXTEND the South Empire-Morrow Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 18 SOUTH, RANGE 28 EAST, NMPM
Section 12: All

(t) EXTEND the East Empire Yates-Seven Rivers Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 17 SOUTH, RANGE 28 EAST, NMPM
Section 28: N/2 N/2

(u) EXTEND the East Grama Ridge-Morrow Gas Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 22 SOUTH, RANGE 34 EAST, NMPM
Section 3: E/2

(v) EXTEND the West Indian Basin-Morrow Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 21 SOUTH, RANGE 22 EAST, NMPM
Section 24: N/2

(w) EXTEND the Langley-Devonian Gas Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 22 SOUTH, RANGE 36 EAST, NMPM
Section 28: S/2

(x) EXTEND the Langley-Ellenburger Gas Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 22 SOUTH, RANGE 36 EAST, NMPM
Section 28: S/2

(y) EXTEND the Los Medanos-Atoka Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 23 SOUTH, RANGE 30 EAST, NMPM
Section 1: S/2

(z) EXTEND the North Loving-Morrow Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 23 SOUTH, RANGE 28 EAST, NMPM
Section 17: S/2
Section 19: E/2
Section 20: W/2

(aa) EXTEND the Lusk-Morrow Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 19 SOUTH, RANGE 31 EAST, NMPM
Section 13: All

(bb) EXTEND the West Malaga-Atoka Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 24 SOUTH, RANGE 28 EAST, NMPM
Section 8: E/2
Section 9: S/2

(cc) EXTEND the Mesa-Queen Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 16 SOUTH, RANGE 31 EAST, NMPM
Section 1: SW/4

(dd) EXTEND the Midway-Devonian Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 17 SOUTH, RANGE 37 EAST, NMPM
Section 8: SE/4

(ee) EXTEND the Nash Draw-Morrow Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 23 SOUTH, RANGE 30 EAST, NMPM
Section 7: S/2

(ff) EXTEND the North Osudo-Morrow Gas Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 20 SOUTH, RANGE 36 EAST, NMPM
Section 29: S/2

(gg) EXTEND the East Red Lake Queen-Grayburg Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 16 SOUTH, RANGE 28 EAST, NMPM
Section 25: NW/4 and N/2 SW/4

(hh) EXTEND the Sand Point-Morrow Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 21 SOUTH, RANGE 28 EAST, NMPM
Section 3: Lots 1, 2, 7, 8, 9, 10, 15 and 16

(ii) EXTEND the Shoebar-Atoka Gas Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 16 SOUTH, RANGE 35 EAST, NMPM
Section 28: N/2 and SW/4

Docket No. 29-80

(jj) EXTEND the Shugart-Pennsylvanian Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 19 SOUTH, RANGE 31 EAST, NMPM
Section 1: W/2
Section 2: N/2

(kk) EXTEND the Sioux Tansill-Yates-Seven Rivers Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 26 SOUTH, RANGE 36 EAST, NMPM
Section 9: SE/4

(ll) EXTEND the Teas Yates-Seven Rivers Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 20 SOUTH, RANGE 34 EAST, NMPM
Section 19: SE/4

(mm) EXTEND the Tom-Tom San Andres Pool in Chaves County, New Mexico, to include therein:

TOWNSHIP 7 SOUTH, RANGE 31 EAST, NMPM
Section 24: SW/4
Section 35: NW/4

(nn) EXTEND the Turkey Track-Atoka Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 19 SOUTH, RANGE 29 EAST, NMPM
Section 1: S/2
Section 2: S/2
Section 11: N/2
Section 14: All

(oo) EXTEND the Turkey Track-Morrow Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 19 SOUTH, RANGE 29 EAST, NMPM
Section 7: S/2
Section 18: All

(pp) EXTEND the Winchester-Wolfcamp Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 19 SOUTH, RANGE 28 EAST, NMPM
Section 34: SE/4

(qq) EXTEND the Yarrow-Delaware Gas Pool in Eddy County, New Mexico, to include therein:

TOWNSHIP 23 SOUTH, RANGE 26 EAST, NMPM
Section 22: NE/4

(rr) EXTEND the Young-Morrow Gas Pool in Lea County, New Mexico, to include therein:

TOWNSHIP 18 SOUTH, RANGE 32 EAST, NMPM
Section 4: S/2
Section 9: E/2

CAMPBELL AND BLACK, P.A.
LAWYERS

JACK M. CAMPBELL
BRUCE D. BLACK
MICHAEL B. CAMPBELL
WILLIAM F. CARR

JEFFERSON PLACE
SANTA FE, NEW MEXICO 87501
TELEPHONE (505) 988-4421

RECEIVED
AUG 26 1980
OIL CONSERVATION DIVISION
SANTA FE

August 25, 1980

Mr. Joe D. Ramey
Division Director
Oil Conservation Division
New Mexico Department of
Energy and Minerals
Post Office Box 2088
Santa Fe, New Mexico 87501

Case 7025

RE: Application of Southland Royalty Company for Compulsory Pooling, Eddy County, New Mexico

Dear Mr. Ramey:

Enclosed in triplicate is the application of Southland Royalty Company in the above-referenced matter.

The applicant requests that this matter be included on the docket for the examiner hearing scheduled to be held on September 17, 1980.

Very truly yours,

William F. Carr

WFC:tn

Enclosures

cc: Mr. Don Davis, Landman
Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

RECEIVED
AUG 25 1980
OIL CONSERVATION DIVISION
SANTA FE

BEFORE THE

OIL CONSERVATION DIVISION

NEW MEXICO DEPARTMENT OF ENERGY AND MINERALS

IN THE MATTER OF THE APPLICATION
OF SOUTHLAND ROYALTY COMPANY
FOR COMPULSORY POOLING
EDDY COUNTY, NEW MEXICO

CASE 7025

APPLICATION

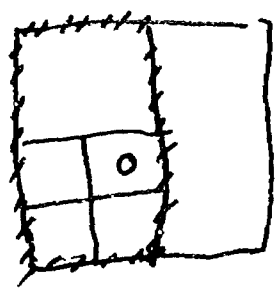
Comes now, SOUTHLAND ROYALTY COMPANY, by and through its undersigned attorneys and, as provided by Section 70-2-17, New Mexico Statutes Annotated, 1978 Compilation, hereby makes application for an order pooling all of the mineral interests in the Pennsylvanian formation in and under the W/½ of Section 35, Township 18 South, Range 29 East, N.M.P.M., Eddy County, New Mexico, and in support thereof would show the Commission:

1. Applicant is the owner of 55.6% of the working interest in and under the W/½ of said Section 35, and applicant has the right to drill thereon.

2. Applicant proposes to dedicate the above-referenced pooled unit to its Empire Federal 35 Com. No. 1 Well to be drilled at an orthodox location 1980 feet from the South and West lines of said Section 35.

3. Applicant has sought and obtained either voluntary agreement for pooling or farm-out from all other working interest owners in the W/½ of said Section 35 except Tenneco Oil Exploration and Production Company, owner of a 25.4% working interest and Bassett-Birney Oil Corporation, owner of a 19.0% working interest.

4. Said pooling of interest and well completion will avoid the drilling of unnecessary wells, will prevent waste and will protect correlative rights.



5. In order to permit the applicant to obtain its just and fair share of the oil and gas underlying the subject lands, the mineral interest should be pooled, and applicant should be designated the operator of the well to be drilled.

WHEREFORE, applicant prays that this application be set for hearing before the Division's duly appointed examiner, and that after notice and hearing as required by law the Division enter its order pooling the lands, including provisions designating the applicant as operator of the well, providing for applicant to recover its costs of drilling, equipping and completing the well, its costs of supervision while drilling, and after completion, including overhead charges, and a risk factor for the risk assumed by the applicant in drilling completing and equipping the well, and such other and further provisions as may be proper in the premises.

Respectfully submitted,

CAMPBELL AND BLACK, P.A.

By William F. Carr

William F. Carr
Post Office Box 2208
Santa Fe, New Mexico 87501
Attorneys for Applicant

RECEIVED
AUG 26 1980
OIL CONSERVATION DIVISION
SANTA FE

BEFORE THE

OIL CONSERVATION DIVISION

NEW MEXICO DEPARTMENT OF ENERGY AND MINERALS

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OF SOUTHLAND ROYALTY COMPANY
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1. Applicant is the owner of 55.6% of the working interest in and under the W/½ of said Section 35, and applicant has the right to drill thereon.

2. Applicant proposes to dedicate the above-referenced pooled unit to its Empire Federal 35 Com. No. 1 Well to be drilled at an orthodox location 1980 feet from the South and West lines of said Section 35.

3. Applicant has sought and obtained either voluntary agreement for pooling or farm-out from all other working interest owners in the W/½ of said Section 35 except Tenneco Oil Exploration and Production Company, owner of a 25.4% working interest and Bassett-Birney Oil Corporation, owner of a 19.0% working interest.

4. Said pooling of interest and well completion will avoid the drilling of unnecessary wells, will prevent waste and will protect correlative rights.

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By William F. Carr

William F. Carr
Post Office Box 2208
Santa Fe, New Mexico 87501
Attorneys for Applicant

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SANTA FE

BEFORE THE

OIL CONSERVATION DIVISION

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OF SOUTHLAND ROYALTY COMPANY
FOR COMPULSORY POOLING
EDDY COUNTY, NEW MEXICO

CASE 7025

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1. Applicant is the owner of 55.6% of the working interest in and under the W/½ of said Section 35, and applicant has the right to drill thereon.

2. Applicant proposes to dedicate the above-referenced pooled unit to its Empire Federal 35 Com. No. 1 Well to be drilled at an orthodox location 1980 feet from the South and West lines of said Section 35.

3. Applicant has sought and obtained either voluntary agreement for pooling or farm-out from all other working interest owners in the W/½ of said Section 35 except Tenneco Oil Exploration and Production Company, owner of a 25.4% working interest and Bassett-Birney Oil Corporation, owner of a 19.0% working interest.

4. Said pooling of interest and well completion will avoid the drilling of unnecessary wells, will prevent waste and will protect correlative rights.

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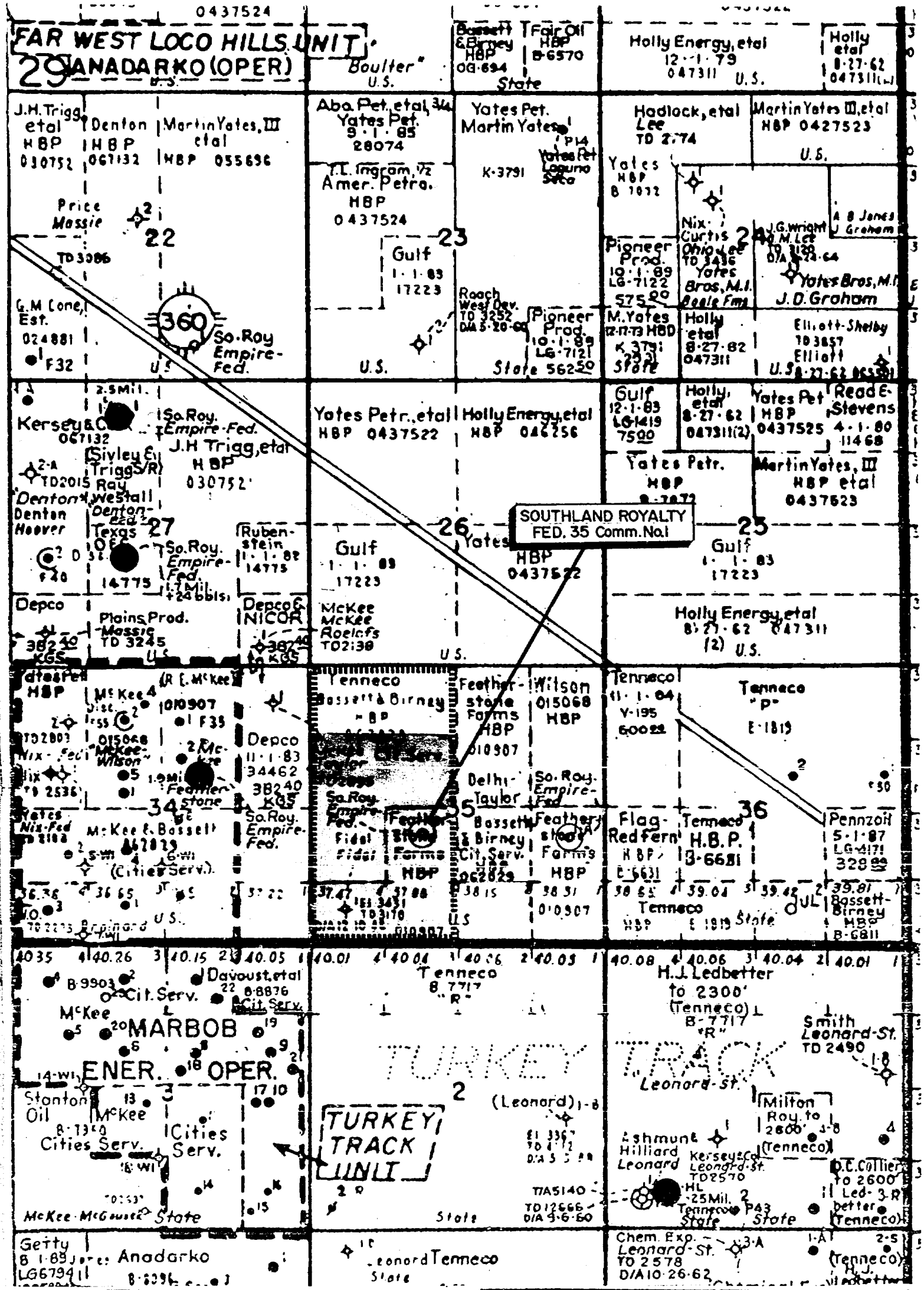
Respectfully submitted,

CAMPBELL AND BLACK, P.A.

By William F. Carr

William F. Carr
Post Office Box 2208
Santa Fe, New Mexico 87501
Attorneys for Applicant



REMARKS

FARMIN SUPPORT, OWNED 100% BY SRC
(Obligation date for well: 11-05-80

FARMIN SUPPORT, OWNED 50% BY SRC
(Obligation date for well: 11-05-80

DEDICATED PRORATION UNIT TO WELL

MORROW OR ATOKA PRODUCER

Southland Royalty Company
SOUTHWESTERN DISTRICT
MIDLAND, TEXAS

EMPIRE (SOUTH) PROSPECT
EDDY COUNTY, NEW MEXICO

Southland Royalty Company

February 26, 1980

File: 500340 ✓
500422

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: Farmout Request
Portions of Sections 33, 34 & 35
T18S, R29E
Eddy County, New Mexico
~~Empire, South Prospect~~ #1873 ✓

Gentlemen:

Reference is made to your leasehold located in the above subject tracts. Southland Royalty Company is presently attempting to secure support from the leasehold owners under these sections for the drilling of several Morrow wells.

A check of the records indicates that Bassett & Birney Oil Corporation owns a 50% working interest in a lease covering the deep rights in the following tracts of land:

Section	W.I.	Gross Acres	Net Acres
Section 33: N½SE¼, SE¼SW¼	50%	120	60
Section 34: Lots 1, 2, 4 & NW¼SW¼	50%	160	80
Section 35: Lot 2, NW¼ NW¼SW¼, NW¼SE¼	50%	280	140
Totals		560	280

Southland requests your support for the project by granting of a Farmout of your acreage under the following general terms:

1. Bassett-Birney deliver its leasehold interest in the E½ of Section 34 to Southland Royalty Company for the drilling of a Morrow well. Southland Royalty Company will have a period of ninety (90) days in which to commence drilling this well. Upon obtaining production from this well, Southland Royalty Company will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled. The remainder of Bassett-Birney's leasehold in Sections 33, 34 and 35,

out side the drilled proration unit will fall under a 120-day continuous development program.

2. Under the terms of this Agreement, Bassett & Birney will retain a 1/16th of 8/8ths ORRI convertible to a 50% working interest at payout on the initial well.

Upon receiving approval for this proposal, Southland will be happy to prepare a Farmout Agreement containing the above provisions. If instead, you choose to join in this well, an AFE and Joint Operating Agreement will be forwarded to you at once.

If there are any questions concerning the above, please do not hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am

Southland Royalty Company

March 24, 1980

500340 ✓

Bassett & Birney Oil Corporation
207 South 4th Street
Artesia, New Mexico 88210

Attention: Mr. Randy Patterson

Re: SRC-Empire Federal Comm. "35" #1
1,980' FN&WL Section 35,
T-18-S, R-29-E,
Eddy County, New Mexico
Empire, South Prospect #1873 ✓
F/O 382, F/O 399

Gentlemen:

Reference is made to the proposed well and to a Farmout request mailed to Bassett & Birney Oil Corporation dated February 26, 1980. In this letter, Southland Royalty Company requested a farmout of your acreage in Sections 33, 34 and 35.

Southland Royalty Company is now prepared to drill a Morrow well in the W½ of Section 35, and by this letter, request your support for the well.

A check of the records indicates that Bassett & Birney Oil Corporation owns a 50% working interest in a lease covering the deep rights in the S½ of the NW¼ and the NW¼ of the SW¼ of Section 35. Southland requests a farmout of your acreage under the following general terms:

1. Bassett & Birney deliver its leasehold interest in the W½ of Section 35 for the drilling of the SRC Empire Federal Comm. "35" #1 well. Southland will have a ninety (90) day period in which to commence the drilling of this well. Upon obtaining production from this well, Southland will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below total depth drilled.

2. Under the terms of this Agreement, Bassett & Birney will retain a 1/16th of 8/8ths overriding royalty interest convertible to a 50% working interest at payout, proportionately reduced.

1100 WALL TOWERS WEST (915) 682-8641 MIDLAND, TEXAS 79701

BEFORE THE
OIL CONSERVATION COMMISSION
Santa Fe, New Mexico
Case No. 7025 Exhibit No. 2
Submitted by DAVIS
Hearing Date 1/19/81

Upon receiving approval for this proposal, Southland Royalty Company will be happy to prepare a Farmout Agreement containing the above provisions.

If instead, Bassett & Birney Oil Corporation chooses to join in this well, upon approval, please execute the three (3) enclosed AFEs, returning two (2) originals to Southland Royalty Company's Midland office, while retaining one (1) original for your files. At such time as we have received the signed AFEs, a Joint Operating Agreement and Communitization Agreement will be forwarded for your approval.

If there are any questions regarding the above, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
5100 WALL TOWERS WEST, MIDLAND, TEXAS 79701

COMPANY NO ___

AFE NUMBER ___

ADD A CHANGE ___ DELETE ___ PROPERTY NUMBER ___-___ ___ ___ ___ ___ ___-___ ___

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "35" No. 1

ORIGINAL O SUPPLEMENTAL ___ PRODUCER ___ DRY HOLE ___ SRC OPERATOR ___ MANUAL ___

AUTHORITY IS REQUESTED TO:

WILDCAT ___ DEV. X Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980 FNL 1980 FWL Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE			ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
		TANGIBLE - 249		
	01 01	Conductor or Drive Pipe	$ -	$ -
350	01 02	Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	03	8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	04	4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	05	4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	06	4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	07	4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	08		-	-
11,450'	02 09	Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	03 10	Wellhead & Safety Equipment	26,000	2,000
	04 11	Packer & Special Equipment	4,500	-
	04 12	Artificial Lift	-	-
	05 13	Tank Battery and process equip.	36,000	-
	10 14	Other Equipment	7,530	3,040
	15	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16	Bassett & Birney . 19026479	$ 43,534	$ 8,467
		INTANGIBLE - 248		
	01 17	Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	01 18	Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	01 19	Rig Moving Costs	-	-
	01 20	Completion Rig 10 Days @ $ 1200 /day	12,000	-
	02 21	Roustabout & Miscellaneous Labor	4,000	2,000
	03 22	Auto, Trucking, Barge, Tug	4,500	2,000
	04 23	Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	05 24	Mud, Oil, Water, Chemicals	45,000	40,000
	06 25	Drill Stem Tests	5,000	5,000
	06 26	Electric Logs & Bond Logs	35,000	35,000
	07 27	Cement, Centralizer, Scratchers, Service	45,000	40,000
	08 28	Bits, Fuel	20,000	20,000
	08 29	Rental Equipment & tubular inspection	25,000	12,000
	09 30	Core & Analyses	-	-
	09 31	Bottle Tests & Sidewall Cores	-	-
	09 32	Perforate	10,000	-
	09 33	Acid & Frack Variable	25,000	-
	09 34	Geological & Engineering	5,000	2,500
	09 35	Mud Logger	20,000	20,000
	10 36	Cost of Control Insurance (SRC Only) .468	5,400	5,400
	10 37	Miscellaneous & Unforseen	24,800	10,100
	11 12 38	District & Overhead Expense	3,000	2,000
	39	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40	Bassett & Birney . 19026479	$ 102,400	$ 92,849
	41	GRAND TOTAL COSTS	$ 767,010	$ 488,000
	42	Bassett & Birney . 19026479	$ 145,935	$ 85,239

AUTHORIZATION REQUESTED

E M Hallin

AUTHORIZATION APPROVED

COMPANY: ___

BY: ___

DATE: ___

Southland Royalty Company

March 24, 1980

Tenneco Oil Exploration & Production
6800 Park Ten Blvd. - Suite 200 North
San Antonio, Texas 78213

Attention: Michael M. Hinze

Re: SRC-Empire Federal Comm "35" #1
1980' FNL & 1980' FWL Section 35,
T-18-S, R-29-E,
Eddy County, New Mexico
Empire, South Prospect #1873
F/O 382, F/O 399

File 500340 ✓

Gentlemen:

Reference is made to the proposed well to be drilled in Section 35, Township 18 South, Range 29 East. Southland Royalty Company is at this time preparing to drill a Morrow well in the W½ of Section 35, and by this letter, request your support for the well.

A check of the records indicates that Tenneco Oil Exploration & Production owns a 100% working interest in a lease covering the deep rights in the N½ of the NW¼ of Section 35. Southland requests a farmout of your acreage under the following general terms:

1. Tenneco deliver its leasehold interest in the W½ of Section 35 for the drilling of the SRC-Empire Federal "35" #1 well. Southland will have a ninety (90) day period in which to commence the drilling of this well. Upon obtaining production from this well, Southland will earn 100% of your leasehold interest within the drilled proration unit to a depth of 100' below the total depth drilled.

2. Under the terms of this Agreement, Tenneco will retain a 1/16th of 8/8ths overriding royalty interest convertible to a 50% working interest at payout, proportionately reduced.

Upon receiving approval for this proposal, Southland Royalty Company will be more than happy to prepare a Farmout Agreement containing the above provisions. If instead, Tenneco chooses to join in this well, upon approval,

please execute the three (3) enclosed AFEs, returning two (2) originals to Southland Royalty Company's Midland Office, while retain one (1) original for your files. At such time as we have received the signed AFEs, a Joint Operating Agreement and Communitization Agreement will be forwarded for your approval.

If there are any questions concerning the above, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis
Landman

DWD:am
Enclosures

Southland Royalty Company
1100 WALL TOWERS WEST MIDLAND, TEXAS 79701

AUTHORIZATION FOR EXPENDITURE

COMPANY NO ___

AFE NUMBER ___

ADD A CHANGE ___ DELETE ___ PROPERTY NUMBER ___

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "35" No. 1

ORIGINAL 0 SUPPLEMENTAL ___ PRODUCER ___ DRY HOLE ___ SRC OPERATOR ___ MANUAL ___

AUTHORITY IS REQUESTED TO:

WILDCAT ___ DEV. X

Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980 FNL 1980 FWL Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249		
	01 Conductor or Drive Pipe	$ -	$ -
350	02 Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	03 8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	04 4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	05 4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	06 4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	07 4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	08	-	-
11,450'	09 Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	10 Wellhead & Safety Equipment	26,000	2,000
	11 Packer & Special Equipment	4,500	-
	12 Artificial Lift	-	-
	13 Tank Battery and process equip.	36,000	-
	14 Other Equipment	7,530	3,040
	15 TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16 Tenneco .25368638	$ 58,046	$ 11,289
	INTANGIBLE - 248		
	17 Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	18 Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	19 Rig Moving Costs	-	-
	20 Completion Rig 10 Days @ $ 1200 /day	12,000	-
	21 Roustabout & Miscellaneous Labor	4,000	2,000
	22 Auto, Trucking, Barge, Tug	4,500	2,000
	23 Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	24 Mud, Oil, Water, Chemicals	45,000	40,000
	25 Drill Stem Tests	5,000	5,000
	26 Electric Logs & Bond Logs	35,000	35,000
	27 Cement, Centralizer, Scratchers, Service	45,000	40,000
	28 Bits, Fuel	20,000	20,000
	29 Rental Equipment & tubular inspection	25,000	12,000
	30 Core & Analyses	-	-
	31 Bottle Tests & Sidewall Cores	-	-
	32 Perforate	10,000	-
	33 Acid & Frack Variable	25,000	-
	34 Geological & Engineering	5,000	2,500
	35 Mud Logger	20,000	20,000
	36 Cost of Control Insurance (SRC Only) .468	5,400	5,400
	37 Miscellaneous & Unforseen	24,800	10,100
	38 District & Overhead Expense	3,000	2,000
	39 TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40 Tenneco .25368638	$ 136,534	$ 112,510
	41 GRAND TOTAL COSTS	$ 767,010	$ 488,000
	42 Tenneco .25368638	$ 194,579	$ 123,799

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: ___

BY: ___

DATE ___

Southland Royalty Company

June 19, 1980

Tenneco Oil Exploration and Production
6800 Park Ten Blvd., Suite 200 North
San Antonio, Texas 78213

Attn: Mr. Steve D. King,
Landman

RE: Proposed SRC Empire Fed. Comm.
"35" #1 Well
W/2 Section 35, T18S, R29E
Eddy County, New Mexico
Empire, South #1873
F/O 382, 399 ~~J/O 500342~~
500340
500422

Gentlemen:

Reference is made to your response of June 4, 1980, to Southland Royalty Company's proposal for the drilling of the SRC Empire Federal Comm. "35" #1 well. Although Southland Royalty Company would look favorably toward the formation of a one section working interest unit encompassing all of section 35, T18S, R29E, and would agree to offer Tenneco any farmin acreage received in support of the "35" #1 well; Southland Royalty Company, at this time, does not feel that any acreage received in support of our initial test well should be offered to partners in the "35" well.

Southland Royalty Company acquired farmin support in Sections 33, 34 and 35, in October of 1979, some nine months ago, in support of our proposed SRC Empire Federal Comm. #1 test well. This well, which was drilled and completed in the S/2 of Section 27, was not offsetting any Morrow production, and was quite risky. Had SRC not received the farmin support we did, this initial well, which has prompted the current development and activity in this immediate area, would not have been drilled. Also, although SRC is aware of Tenneco's geological expertise in this area, Southland Royalty Company has also been successful in the drilling of numerous Morrow wells in the area.

I look forward to hearing from you concerning the formation of a unit. If there are any questions concerning this matter, please feel free to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd

1100 WALL TOWERS WEST (915) 682-8641 MIDLAND, TEXAS 79701

Southland Royalty Company

June 30, 1980

Flag-Redfern Oil Company
1200 Wall Towers West
Midland, Texas 79701

RE: Proposed 640 W.I. Unit
Sec. 35, T18S, R29E
Eddy County, New Mexico
Empire, South #1873
PT-405 J/O 500340

Dear John:

Reference is made to your letter of May 28, 1980, and to our recent conversations, concerning the drilling of a Morrow test in Section 35, T18S, R29E. In your letter you proposed the formation of a N/2 unit in Section 35 for the drilling of a Morrow test. Please be advised that SRC has already proposed the formation of a W/2 unit, but as I related in our conversations, would look favorably towards the formation of a 640 acre unit.

Formation of a one section working interest unit, would give all lease holders in section 35 the opportunity to participate in more wells, while also allowing all owners to participate in the well closest to proven production. If, Flag-Redfern Oil Company is receptive to this idea, I will proceed to try and and acquire the necessary approval from all other parties in section 35. If there are any questions concerning this matter, please don't hesitate to call, and I look forward to hearing from you concerning this matter soon.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd

Southland Royalty Company

July 8, 1980

Bassett-Birney Oil Corporation
207 South Fourth Street
Artesia, New Mexico 88210

Attn: Mr. Jack McCaw

Empire, S.

RE: SRC-Empire Fed. Comm. "35" #1
1980' FSL & 1980' FWL, Sec. 35
T18S, R29E, Eddy Co, New Mexico
F/O 382 and 399 500340 J/O

500340

Gentlemen:

Reference is made to my letters of February 26th, 1980 and March 24, 1980, concerning the above proposed well. In the letter of March 24th, 1980, Southland proposed the drilling of the subject well at a location of 1980' FNL and 1980' FWL of Sec. 35. Southland has now moved the location of this well to 1980' FSL and 1980' FWL, and once again requests your support for the subject well.

Enclosed, please find three original AFE's,along with a Joint Operating Agreement which contains three sets of signature pages for the 35 #1 well. At such time as these instruments meet with your approval, please have the appropriate company officer execute all AFE's and signature pages, returning two executed originals of each to our Midland Office for further handling. If instead, you choose to Farmout your interest under this well, Southland will be happy to prepare a Farmout Agreement which will contain the provisions mentioned in my prior two letters.

If you have any questions concerning this matter, please don't hesitate to call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd
Encl.

1100 WALL TOWERS WEST (915) 682-8641 MIDLAND, TEXAS 79701

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
5100 WALL TOWERS WEST MIDLAND, TEXAS 79701

COMPANY NO 01

AFE NUMBER 022E

ADD A CHANGE DELETE PROPERTY NUMBER 0-5 0 0 3 4 0-

AFE DATE 3 / 17 / 80 NAME SRC Empire Federal Comm "35" No. 1

ORIGINAL 0 SUPPLEMENTAL PRODUCER DRY HOLE SRC OPERATOR (1) MANUAL

AUTHORITY IS REQUESTED TO:

WILDCAT DEV. (1)

Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980 FSL 1980 FWL Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249		
	Conductor or Drive Pipe	$ -	$ -
350	Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'		-	-
11,450'	Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	Wellhead & Safety Equipment	26,000	2,000
	Packer & Special Equipment	4,500	-
	Artificial Lift	-	-
	Tank Battery and process equip.	36,000	-
	Other Equipment	7,530	3,040
	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	Bassett-Birney .19026479	$ 43,534	$ 8,467
	INTANGIBLE - 248		
	Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	Rig Moving Costs	-	-
	Completion Rig 10 Days @ $ 1200 /day	12,000	-
	Roustabout & Miscellaneous Labor	4,000	2,000
	Auto, Trucking, Barge, Tug	4,500	2,000
	Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	Mud, Oil, Water, Chemicals	45,000	40,000
	Drill Stem Tests	5,000	5,000
	Electric Logs & Bond Logs	35,000	35,000
	Cement, Centralizer, Scratchers, Service	45,000	40,000
	Bits, Fuel	20,000	20,000
	Rental Equipment & tubular inspection	25,000	12,000
	Core & Analyses	-	-
	Bottle Tests & Sidewall Cores	-	-
	Perforate	10,000	-
	Acid & Frack Variable	25,000	-
	Geological & Engineering	5,000	2,500
	Mud Logger	20,000	20,000
	Cost of Control Insurance (SRC Only) .468	5,400	5,400
	Miscellaneous & Unforseen	24,800	10,100
	District & Overhead Expense	3,000	2,000
	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	Bassett-Birney .19026479	$ 102,400	$ 84,382
	GRAND TOTAL COSTS	$ 767,010	$ 488,000
	Bassett-Birney .19026479	$ 145,934	$ 92,849

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: _____

BY: _____

DATE: _____

SRC - Empire Federal
"35" Comm. #1 500340

Empire, South Prospect
500340 J/O
F/O 382; F/O 399

A.A.P.L. FORM 610 - 1977

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

July 8, 19 80,

OPERATOR SOUTHLAND ROYALTY COMPANY

CONTRACT AREA W/2 Section 35, T18S, R29E

COUNTY ~~OR PARISH~~ OF Eddy STATE OF New Mexico

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between SOUTHLAND ROYALTY COMPANY, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators".

WITNESSETH:

WHEREAS, the parties to this agreement are owners of oil and gas leases and/or oil and gas interests in the land identified in Exhibit "A", and the parties hereto have reached an agreement to explore and develop these leases and or oil and gas interests for the production of oil and gas to the extent and as hereinafter provided:

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.
DEFINITIONS

As used in this agreement, the following words and terms shall have the meanings here ascribed to them:

A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.

B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.

D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".

E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.

F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.

G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.

H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II.
EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

[X] A. Exhibit "A", shall include the following information:
- (1) Identification of lands subject to agreement,
- (2) Restrictions, if any, as to depths or formations,
- (3) Percentages or fractional interests of parties to this agreement,
- (4) Oil and gas leases and/or oil and gas interests subject to this agreement,
- (5) Addresses of parties for notice purposes.

[X] B. Exhibit "B", Form of Lease.

[X] C. Exhibit "C", Accounting Procedure.

[X] D. Exhibit "D", Insurance.

[X] E. Exhibit "E", Gas Balancing Agreement.

[X] F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.

If any provision of any exhibit, except Exhibit "E", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

ARTICLE III.
INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an unleased oil and gas interest in the Contract Area, that interest shall be treated for the purpose of this agreement and during the term hereof as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B". As to such interest, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the lessee interest.

B. Interest of Parties in Costs and Production:

Exhibit "A" lists all of the parties and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and material acquired in operations on the Contract Area shall be owned by the parties as their interests are shown in Exhibit "A". All production of oil and gas from the Contract Area, subject to the payment of lessor's royalties ~~which will be borne by the Joint Account~~, shall also be owned by the parties in the same manner during the term hereof; provided, however, this shall not be deemed an assignment or cross-assignment of interests covered hereby.

ARTICLE IV.
TITLES

A. Title Examination:

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including Federal Lease Status Reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

~~Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be a part of the administrative overhead as provided in Exhibit "C," and shall not be a direct charge, whether performed by Operator's staff attorneys or by outside attorneys.~~

[X] Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Exhibit "A".* Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection with leases or oil and gas interests contributed by such party. The Operator shall be responsible for the preparation and recording of Pooling Designations or Declarations as well as the conduct of hearings before Governmental Agencies for the securing of spacing or pooling orders. This shall not prevent any party from appearing on its own behalf at any such hearing.

No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to participate in the drilling of the well.

B. Loss of Title:

1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A", this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests, and

(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development

*except when such costs are incurred in connection with an operation conducted under Article

or operating costs which it may have theretofore paid, but there shall be no monetary liability on its part to the other parties hereto for drilling, development, operating or other similar costs by reason of such title failure; and

(b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract Area by the amount of the interest lost; and

(c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract Area is increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such interests (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well; and

(d) Should any person not a party to this agreement, who is determined to be the owner of any interest in the title which has failed, pay in any manner any part of the cost of operation, development, or equipment, such amount shall be paid to the party or parties who bore the costs which are so refunded; and

(e) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be borne by the party or parties whose title failed in the same proportions in which they shared in such prior production; and

(f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in connection therewith.

2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, is not paid or is erroneously paid, and as a result a lease or interest therein terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new lease covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties shall be revised on an acreage basis, effective as of the date of termination of the lease involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the lease or interest which has terminated. In the event the party who failed to make the required payment shall not have been fully reimbursed, at the time of the loss, from the proceeds of the sale of oil and gas attributable to the lost interest, calculated on an acreage basis, for the development and operating costs theretofore paid on account of such interest, it shall be reimbursed for unrecovered actual costs theretofore paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost interest, on an acreage basis, up to the amount of unrecovered costs;

(b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an acreage basis, of that portion of oil and gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such lease termination, would be attributable to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said portion of the oil and gas to be contributed by the other parties in proportion to their respective interests; and

(c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall not be considered failure of title but shall be joint losses and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of the Contract Area.

ARTICLE V.
OPERATOR

A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:

SOUTHLAND ROYALTY COMPANY shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operator, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the Parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed, shall be determined by Operator, and all such employees shall be the employees of Operator.

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the 8th day of October, 1980, Operator shall commence the drilling of a well for oil and gas at the following location:

1980' FSL & 1980' FWL, Section 35, T18S, R29E, Eddy County, New Mexico

and shall thereafter continue the drilling of the well with due diligence to

11,600' or a depth sufficient to test the Morrow formation

unless granite or other practically impenetrable substance or condition in the hole, which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E.1. hereof.

B. Subsequent Operations:

1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday or legal holidays. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or response given by telephone shall be promptly confirmed in writing.

2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, within sixty (60) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period where the drilling rig is on location, as the case may be) actually commence work on the proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest of the parties approving such operation, and (b) its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A", or (b) carry its proportionate part of Non-Consenting Parties' interest.* The proposing party, at its election, may withdraw such proposal if there is insufficient participation, and shall promptly notify all parties of such decision. *and failure so to advise the proposing party shall constitute an election under (b).

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk, and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or market value thereof if such share is not sold (after deducting production taxes, royalty, overriding royalty and other interests existing on the effective date hereof, payable out of or measured by the production from such well accruing with respect to such interest until it reverts) shall equal the total of the following:

(a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to each Non-Consenting Party had it participated in the well from the beginning of the operations; and

(b) 300% of that portion of the costs and expenses of drilling, reworking, deepening, or plugging back, testing and completing, after deducting any cash contributions received under Article VIII.C., and

300 % of that portion of the cost of newly acquired equipment in the well (to and including the well-head connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's election, shall be sold to its purchaser, if available, under the terms of its existing gas sales contract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from such sale direct to the Consenting Parties until the amounts provided for in this Article are recovered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not contracted for sale of its gas at the time such gas is available for delivery, or has not made the election as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-Consenting Party's share of gas as hereinabove provided during the recoupment period.

During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production.

In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.

Within sixty (60) days after the completion of any operation under this Article, the party conducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas produced during any month, Consenting Parties shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs of the work done and of the equipment purchased, in determining when the interest of such Non-Consenting Party shall revert to it as above provided; and if there is a credit balance, it shall be paid to such Non-Consenting party.

If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent of all parties, no wells shall be completed in or produced from a source of supply from which a well located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such source of supply.

The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A. except (a) when Option 2. Article VII.D.1., has been selected, or (b) to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article VI.A.

C. *Right to Take Production in Kind:*

Each party shall have the right to take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating oil for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposal by any party of its proportionate share of the production shall be borne by such party. Any

party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment direct from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate commerce, of any other party's share of gas production without first giving such other party thirty (30) days prior written notice of such intended sale.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and/or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any Gas Balancing Agreement between the parties hereto, whether such Agreement is attached as Exhibit "E", or is a separate Agreement.

D. Access to Contract Area and Information:

Each party shall have access to the Contract Area at all reasonable times, at its sole risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the information.

E. Abandonment of Wells:

1. Abandonment of Dry Holes: Except for any well drilled pursuant to Article VI.B.2., any well which has been drilled under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling of such well. Any party who objects to the plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and/or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well which has been drilled or reworked pursuant to Article VI.B.2. hereof for which the Consenting Parties have not been fully reimbursed as therein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of such well, all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one year and so long thereafter as oil and/or gas is produced from the interval or inter-

vals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentages of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interest in the remaining portion of the Contract Area.

Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned well.

ARTICLE VII.
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.

B. Liens and Payment Defaults:

Each Non-Operator grants to Operator a lien upon ~~its oil and gas rights in the Contract Area, and~~ a security interest in its share of oil and or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon at the rate provided in the Accounting Procedure attached hereto as Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the State, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's share of oil and or gas until the amount owed by such Non-Operator, plus interest has been paid. Each purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.

If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.

C. Payments and Accounting:

Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in the Accounting Procedure attached hereto as Exhibit "C". Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Limitation of Expenditures:

1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this Agreement, it being understood that the consent to the drilling or deepening shall include:

~~☐ Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and equipping of the well, including necessary tankage and or surface facilities.~~

☒ Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its authorized depth, and all tests have been completed, Operator shall give immediate notice to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion attempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, including necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less than all parties.

2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agreement, it being understood that the consent to the reworking or plugging back of a well shall include consent to all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage and/or surface facilities.

3. Other Operations: Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Twenty-Five Thousand and no/100--- Dollars ($ 25,000.00) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares "Authority for Expenditures" for its own use, Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project costing in excess of Twenty-Five Thousand and no/100-------- Dollars ($ 25,000.00).

E. Royalties, Overriding Royalties and Other Payments:

Each party shall pay or deliver, or cause to be paid or delivered, all royalties to the extent of one-fourth (1/4) due on its share of production and shall hold the other parties free from any liability therefor. If the interest of any party in any oil and gas lease covered by this agreement is subject to any royalty, overriding royalty, production payment, or other charge over and above the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account for or cause to be accounted for, such interest to the owners thereof.

No party shall ever be responsible, on any price basis higher than the price received by such party, to any other party's lessor or royalty owner; and if any such other party's lessor or royalty owner should demand and receive settlements on a higher price basis, the party contributing such lease shall bear the royalty burden insofar as such higher price is concerned.

F. Rentals, Shut-in Well Payments and Minimum Royalties:

Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.2.

Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shut-in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sunday and Holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments

of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

G. Taxes:

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. Operator shall bill other parties for their proportionate share of all tax payments in the manner provided in Exhibit "C".

If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final determination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint account, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as provided in Exhibit "C".

Each party shall pay or cause to be paid all production, severance, gathering and other taxes imposed upon or with respect to the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.

H. Insurance:

At all times while operations are conducted hereunder, Operator shall comply with the Workmen's Compensation Law of the State where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be an amount equivalent to the premium which would have been paid had such insurance been obtained. Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the Workmen's Compensation Law of the State where the operations are being conducted and to maintain such other insurance as Operator may require.

In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's fully owned automotive equipment.

ARTICLE VIII.
ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

A. Surrender of Leases:

The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole or in part unless all parties consent thereto.

However, should any party desire to surrender its interest in any lease or in any portion thereof, and other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not desiring to surrender it. If the interest of the assigning party includes an oil and gas interest, the assigning party shall execute and deliver to the party or parties not desiring to surrender an oil and gas lease covering such oil and gas interest for a term of one year and so long thereafter as oil and/or gas is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B". Upon such assignment, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the acreage assigned and the operation of any well thereon, and the assigning party shall have no further interest in the lease assigned and its equipment and production other than the royalties retained in any lease made under the terms of this Article. The parties assignee shall pay to the party assignor the reasonable salvage value of the latter's interest in any wells and equipment on the assigned acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. If the assignment is in favor of more than one party, the assigned interest shall

be shared by the parties assignee in the proportions that the interest of each bears to the interest of all parties assignee.

Any assignment or surrender made under this provision shall not reduce or change the assignor's or surrendering parties' interest, as it was immediately before the assignment, in the balance of the Contract Area; and the acreage assigned or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this agreement.

B. Renewal or Extension of Leases:

If any party secures a renewal of any oil and gas lease subject to this Agreement, all other parties shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area.

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this agreement.

The provisions in this Article shall apply also and in like manner to extensions of oil and gas leases.

C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash toward the drilling of a well or any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. If all parties hereto are Drilling Parties and accept such tender, such acreage shall become a part of the Contract Area and be governed by the provisions of this agreement. If less than all parties hereto are Drilling Parties and accept such tender, such acreage shall not become a part of the Contract Area. Each party shall promptly notify all other parties of all acreage or money contributions it may obtain in support of any well or any other operation on the Contract Area.

If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Subsequently Created Interest:

Notwithstanding the provisions of Article VIII.E. and VIII.G., if any party hereto shall, subsequent to execution of this agreement, create an overriding royalty, production payment, or net proceeds interest, which such interests are hereinafter referred to as "subsequently created interest", such subsequently created interest shall be specifically made subject to all of the terms and provisions of this agreement, as follows:

1. If non-consent operations are conducted pursuant to any provision of this agreement, and the party conducting such operations becomes entitled to receive the production attributable to the interest out of which the subsequently created interest is derived, such party shall receive same free and clear of such subsequently created interest. The party creating same shall bear and pay all such subsequently created interests and shall indemnify and hold the other parties hereto free and harmless from any and all liability resulting therefrom.

2. If the owner of the interest from which the subsequently created interest is derived (1) fails to pay, when due, its share of expenses chargeable hereunder, or (2) elects to abandon a well under provisions of Article VI.E. hereof, or (3) elects to surrender a lease under provisions of Article VIII.A. hereof, the subsequently created interest shall be chargeable with the pro rata portion of all expenses hereunder in the same manner as if such interest were a working interest. For purposes of collecting such chargeable expenses, the party or parties who receive assignments as a result of (2) or (3) above shall have the right to enforce all provisions of Article VII.B. hereof against such subsequently created interest.

E. Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or

2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the right of the other parties.

If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such party's interests within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds hereof.

F. Waiver of Right to Partition:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

~~**G. Preferential Right to Purchase:**~~

~~Should any party desire to sell all or any part of its interests under this agreement, or its rights and~~ interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent ~~company, or to any company in which any one party owns a majority of the stock~~.

ARTICLE IX.
INTERNAL REVENUE CODE ELECTION

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No

such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from Operations hereunder can be adequately determined without the computation of partnership taxable income.

ARTICLE X.
CLAIMS AND LAWSUITS

Operator may settle any single damage claim or suit arising from operations hereunder if the expenditure does not exceed Five Thousand and no/100---------- Dollars ($ 5,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, the party shall immediately notify Operator, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

ARTICLE XI.
FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure. The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

ARTICLE XII.
NOTICES

All notices authorized or required between the parties, and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by United States mail or Western Union telegram, postage or charges prepaid, or by teletype, and addressed to the party to whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed, and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid, or when sent by teletype. Each party shall have the right to change its address at any time, and from time to time, by giving written notice hereof to all other parties.

ARTICLE XIII.
TERM OF AGREEMENT

This agreement shall remain in full force and effect as to the oil and gas leases and or oil and gas interests subjected hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any lease, or oil and gas interest contributed by any other party beyond the term of this agreement.

~~Option No. 1: So long as any of the oil and gas leases subject to this agreement remain in force and effect, or any of the wells capable of producing oil or gas, or drilling or reworking operations are conducted thereon, or any of the lands covered by this agreement are utilized for underground storage of oil or gas, or so long thereafter as drilling, reworking, or production operations are conducted hereon or production in paying quantities is obtained from any lease or oil and gas interest~~

[X] Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and/or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of 90 days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling or reworking a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and or gas from the Contract Area, this agreement shall terminate unless drilling or reworking operations are commenced within 60 days from the date of abandonment of said well.

It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

ARTICLE XIV.
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the conservation laws of the state in which the committed acreage is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and orders.

B. Governing Law:

The essential validity of this agreement and all matters pertaining thereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state where most of the land in the Contract Area is located shall govern.

ARTICLE XV.
OTHER PROVISIONS

SALE OF ROYALTY GAS

It is recognized by the parties hereto that in addition to each party's share of working interest production, such party shall have the right, subject to existing contracts, to market the royalty gas attributable to each lease which it contributes to the unit area and to receive payments due for such royalty gas produced from or allocated to such lease or leases. It is agreed that, regardless of whether each party markets or contracts for its share of gas, including the royalty gas under the leases which it contributed to the Unit, such party agrees to pay or cause to be paid to the royalty owners under its lease or leases the proceeds attributable to their respective royalty interest and to hold all other parties hereto harmless for its failure to do so.

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of _____ day of _____, 19____.

OPERATOR

SOUTHLAND ROYALTY COMPANY

By: C. E. Mear

_____

DD RWO Fund

NON-OPERATORS

TENNECO OIL EXPLORATION & PRODUCTION

_____ By: _____

BASSETT-BIRNEY OIL CORPORATION

_____ By: _____

FEATHERSTONE FARMS, LTD.

_____ BY: _____

ROBERT E. McKEE COMPANY

_____ BY: _____

CORPORATION ACKNOWLEDGMENT

THE STATE OF Texas

COUNTY OF Midland

BEFORE ME, the undersigned authority, on this day personally appeared C. E. Mosa, known to me to be the person whose name is subscribed to the foregoing instrument, as Attorney-in-Fact of Southland Royalty Company, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the 18th day of July A.D. 1980.

My Commission Expires:
Oct. 31, 1980

Teresa Harrell
Notary Public in and for Midland County, Texas

CORPORATION ACKNOWLEDGMENT

THE STATE OF

COUNTY OF

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing instrument, as _____ of _____, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the _____ day of _____ A.D. 19____.

My Commission Expires:

_____
Notary Public in and for _____ County,

CORPORATION ACKNOWLEDGMENT

THE STATE OF

COUNTY OF

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing instrument, as _____ of _____, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the _____ day of _____ A.D. 19____.

My Commission Expires:

_____
Notary Public in and for _____ County,

W/2 Section 35, T18S, R29E
Eddy County, New Mexico

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of _____ day of _____, 19____.

OPERATOR

SOUTHLAND ROYALTY COMPANY

_____ By: C. E. Mear

DD Rwp Kill

NON-OPERATORS

TENNECO OIL COMPANY

ATTEST:

D L Matlock

D. L. Matloch, Asst. Secretary

By: D K Taylor

D.S.TAYLOR, Vice-President
BASSETT-BIRNEY OIL CORPORATION

SDK
mmm
4HH

_____ By: _____

FEATHERSTONE FARMS, LTD.

_____ BY: _____

ROBERT E. McKEE COMPANY

_____ BY: _____

CORPORATION ACKNOWLEDGMENT

THE STATE OF Texas

COUNTY OF Midland

BEFORE ME, the undersigned authority, on this day personally appeared C. E. Mear, known to me to be the person whose name is subscribed to the foregoing instrument, as Attorney-in-Fact of Southland Royalty Company, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the 18th day of July A.D. 1980.

My Commission Expires:
Oct. 31, 1980

Susan Harrell
Notary Public in and for Midland County, Texas

CORPORATION ACKNOWLEDGMENT

THE STATE OF Texas

COUNTY OF Bexar

BEFORE ME, the undersigned authority, on this day personally appeared D. L. Taylor, known to me to be the person whose name is subscribed to the foregoing instrument, as Vice President of Tennessee Gas Company, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the 15 day of August A.D. 19 80.

My Commission Expires:
CAROLYN WRIGHT
Notary Public, Bexar County, Texas
My Commission Expires 9-15-80

Carolyn Wright
Notary Public in and for Bexar County,

CORPORATION ACKNOWLEDGMENT

THE STATE OF

COUNTY OF

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing instrument, as _____ of _____, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the _____ day of _____ A.D. 19____.

My Commission Expires:

Notary Public in and for _____ County,

EXHIBIT "A"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration and Production and Bassett-Birney Oil Corporation, Non-Operators.

LANDS SUBJECT TO AGREEMENT:

W/2 of Section 35, T18S, R29E, Eddy County, New Mexico, below the base of the San Andres formation.;

NE/4SW/4, of Section 35, T18S, R29E, Eddy County, New Mexico, insofar as it covers the depths from the surface of the earth to the base of the San Andres formation.

ADDRESSES AND INTERESTS OF PARTIES:

	WI (BPO)	WI (APO)
Southland Royalty Company 1100 Wall Towers West Midland, Texas 79701	.55604883	.27802442
Tenneco Oil Exploration & Production 6800 Park Ten Blvd., Suite 200 North San Antonio, Texas 78213	.25368638	.25368638
Bassett-Birney Oil Corporation 202 South Fourth Street Artesia, New Mexico 88210	.19026479	.19026479
Robert E. McKee Co. P. O. Box 20562 El Paso, Texas 79998	-0-	.09513239
Featherstone Farms, Ltd. 1717 W. Second Street Roswell, New Mexico 88201	-0-	.18289202
	1.000000	1.00000000

EXHIBIT "B"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

OIL AND GAS LEASE

THIS AGREEMENT made this_____day of_____19___, between_____

_____

as Lessor, and_____ as Lessee, WITNESSETH:

1. Lessor in consideration of Ten and No/100 Dollars ($10.00) in hand paid of the royalties herein provided, and of the agreements of Lessor herein contained, hereby grants, leases and lets exclusively unto Lessee for the purpose of investigating, exploring, producing, drilling and mining for and producing oil and gas, laying pipe lines, building roads, tanks, power stations, telephone lines and other structures thereon to produce, care, take care of, treat, transport, and own said products, the following

described land in_____County, Texas, to-wit:

and containing_____acres, more or less. In the event a resurvey of said lands shall reveal the existance of excess and/or vacant lands lying adjecent to the lands above described and the Lessor, his heirs, or assigns, shall by virtue of its ownership of the lands above described, have preference right to acquire said excess and/or vacant lands, then in that event this lease shall cover and include all such excess and/or vacant lands which the Lessor, its successors or assigns, shall have the preference right to acquire by virtue of its ownership of the lands above described as and when acquired by the Lessor; and the Lessee shall pay the Lessor for such excess and/or vacant lands at the same rate per acre as the cash consideration paid for the acreage hereinabove mentioned.

2. Subject to the other provisions herein contained, this lease shall be for a term of_____from this date (called "primary term") and as long thereafter as oil or gas is produced from said land hereunder.

3. The royalties to be paid Lessor are: (a) on oil one-fourth (1/4) of that produced and saved from said land, the same to be delivered at the wells or to the credit of Lessor into the pipe line to which the wells may be connected; Lessee may from time to time purchase any royalty oil in its possession, paying the market price therefor prevailing for the field where produced on the date of purchase; and (b) on gas, including casinghead gas or other gaseous substance, produced from said land and sold or used off the premises or in the manufacture of gasoline or other products therefrom, the market value at the well of one-fourth (1/4) of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-fourth (1/4) of the amount realized from such sale; where gas from a well producing gas only is not sold or used, Lessee may pay as annual royalty, commencing ninety (90) days after such well is first shut in, the sum of_____per well per year, and upon such payment it will be considered that gas is being produced within the meaning of Paragraph 2 hereof; provided, however, that such shut in payments shall not continue this lease in force for any consecutive period of more than_____ years. Lessee shall have free use of oil, gas and water from said land, except water from Lessor's wells, for all operations hereunder, and the royalty on oil, gas or water shall be computed after deducting any so used.

4. If prior to discovery of oil or gas on said land, Lessee should drill a dry hole or holes thereon, or if after discovery of oil or gas, the production thereof should cease from any cause, this lease shall not terminate if Lessee commences additional drilling or re-working operations within sixty (60) days thereafter. If at the expiration of the primary term, oil or gas is not being produced on said land, but Lessee is then engaged in drilling or re-working operations thereon, the lease shall remain in force so long as operations on said well or for drilling or re-working of any additional well are prosecuted with no cessation of more than sixty (60) consecutive days and if they result in the production of oil or gas so long thereafter as oil or gas is produced from said land. In the event a well or wells producing oil or gas in paying quantities should be brought in on adajacent land and draining the leased premises, Lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.

5. Lessee shall have the right at any time until six months after the expiration of this lease to remove all property and fixtures placed by Lessee on said land, including the right to draw and remove all casing. When required by Lessor, Lessee will bury all pipe lines below ordinary plow depth, and no well shall be drilled within two hundred (200) feet of any residence or barn now on said land without Lessor's consent.

6. The rights of either party hereunder may be assigned in whole or in part and the provisions hereof shall extend to the heirs, successors and assigns, but no change or division in ownership of the land, or royalties, however accomplished, shall operate to enlarge the obligations or diminish the rights of Lessor. No sale or enlargement by either party shall be binding on the other party hereto until such party shall have been furnished with a certified copy of recorded instrument evidencing same. If six or more parties become entitled to royalty hereunder, Lessee may withold payment thereof unless and until furnished with a recordable instrument executed by all such parties designating an agent to receive payment for all.

7. Lessor herein makes no warranty of title, either express or implied. Lessor hereby agrees that Lessee at its option may discharge any tax, martgage or other lien upon said land and in the event Lessee does so, it shall be subrogated to such lien with the right to enforce same and apply royalties accruing hereunder toward satisfying same. It is agreed that if Lessor owns an interest in said land less than the entire fee simple, then the royalties to be paid Lessor shall be reduced proportionately.

8. If any operations permitted or required hereunder or the performance by Lessee of any covenant, agreement or requirement hereof is delayed or interrupted directly or indirectly by any past or future acts, orders, regulations, or requirements of the Government of the United States or of any state or other governmental body, or any agent, officer, representative or authority of any of them, the period of such Delay or interruption shall not be counted against the Lessee, and the primary term of this lease shall automatically be extended after the expiration of the primary term set forth in Section 2 above so long as the cause or causes for such delay or interruption continue and for a period of six (6) months thereafter; and such extended term shall constitute and shall be considered for the purposes of this lease as a part of the primary term hereof. The Lessee shall not be liable to Lessor in damages for failure to perform any operation permitted or required hereunder or to comply with any covenant, agreement or requirement hereof during the time Lessee is relieved from the obligations to comply with such covenants, agreements, or requirements.

IN WITNESS WHEREOF, this instrument is executed on the date first above written.

_____

EXHIBIT " C "

Attached to and made a part of Operating Agreement dated September 22, 1980, by and between South

ACCOUNTING PROCEDURE
JOINT OPERATIONS

I. GENERAL PROVISIONS

1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

2. Statement and Billings

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

3. Advances and Payments by Non-Operators

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

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

4. Adjustments

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

5. Audits

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

6. Approval by Non-Operators

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

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. **Rentals and Royalties**

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

2. **Labor**

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

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

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

   B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II. Such costs under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 2A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.

   C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II.

   D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II.

3. **Employee Benefits**

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

4. **Material**

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

5. **Transportation**

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

   A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by the Parties.

   B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.

   C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking cost of $200 or less excluding accessorial charges.

6. **Services**

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

7. **Equipment and Facilities Furnished by Operator**

   A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on investment not to exceed eight per cent (8%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.

   B. In lieu of charges in Paragraph 7A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

8. **Damages and Losses to Joint Property**

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

9. **Legal Expense**

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

10. **Taxes**

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

11. **Insurance**

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

12. **Other Expenditures**

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

III. OVERHEAD

1. **Overhead - Drilling and Producing Operations**

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

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

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

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

A. Overhead - Fixed Rate Basis

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

Drilling Well Rate $ 3,000.00
Producing Well Rate $ 300.00

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

(a) Drilling Well Rate

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

[2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days

[3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

[1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.

[2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.

[3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.

[4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.

[5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

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

~~B. Overhead - Percentage Basis~~

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

(a) Development

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

(b) Operating

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

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

2. Overhead - Major Construction

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess of $ 25,000.00 :

A. 5.0 % of total costs if such costs are more than $ 25,000.00 but less than $ 100,000.00 ; plus
B. 2.0 % of total costs in excess of $ 100,000.00 but less than $1,000,000; plus
C. 2.0 % of total costs in excess of $1,000,000.

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

3. Amendment of Rates

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

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

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

1. Purchases

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

2. Transfers and Dispositions

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

A. New Material (Condition A)

(1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.

(2) Line Pipe

(a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.

(b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.

(3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

B. Good Used Material (Condition B)

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

(1) Material moved to the Joint Property

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

(2) Material moved from the Joint Property

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

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

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

C. Other Used Material (Condition C and D)

(1) Condition C

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

(2) Condition D

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

D. Obsolete Material

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

E. Pricing Conditions

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

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

3. Premium Prices

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

4. Warranty of Material Furnished by Operator

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

V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

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

3. Special Inventories

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

4. Expense of Conducting Periodic Inventories

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

EXHIBIT "D"

INSURANCE

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

(a) Operator shall at all times during the terms of this Agreement carry insurance to protect the parties hereto as follows:

(1) Workmen's compensation and occupational disease insurance as required by the laws of the state or states in which operations will be conducted and employer's liability insurance with a limit of not less than $100,000.

(2) Comprehensive general public liability insurance, excluding products liability insurance, with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident and $100,000 aggregate limit applicable to all loss of or damage to property during the policy period.

(3) Automotive public liability insurance covering all automotive equipment used in performance of work under this Agreement with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident.

(b) Operator shall require all contractors performing work under this Agreement to carry the following insurance:

(1) Workmen's compensation and occupational disease insurance as required by the laws of the state or states in which operations will be conducted and employers' liability insurance with a limit of not less than $100,000.

(2) Comprehensive general liability insurance with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident and $100,000 aggregate limit applicable to all loss of or damage to property during the policy period.

(3) Automotive public liability insurance covering all automotive equipment used in performance of work under this Agreement with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident.

EXHIBIT "E"

GAS BALANCING AGREEMENT

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

The parties to the Operating Agreement to which this agreement is attached, own working interest in the gas rights underlying the Unit Area covered by such Operating Agreement in accordance with the percentages of participation as set forth in Exhibit "A" to said Agreement.

In accordance with the terms of the Operating Agreement, each party thereto has the right to take in kind its share of gas produced from the Unit Area and market or otherwise dispose of same. In the event any party hereto is not at any time taking or marketing its share of gas, or has contracted to sell its share of gas produced from the Unit Area to a purchaser which does not at any time take the full share of gas attributable to the interest of such party, the terms of this agreement shall automatically become operative.

During the period when any party hereto is not marketing or otherwise disposing of its share of gas produced from any proration unit within the Unit Area, the other parties hereto shall be entitled to produce, in addition to their own share of production, that portion of such other party's share of production which said party is unable to market or otherwise dispose of and shall be entitled to take such gas production and deliver same to its or their purchaser(s). All parties hereto shall share in and own the liquid hydrocarbons recovered from such gas by lease equipment in accordance with their respective interests, and subject to the aforesaid Operating Agreement, but the party or parties taking such gas shall own all of such gas delivered to its or their purchaser(s).

An account shall be established for each party not marketing or otherwise disposing of its share of the gas produced, which account shall be credited with an amount of gas equal to such party's full share of the gas produced, less its share of gas used in lease operations, vented or lost, and less that portion marketed or otherwise disposed of by such party. The Operator will maintain a current over and under account of the gas balance between the parties and will furnish all parties hereto monthly statements showing the total quantity of gas produced, the amount used in lease operations, vented or lost, the total quantity of liquid hydrocarbons recovered therefrom, and the monthly and cumulative over and under account of each party.

Each party hereto will make settlement with the royalty owners to whom it is accountable, just as if such party were marketing or otherwise disposing of its share, and its share only, of such gas production. Each party hereto agrees to hold each other harmless from any and all claims for royalty payments asserted by royalty owners to whom each party is accountable. The term "royalty owner" shall include owners of royalty, overriding royalties, production payments and similar interests.

After notice to the Operator, any party at any time may begin marketing or otherwise disposing of its share of the gas produced from a proration unit with respect to which it has an under account balance. In addition to such share, said party, until it has balanced the gas account as to its interest, shall be entitled to take a share of gas determined by multiplying thirty-three and one-third percent (33 1/3%) of the interest in the current gas production of the party or parties having an over account balance by a fraction, the numerator of which is the interest in the proration unit of such party with the under account balance and the denominator of which is the total percentage interest in such proration unit of all parties having an under account balance and who are currently marketing or otherwise disposing of a portion of their under account balance in addition to their share of gas.

Each party marketing or otherwise disposing of gas shall pay the production taxes due on such gas.

Nothing herein shall be construed to deny any party the right, from time to time, to produce and deliver to its purchaser its full share of the allowable gas production to meet the deliverability tests required by its purchaser.

Should production of gas from a proration unit be permanently discontinued before the gas account is balanced, settelement will be made between those parties credited with under account and over account balances. In making such settlement, the party or parties credited with an under account balance will be paid by the party or parties credited with an over account balance a sum of money equal to that received attributable to such over account, less applicable taxes theretofore paid. For gas sold or delivered into intrastate commerce said sum shall be computed at the price received for sale of the gas. For gas sold or delivered into interstate commerce said sum shall be computed at the rate collected, not subject to possible refund, as provided by the Federal Energy Regulatory Commission, plus any additional collected amount which is ultimately not required to be refunded, such additional collected amount to be accounted for at such time as final determination is made with respect thereto.

Nothing herein shall change or affect each party's obligation to pay its proportionate share of all costs and liabilities incurred, as provided in the aforesaid Operating Agreement.

This agreement shall constitute a separate agreement as to each proration unit within the Unit Area. It shall inure to the benefit of and be binding upon the parties hereto, their successors, legal representatives and assigns. It shall become effective in accordance with its terms and shall remain in force and effect as long as the Operating Agreement to which it is attached remains in effect.

EXHIBIT "F"

Attached to and made a part of Operating Agreement dated July 8, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

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 origin 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 relevent 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 non-discrimination 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 orders 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 (EEO1) 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.

Southland Royalty Company

July 15, 1980

Tenneco Oil Exploration
and Production
6800 Park Ten Boulevard
Suite 200 North
San Antonio, Texas 78213

Attention: Mr. Steve King

RE: SRC Empire Federal Comm "35" #1
1980' FSL & 1980' FWL - Sec. 35,
T18S, R29E
Eddy County, New Mexico
~~Empire, South Prospect #1873~~
F/O 382 and F/O 399 J/O 500340

500340 & 500422 ✓

Dear Steve:

Reference is made to our telephone conversation of even date concerning our original proposal to drill a Morrow test in the W/2 of Section 35, and our most recent attempts to form a one section working interest unit encompassing all of section 35. Due to the conflict concerning R. E. McKee's interest in section 35, Bassett-Birney Corporation has refused to join in a working interest unit.

Therefore, Southland Royalty Company,once again proposes its original well to be drilled in the W/2 of Section 35. Although this well is to be drilled in a W/2 proration unit as was our first proposal, there has been a footage location change. The subject well has been moved to 1980' FSL and 1980' FWL of Section 35.

Enclosed,. please find three original AFE's, along with a Joint Operating Agreement which contains three sets of signature pages for the subject well. At such time as this well is approved by Tenneco, please have the appropriate company officer execute all AFE's and signature pages, returning two executed originals of each to our Midland Office for further handling.

1100 WALL TOWERS WEST (915) 682-8641 MIDLAND, TEXAS 79701

As we discussed in our telephone conversation, Southland Royalty Company is also preparing to propose a Morrow test to be drilled in the E/2 of Section 35. The location of 660' FSL and 1980' FEL of Section 35 was wrong, and our proposed location for this well will be 1980' FSL and 660' FEL of Section 35, T18S, R29E. As we hope to spud these wells in the very near future, I anxiously await your reply.

If you have any questions, or if I can be of any assistance concerning this matter, please do not hesitate to give me a call.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 WALL TOWERS WEST MIDLAND, TEXAS 79701

COMPANY NO 01

AFE NUMBER 022E

PROPERTY NUMBER 0-5023120-

ADD A CHANGE DELETE

AFE DATE 3/17/80 NAME SRC Empire Federal Comm "35" No. 1

ORIGINAL 0 SUPPLEMENTAL PRODUCER DRY HOLE SRC OPERATOR ✓ MANUAL

AUTHORITY IS REQUESTED TO: Drill and complete to TD of 11,450' as gas well in

WILDCAT DEV. #1

Morrow formation complete w/tank battery.

LOCATION: 1980 FSL 1980 FWL Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249	$ -	$ -
350	01 Conductor or Drive Pipe	5,860	5,860
3200'	02 Casing 11/3/4" 42# H-40 ST&C @ $16.75	33,600	33,600
1870'	03 8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(av.)	14,620	-
5470'	04 4 1/2" 13.5 #N-80 LT&C @ $7.82	36,760	-
3020'	05 4 1/2" 11.6# N-80 LT&C @ $6.72	15,250	-
1090'	06 4 1/2" 11.6# K-55 ST&C @ $5.05	7,810	-
11,450'	07 4 1/2" 11.6# N-80 Butt. @ $7.17	-	-
11,450'	08	40,880	-
	09 Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	26,000	2,000
	10 Wellhead & Safety Equipment	4,500	-
	11 Packer & Special Equipment	-	-
	12 Artificial Lift	36,000	-
	13 Tank Battery and process equip.	7,530	3,040
	14 Other Equipment		
	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	15		
	Tenneco .25368638	$ 58,046	$ 11,289
	16		
	INTANGIBLE - 248	$ 170,000	$170,000
	17 Drilling 10,000 ft. @ $ 17.00 /ft.	67,500	67,500
	18 Rig, Day Work 15 Days @ $ 4500 /day	-	-
	19 Rig Moving Costs	12,000	-
	20 Completion Rig 10 Days @ $ 1200 /day	4,000	2,000
	21 Roustabout & Miscellaneous Labor	4,500	2,000
	22 Auto, Trucking, Barge, Tug	12,000	10,000
	23 Roads, Canals, Location, Damages, Cleanup	45,000	40,000
	24 Mud, Oil, Water, Chemicals	5,000	5,000
	25 Drill Stem Tests	35,000	35,000
	26 Electric Logs & Bond Logs	45,000	40,000
	27 Cement, Centralizer, Scratchers, Service	20,000	20,000
	28 Bits, Fuel	25,000	12,000
	29 Rental Equipment & tubular inspection	-	-
	30 Core & Analyses	-	-
	31 Bottle Tests & Sidewall Cores	10,000	-
	32 Perforate	25,000	-
	33 Acid & Frack Variable	5,000	2,500
	34 Geological & Engineering	20,000	20,000
	35 Mud Logger	5,400	5,400
	36 Cost of Control Insurance (SRC Only) .468	24,800	10,100
	37 Miscellaneous & Unforseen	3,000	2,000
	38 District & Overhead Expense		
	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	39		
	Tenneco .25368638	$ 136,534	$ 112,510
	40		
	GRAND TOTAL COSTS	$ 767,010	$ 488,000
	41		
	Tenneco .25368638	$ 194,580	$ 123,799
	42		

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: TENNECO OIL COMPANY

BY:

DATE: August 12, 1980

Form 9-1123
(Rev. Dec. 1957)

(Submit in triplicate to appropriate
Regional Oil and Gas or Mining Supervisor)

File-500340

DESIGNATION OF OPERATOR

The undersigned is, on the records of the Bureau of Land Management, holder of lease

DISTRICT LAND OFFICE: Artesia , New Mexico
SERIAL NO.: NM-010907- A

and hereby designates

NAME: Southland Royalty Company
ADDRESS: 1100 Wall Towers West, Midland, TX 79701

as his operator and local agent, with full authority to act in his behalf in complying with the terms of the lease and regulations applicable thereto and on whom the supervisor or his representative may serve written or oral instructions in securing compliance with the Operating Regulations with respect to (describe acreage to which this designation is applicable):

Lot 3, Lot 4, and NE/4 SW/4 Section 35, T18S, R29E
Eddy County, New Mexico

It is understood that this designation of operator does not relieve the lessee of responsibility for compliance with the terms of the lease and the Operating Regulations. It is also understood that this designation of operator does not constitute an assignment of any interest in the lease.

In case of default on the part of the designated operator, the lessee will make full and prompt compliance with all regulations, lease terms, or orders of the Secretary of the Interior or his representative.

The lessee agrees promptly to notify the supervisor of any change in the designated operator.

FEATHERSTONE FARMS, LTD.

BY: .....
(Signature of lessee)
Olen F. Featherstone II
Managing Partner

7/23/80
(Date)

1717 West Second, Roswell, NM 88201
(Address)

U.S. GOVERNMENT PRINTING OFFICE: 1964—O-726-354

910-536

Copy sent to Meta

Southland Royalty Company

July 25, 1980

Bassett-Birney Oil Corp.
207 South Fourth Street
Artesia, New Mexico 88210

Attention: Mr. Jack McCaw

Re: SRC Empire Fed. "35" Comm. #1 &
SRC Empire Fed. "35-A" Comm. #1
Sec. 35, T18S, R29E
Eddy County, New Mexico
SRC 500340 J/O; ~~500422 J/O~~
F/O 382; F/O 399

F-500340 500422

Dear Mr. McCaw:

Reference is made to my earlier letters concerning the proposed SRC Empire Fed. "35" Comm. No. 1, and to our most recent telephone conversation concerning my attempts to form a one section working interest unit encompassing all of Section 35, T18S, R29E. In that telephone conversation, you indicated that at this time, Bassett-Birney would not join in any well drilled on this acreage.

Due to the tight rig situation, and obligation dates SRC has under our support agreements in Section 35, SRC must attempt to acquire support for two Morrow tests under Section 35 on a well-to-well basis. Enclosed are three original AFE's along with a Joint Operating Agreement which contains three extra sets of signature pages for the newly proposed SRC Empire Fed. "35-A" Comm. No. 1. This well is proposed to be drilled 1980' FSL & 660' FEL of Section 35, in a E/2 proration unit. If you choose to join in this well, please execute all AFE's and signature pages to the Joint Operating Agreement, returning two originals of each to our Midland Office. If, instead, you decide to farmout under this well, SRC will be happy to prepare a farmout agreement which will provide you with a 1/16th of 8/8ths overriding royalty interest with the option to convert this override to a 50% working interest at payout (proportionately reduced).

If you have any questions concerning this matter, please don't hesitate calling.

Yours very truly,

Don Davis

Don W. Davis
Landman

DWD:lh

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 Wall Towers West Midland Texas 79701

COMPANY NO 01

AFE NUMBER 022E

ADD A CHANGE DELETE PROPERTY NUMBER 0-5023-12-

AFE DATE 3 / 17 / 80 NAME SRC Empire Fed. "35-A" Comm. No. 1

ORIGINAL 0 SUPPLEMENTAL PRODUCER DRY HOLE SRC OPERATOR U MANUAL

AUTHORITY IS REQUESTED TO:

WILDCAT DEV. D Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980' FSL & 660' FEL, Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE		ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	TANGIBLE - 249		
	01 Conductor or Drive Pipe	$ -	$ -
350	02 Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	03 8 5/8" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,500	33,600
1870'	04 4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	05 4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	06 4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	07 4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'	08	-	-
11,450'	09 Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	10 Wellhead & Safety Equipment	26,000	2,000
	11 Packer & Special Equipment	4,500	-
	12 Artificial Lift	-	-
	13 Tank Battery and process equip.	36,000	-
	14 Other Equipment	7,530	3,040
	15 TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	16 Bassett-Birney .063199	$ 14,461	$ 2,812
	INTANGIBLE - 248		
	17 Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	18 Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	19 Rig Moving Costs	-	-
	20 Completion Rig 10 Days @ $ 1200 /day	12,000	-
	21 Roustabout & Miscellaneous Labor	4,000	2,000
	22 Auto, Trucking, Barge, Tug	4,500	2,000
	23 Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	24 Mud, Oil, Water, Chemicals	45,000	40,000
	25 Drill Stem Tests	5,000	5,000
	26 Electric Logs & Bond Logs	35,000	35,000
	27 Cement, Centralizer, Scratchers, Service	45,000	40,000
	28 Bits, Fuel	20,000	20,000
	29 Rental Equipment & tubular inspection	25,000	12,000
	30 Core & Analyses	-	-
	31 Bottle Tests & Sidewall Cores	-	-
	32 Perforate	10,000	-
	33 Acid & Frack Variable	25,000	-
	34 Geological & Engineering	5,000	2,500
	35 Mud Logger	20,000	20,000
	36 Cost of Control Insurance (SRC Only) .468	5,400	5,400
	37 Miscellaneous & Unforseen	24,800	10,100
	38 District & Overhead Expense	3,000	2,000
	39 TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	40 Bassett-Birney .063199	$ 34,014	$ 28,029
	41 GRAND TOTAL COSTS	$ 787,010	$ 489,000
	42 Bassett-Birney .063199	$ 48,474	$ 30,841

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY:

BY:

DATE:

Southland Royalty Company

July 29, 1980

500422 -

Flag-Redfern Oil Company
1200 Wall Towers West
Midland, Texas 79701

Attention: Mr. John Smart

RE: SRC-Empire Federal "35-A" Comm #1
1980' FSL & 660' FEL Section 35
T18S, R29E, Eddy County, New Mexico
Empire South Prospect #1873
J/O 500422

Dear John:

Reference is made to our recent conversations concerning SRC's original proposal to drill a Morrow test in the W/2 of Section 35, and our most recent attempts to form a one section working interest unit encompassing all of section 35. As I related to you earlier, due to the conflict concerning R. E. McKee's interest in Section 35, Bassett-Birney Corporation has refused to join in a working interest unit.

Therefore, Southland Royalty Company, once again, is proceeding with its plans to drill two wells in Section 35 on a well by well basis. Enclosed, are three original AFE's along with a Joint Operating Agreement which contains three extra signature pages, for the newly proposed SRC-Empire Federal "35-A" Comm. #1 well to be drilled 1980' FSL & 660' FEL of Section 35, T18S, R29E. The well will encompass an E/2 proration unit.

At such time as this well is approved by Flag-Redfern,please have the appropriate company officers execute all AFE's and signature pages, returning two executed originals of each to our Midland Office for our further handling. If instead, Flag-Redfern chooses to farmout to this well, Southland Royalty Company will be happy to prepare a Farmout Agreement which will provide for a 1/16th override convertible to a 50% working interest at payout.

If there are any questions, or if I can be of assistance concerning this matter, please don't hesitate calling.

Yours very truly,

SOUTHLAND ROYALTY COMPANY

Don Davis

Don W. Davis

DWD/jwd

AUTHORIZATION FOR EXPENDITURE

Southland Royalty Company
1100 Wall Towers West Midland Texas 79701

COMPANY NO 01

AFE NUMBER 022E

ADD A CHANGE DELETE PROPERTY NUMBER 0-5 0 0 3 1 0-

AFE DATE 3 / 17 / 80 NAME SRC Empire Fed. "35-A" Comm. No. 1

ORIGINAL 0 SUPPLEMENTAL PRODUCER DRY HOLE SRC OPERATOR JV MANUAL

AUTHORITY IS REQUESTED TO:

WILDCAT DEV. ~~X~~ D Drill and complete to TD of 11,450' as gas well in Morrow formation complete w/tank battery.

LOCATION: 1980' FSL & 660' FEL, Sec. 35 T-18-S R-29-E Eddy, N.M.

FOOTAGE	TANGIBLE - 249	ESTIMATED COST PRODUCING	ESTIMATED COST DRY HOLE
	Conductor or Drive Pipe	$ -	$ -
350	Casing 11/3/4" 42# H-40 ST&C @ $16.75	5,860	5,860
3200'	8 5/9" 24# K-55, 24# S-80, 28# S-80ST @ $10.50(Av.)	33,600	33,600
1870'	4 1/2" 13.5 #N-80 LT&C @ $7.82	14,620	-
5470'	4 1/2" 11.6# N-80 LT&C @ $6.72	36,760	-
3020'	4 1/2" 11.6# K-55 ST&C @ $5.05	15,250	-
1090'	4 1/2" 11.6# N-80 Butt. @ $7.17	7,810	-
11,450'		-	-
11,450'	Tubing 2 3/8" EVE 4.7# N-80 @ $3.57	40,880	-
	Wellhead & Safety Equipment	26,000	2,000
	Packer & Special Equipment	4,500	-
	Artificial Lift	-	-
	Tank Battery and process equip.	36,000	-
	Other Equipment	7,530	3,040
	TOTAL TANGIBLE 100%	$ 228,810	$ 44,500
	Flag-Redfern .252797	$ 57,842	$ 11,249
	INTANGIBLE - 248		
10,000	Drilling 10,000 ft. @ $ 17.00 /ft.	$ 170,000	$170,000
	Rig, Day Work 15 Days @ $ 4500 /day	67,500	67,500
	Rig Moving Costs	-	-
	Completion Rig 10 Days @ $ 1200 /day	12,000	-
	Roustabout & Miscellaneous Labor	4,000	2,000
	Auto, Trucking, Barge, Tug	4,500	2,000
	Roads, Canals, Location, Damages, Cleanup	12,000	10,000
	Mud, Oil, Water, Chemicals	45,000	40,000
	Drill Stem Tests	5,000	5,000
	Electric Logs & Bond Logs	35,000	35,000
	Cement, Centralizer, Scratchers, Service	45,000	40,000
	Bits, Fuel	20,000	20,000
	Rental Equipment & tubular inspection	25,000	12,000
	Core & Analyses	-	-
	Bottle Tests & Sidewall Cores	-	-
	Perforate	10,000	-
	Acid & Frack Variable	25,000	-
	Geological & Engineering	5,000	2,500
	Mud Logger	20,000	20,000
	Cost of Control Insurance (SRC Only) .468	5,400	5,400
	Miscellaneous & Unforseen	24,800	10,100
	District & Overhead Expense	3,000	2,000
	TOTAL INTANGIBLE 100%	$ 538,200	$ 443,500
	Flag-Redfern .252797	$ 136,055	$ 112,115
	GRAND TOTAL COSTS	$ 767,010	$ 488,000
	Flag-Redfern .252797	$ 193,898	$ 123,365

AUTHORIZATION REQUESTED

AUTHORIZATION APPROVED

COMPANY: _____

BY: _____

DATE: _____

Tenneco Oil
Exploration and Production
A Tenneco Company

Southwestern Division

6800 Park Ten Blvd. • Suite 200 North
San Antonio, Texas 78213
(512) 734-8161

500340 O.O.

August 27, 1980

Don W. Davis
Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

RE: Operating Agreements
W½ Sec. 35, E½ Sec. 35,
T18S-R29E,
Eddy County, New Mexico
Turkey Track Area

Dear Don,

Enclosed are fully executed signature pages for both of your Operating Agreements referred to above. When available, please furnish Tenneco copies of the remaining signatures for our files.

Please feel free to contact me if I can help you further.

Very truly yours,

TENNECO OIL COMPANY

Steven D. King
Landman

SDK:bce
Enclosures as stated

BASSETT-BIRNEY OIL CORPORATION
Oil Producers and Operators
ARTESIA, NEW MEXICO 88210
YATES BUILDING — 207 SOUTH FOURTH
PHONE: (505) 748-1331

September 4, 1980

Southland Royalty Company
1100 Wall Towers West
Midland, Texas 79701

Attention: Mr. Don W. Davis, Landman

Re: Proposed Southland Royalty Company Empire
Federal "35" Com. No. 1 and "35-A" Com. No. 1
Wells, W/2 and E/2 Sec. 35, T-18-S, R-29-E,
Eddy County, New Mexico

Gentlemen:

This acknowledges receipt of your letters of July 8 and July 25, 1980, together with joint operating agreements and AFEs covering the proposed drilling of the subject wells.

The joint operating agreement dated July 8 covering W/2 Section 35 and the AFE for your No. "35" Com. No. 1, credits our company with a 19.026479% (60/315.35) interest, when in fact we own a 38.052957% (120/315.35) interest. The joint operating agreement dated July 17, 1980 covering E/2 Section 35 and the AFE for your No. "35-A" Com. No. 1, credits our company with a 6.3199% (20/316.46) interest, when in fact we own a 12.6398% (40/316.46) interest. Southland Royalty has instituted a suit against, among other parties, Bassett-Birney Oil Corporation, in the United States District Court for the District of New Mexico, Case No. CIV-80-0614 HB, contesting a portion of our title to the working interest underlying the proposed wells. In view of the incorrect statements in your operating agreements and AFEs as to our ownership in the proposed wells and the pending lawsuit, we are unable to approve either the AFEs or joint operating agreements.

Bassett-Birney is willing to pool its interests in the W/2 of Section 35 and in the E/2 of Section 35 for the drilling of the "35" Com. No. 1 Well and the "35-A" Com. No. 1 Well.

RECEIVED
LAND DEPT.
SEP 5 1980
SOUTHLAND ROYALTY CO.
MIDLAND, TEXAS

September 4, 1980

If you have any questions, please do not hesitate to call me.

Very truly yours,

BASSETT-BIRNEY OIL CORPORATION

By: Jack W. McCaw,
Vice President

Tenneco Oil
Exploration and Production
A Tenneco Company

Southwestern Division

6800 Park Ten Blvd. • Suite 200 North
San Antonio, Texas 78213
(512) 734-8161

F-600340

September 15, 1980

Southland Royalty Company
1100 Wall Tower West
Midland, Texas 79701

Attention: Don Davis

RE: SRC Empire Federal "35-A"
Comm. No. 1 Well and SRC
Empire Federal Comm. "35"
No. 1 Well, Sec. 35 T18S-R29E
Eddy County, New Mexico

Dear Mr. Davis:

Enclosed please find copies of your AFE No. 022E covering the captioned wells executed on behalf of Tenneco Oil Company.

Should you have additional requests or questions, please feel free to call.

Sincerely,

TENNECO OIL COMPANY

John Enloe

John Enloe
Landman

JE:bce
Enclosure as stated

RECEIVED
LAND DEPT.
SEP 18 1980
SOUTHLAND ROYALTY CO.
MIDLAND, TEXAS

ITOEP 111A 12 78

SRC Empire Fed. "35" Comm. #1
Empire, South Prospect
500340 J/O; F/0382; F/O 399

A.A.P.L. FORM 610 - 1977

MODEL FORM OPERATING AGREEMENT

REVISED

OPERATING AGREEMENT

DATED

September 22, 1980,

OPERATOR SOUTHLAND ROYALTY COMPANY

CONTRACT AREA W/2 Section 35, T18S, R29E

COUNTY ~~OR PARISH~~ OF Eddy STATE OF New Mexico

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AMERICAN ASSOCIATION OF PETROLEUM LANDMEN
APPROVED FORM. A.A.P.L. NO. 610 - 1977 REVISED
MAY BE ORDERED DIRECTLY FROM THE PUBLISHER
KRAFTBILT PRODUCTS, BOX 800, TULSA, OK 74101

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between SOUTHLAND ROYALTY COMPANY, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators",

WITNESSETH:

WHEREAS, the parties to this agreement are owners of oil and gas leases and/or oil and gas interests in the land identified in Exhibit "A", and the parties hereto have reached an agreement to explore and develop these leases and or oil and gas interests for the production of oil and gas to the extent and as hereinafter provided:

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.
DEFINITIONS

As used in this agreement, the following words and terms shall have the meanings here ascribed to them:

A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.

B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.

D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".

E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.

F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.

G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.

H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II.
EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

[X] A. Exhibit "A", shall include the following information:
(1) Identification of lands subject to agreement,
(2) Restrictions, if any, as to depths or formations,
(3) Percentages or fractional interests of parties to this agreement,
(4) Oil and gas leases and/or oil and gas interests subject to this agreement,
(5) Addresses of parties for notice purposes.

[X] B. Exhibit "B", Form of Lease.

[X] C. Exhibit "C", Accounting Procedure.

[X] D. Exhibit "D", Insurance.

[X] E. Exhibit "E", Gas Balancing Agreement.

[X] F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.

If any provision of any exhibit, except Exhibit "E", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

ARTICLE III.
INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an unleased oil and gas interest in the Contract Area, that interest shall be treated for the purpose of this agreement and during the term hereof as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B". As to such interest, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the lessee interest.

B. Interest of Parties in Costs and Production:

Exhibit "A" lists all of the parties and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and material acquired in operations on the Contract Area shall be owned by the parties as their interests are shown in Exhibit "A". All production of oil and gas from the Contract Area, subject to the payment of lessor's royalties ~~which will be borne by the Joint Account~~, shall also be owned by the parties in the same manner during the term hereof; provided, however, this shall not be deemed an assignment or cross-assignment of interests covered hereby.

ARTICLE IV.
TITLES

A. Title Examination:

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including Federal Lease Status Reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

☐ ~~Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including~~ preliminary, supplemental, shut-in gas royalty opinions and ~~division order~~ title opinions) shall be a part of the ~~administrative overhead as~~ provided in Exhibit "C," and shall not be a direct charge, whether ~~performed by Operator's staff attorneys or by outside attorneys~~.

☒ Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Exhibit "A".* Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection with leases or oil and gas interests contributed by such party. The Operator shall be responsible for the preparation and recording of Pooling Designations or Declarations as well as the conduct of hearings before Governmental Agencies for the securing of spacing or pooling orders. This shall not prevent any party from appearing on its own behalf at any such hearing.

No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to participate in the drilling of the well.

B. Loss of Title:

1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A", this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests, and

(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development

*except when such costs are incurred in connection with an operation conducted under Article VI B.2 in which event such costs are to be borne by the drilling parties in the proportions elected by such parties.

or operating costs which it may have theretofore paid, but there shall be no monetary liability on its part to the other parties hereto for drilling, development, operating or other similar costs by reason of such title failure; and

(b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract Area by the amount of the interest lost; and

(c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract Area is increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such interests (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well; and

(d) Should any person not a party to this agreement, who is determined to be the owner of any interest in the title which has failed, pay in any manner any part of the cost of operation, development, or equipment, such amount shall be paid to the party or parties who bore the costs which are so refunded; and

(e) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be borne by the party or parties whose title failed in the same proportions in which they shared in such prior production; and

(f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in connection therewith.

2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, is not paid or is erroneously paid, and as a result a lease or interest therein terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new lease covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties shall be revised on an acreage basis, effective as of the date of termination of the lease involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the lease or interest which has terminated. In the event the party who failed to make the required payment shall not have been fully reimbursed, at the time of the loss, from the proceeds of the sale of oil and gas attributable to the lost interest, calculated on an acreage basis, for the development and operating costs theretofore paid on account of such interest, it shall be reimbursed for unrecovered actual costs theretofore paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost interest, on an acreage basis, up to the amount of unrecovered costs;

(b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an acreage basis, of that portion of oil and gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such lease termination, would be attributable to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said portion of the oil and gas to be contributed by the other parties in proportion to their respective interests; and

(c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall not be considered failure of title but shall be joint losses and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of the Contract Area.

ARTICLE V.
OPERATOR

A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:

SOUTHLAND ROYALTY COMPANY shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

B. Resignation or Removal of Operator and Selection of Successor:

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operator, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the Parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed, shall be determined by Operator, and all such employees shall be the employees of Operator.

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the 8th day of December, 1980, Operator shall commence the drilling of a well for oil and gas at the following location:

1980' FSL & 1980' FWL, Section 35, T18S, R29E, Eddy County, New Mexico

and shall thereafter continue the drilling of the well with due diligence to

11,600' or a depth sufficient to test the Morrow formation

unless granite or other practically impenetrable substance or condition in the hole which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E.1. hereof.

B. Subsequent Operations:

1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday or legal holidays. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or response given by telephone shall be promptly confirmed in writing.

2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, within sixty (60) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period where the drilling rig is on location, as the case may be) actually commence work on the proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest of the parties approving such operation, and (b) its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A", or (b) carry its proportionate part of Non-Consenting Parties' interest.* The proposing party, at its election, may withdraw such proposal if there is insufficient participation, and shall promptly notify all parties of such decision. *and failure so to advise the proposing party shall constitute an election under (b).

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk, and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or market value thereof if such share is not sold (after deducting production taxes, royalty, overriding royalty and other interests existing on the effective date hereof, payable out of or measured by the production from such well accruing with respect to such interest until it reverts) shall equal the total of the following:

(a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to each Non-Consenting Party had it participated in the well from the beginning of the operation; and

(b) 300 % of that portion of the costs and expenses of drilling, reworking, deepening, or plugging back, testing and completing, after deducting any cash contributions received under Article VIII.C., and

300 % of that portion of the cost of newly acquired equipment in the well (to and including the well-head connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's election, shall be sold to its purchaser, if available, under the terms of its existing gas sales contract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from such sale direct to the Consenting Parties until the amounts provided for in this Article are recovered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not contracted for sale of its gas at the time such gas is available for delivery, or has not made the election as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-Consenting Party's share of gas as hereinabove provided during the recoupment period.

During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production.

In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.

Within sixty (60) days after the completion of any operation under this Article, the party conducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas produced during any month, Consenting Parties shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs of the work done and of the equipment purchased, in determining when the interest of such Non-Consenting Party shall revert to it as above provided; and if there is a credit balance, it shall be paid to such Non-Consenting party.

If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent of all parties, no wells shall be completed in or produced from a source of supply from which a well located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such source of supply.

The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b) to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article VI.A.

C. Right to Take Production in Kind:

Each party shall have the right to take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating oil for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any

party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment direct from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate commerce, of any other party's share of gas production without first giving such other party thirty (30) days prior written notice of such intended sale.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and/or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any Gas Balancing Agreement between the parties hereto, whether such Agreement is attached as Exhibit "E", or is a separate Agreement.

D. Access to Contract Area and Information:

Each party shall have access to the Contract Area at all reasonable times, at its sole risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the information.

E. Abandonment of Wells:

1. Abandonment of Dry Holes: Except for any well drilled pursuant to Article VI.B.2., any well which has been drilled under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling of such well. Any party who objects to the plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and/or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well which has been drilled or reworked pursuant to Article VI.B.2. hereof for which the Consenting Parties have not been fully reimbursed as therein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of such well, all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one year and so long thereafter as oil and/or gas is produced from the interval or inter-

vals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentages of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interest in the remaining portion of the Contract Area.

Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned well.

ARTICLE VII.
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.

B. Liens and Payment Defaults:

Each Non-Operator grants to Operator a lien upon ~~its oil and gas rights in the Contract Area, and~~ a security interest in its share of oil and or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon at the rate provided in the Accounting Procedure attached hereto as Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the State, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's share of oil and or gas until the amount owed by such Non-Operator, plus interest has been paid. Each purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.

If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.

C. Payments and Accounting:

Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in the Accounting Procedure attached hereto as Exhibit "C". Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more

D. Limitation of Expenditures:

1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this Agreement, it being understood that the consent to the drilling or deepening shall include:

~~☐ Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and equipping of the well, including necessary tankage and or surface facilities.~~

☒ Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its authorized depth, and all tests have been completed, Operator shall give immediate notice to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion attempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, including necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less than all parties.

2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agreement, it being understood that the consent to the reworking or plugging back of a well shall include consent to all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage and/or surface facilities.

3. Other Operations: Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Twenty-Five Thousand and no/100--- Dollars ($ 25,000.00) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares "Authority for Expenditures" for its own use, Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project costing in excess of Twenty-Five Thousand and no/100--------- Dollars ($ 25,000.00).

E. Royalties, Overriding Royalties and Other Payments:

Each party shall pay or deliver, or cause to be paid or delivered, all royalties to the extent of one-fourth (1/4) ____due on its share of production and shall hold the other parties free from any liability therefor. If the interest of any party in any oil and gas lease covered by this agreement is subject to any royalty, overriding royalty, production payment, or other charge over and above the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account for or cause to be accounted for, such interest to the owners thereof.

No party shall ever be responsible, on any price basis higher than the price received by such party, to any other party's lessor or royalty owner; and if any such other party's lessor or royalty owner should demand and receive settlements on a higher price basis, the party contributing such lease shall bear the royalty burden insofar as such higher price is concerned.

F. Rentals, Shut-in Well Payments and Minimum Royalties:

Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.2

Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sunday and holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments

of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

G. Taxes:

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. Operator shall bill other parties for their proportionate share of all tax payments in the manner provided in Exhibit "C".

If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final determination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint account, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as provided in Exhibit "C".

Each party shall pay or cause to be paid all production, severance, gathering and other taxes imposed upon or with respect to the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.

H. Insurance:

At all times while operations are conducted hereunder, Operator shall comply with the Workmen's Compensation Law of the State where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be an amount equivalent to the premium which would have been paid had such insurance been obtained. Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the Workmen's Compensation Law of the State where the operations are being conducted and to maintain such other insurance as Operator may require.

In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's fully owned auto motive equipment.

ARTICLE VIII.
ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

A. Surrender of Leases:

The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole or in part unless all parties consent thereto.

However, should any party desire to surrender its interest in any lease or in any portion thereof, and other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not desiring to surrender it. If the interest of the assigning party includes an oil and gas interest, the assigning party shall execute and deliver to the party or parties not desiring to surrender an oil and gas lease covering such oil and gas interest for a term of one year and so long thereafter as oil and/or gas is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B". Upon such assignment, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the acreage assigned and the operation of any well thereon, and the assigning party shall have no further interest in the lease assigned and its equipment and production other than the royalties retained in any lease made under the terms of this Article. The parties assignee shall pay to the party assignor the reasonable salvage value of the latter's interest in any wells and equipment on the assigned acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. If the assignment is in favor of more than one party, the assigned interest shall

be shared by the parties assignee in the proportions that the interest of each bears to the interest of all parties assignee.

Any assignment or surrender made under this provision shall not reduce or change the assignor's or surrendering parties' interest, as it was immediately before the assignment, in the balance of the Contract Area; and the acreage assigned or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this agreement.

B. Renewal or Extension of Leases:

If any party secures a renewal of any oil and gas lease subject to this Agreement, all other parties shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area.

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this agreement.

The provisions in this Article shall apply also and in like manner to extensions of oil and gas leases.

C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash toward the drilling of a well or any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. If all parties hereto are Drilling Parties and accept such tender, such acreage shall become a part of the Contract Area and be governed by the provisions of this agreement. If less than all parties hereto are Drilling Parties and accept such tender, such acreage shall not become a part of the Contract Area. Each party shall promptly notify all other parties of all acreage or money contributions it may obtain in support of any well or any other operation on the Contract Area.

If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Subsequently Created Interest:

Notwithstanding the provisions of Article VIII.E. and VIII.G., if any party hereto shall, subsequent to execution of this agreement, create an overriding royalty, production payment, or net proceeds interest, which such interests are hereinafter referred to as "subsequently created interest", such subsequently created interest shall be specifically made subject to all of the terms and provisions of this agreement, as follows:

1. If non-consent operations are conducted pursuant to any provision of this agreement, and the party conducting such operations becomes entitled to receive the production attributable to the interest out of which the subsequently created interest is derived, such party shall receive same free and clear of such subsequently created interest. The party creating same shall bear and pay all such subsequently created interests and shall indemnify and hold the other parties hereto free and harmless from any and all liability resulting therefrom.

2. If the owner of the interest from which the subsequently created interest is derived (1) fails to pay, when due, its share of expenses chargeable hereunder, or (2) elects to abandon a well under provisions of Article VI.E. hereof, or (3) elects to surrender a lease under provisions of Article VIII.A. hereof, the subsequently created interest shall be chargeable with the pro rata portion of all expenses hereunder in the same manner as if such interest were a working interest. For purposes of collecting such chargeable expenses, the party or parties who receive assignments as a result of (2) or (3) above shall have the right to enforce all provisions of Article VII.B. hereof against such subsequently created interest.

E. Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all leases and equipment and production; or

2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the right of the other parties.

If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such party's interests within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds hereof.

F. Waiver of Right to Partition:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

~~**G. Preferential Right to Purchase:**~~

~~Should any party desire to sell all or any part of its interests under this agreement, or its rights and~~ interests in the Contract Area, it shall promptly give written notice to the other parties, with ~~full~~ information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optiona' prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent ~~company, or to any company in which any one party owns a majority of the stock~~.

ARTICLE IX.
INTERNAL REVENUE CODE ELECTION

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No

such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from Operations hereunder can be adequately determined without the computation of partnership taxable income.

ARTICLE X.
CLAIMS AND LAWSUITS

Operator may settle any single damage claim or suit arising from operations hereunder if the expenditure does not exceed Five Thousand and no/100---------- Dollars ($ 5,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, the party shall immediately notify Operator, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

ARTICLE XI.
FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure. The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

ARTICLE XII.
NOTICES

All notices authorized or required between the parties, and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by United States mail or Western Union telegram, postage or charges prepaid, or by teletype, and addressed to the party to whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed, and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid, or when sent by teletype. Each party shall have the right to change its address at any time, and from time to time, by giving written notice hereof to all other parties.

ARTICLE XIII.
TERM OF AGREEMENT

This agreement shall remain in full force and effect as to the oil and gas leases and/or oil and gas interests subjected hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any lease, or oil and gas interest contributed by any other party beyond the term of this agreement.

~~( ) Option No. 1: So long as any of the oil and gas leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise, and/or so long as oil or gas production continues from any lease or oil and gas interest~~.

☒ Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and/or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of 90 days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling or reworking a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and/or gas from the Contract Area, this agreement shall terminate unless drilling or reworking operations are commenced within 60 days from the date of abandonment of said well.

It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

ARTICLE XIV.
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the conservation laws of the state in which the committed acreage is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and orders.

B. Governing Law:

The essential validity of this agreement and all matters pertaining thereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state where most of the land in the Contract Area is located shall govern.

ARTICLE XV.
OTHER PROVISIONS

A. SALE OF ROYALTY GAS

It is recognized by the parties hereto that in addition to each party's share of working interest production, such party shall have the right, subject to existing contracts, to market the royalty gas attributable to each lease which it contributes to the unit area and to receive payments due for such royalty gas produced from or allocated to such lease or leases. It is agreed that, regardless of whether each party markets or contracts for its share of gas, including the royalty gas under the leases which it contributed to the Unit, such party agrees to pay or cause to be paid to the royalty owners under its lease or leases the proceeds attributable to their respective royalty interest and to hold all other parties hereto harmless for its failure to do so.

B. Interim Agreement between Southland Royalty Company and Bassett-Birney Oil Corporation Pending the Ultimate Resolution of Title Dispute contained in Case No. CIV-80-0614-HB before the United States District Court, District of New Mexico.

This agreement between Southland Royalty Company hereinafter referred to as "SRC" and Bassett-Birney Oil Corporation hereinafter referred to as "B-B" is in no way to be construed as a settlement or a proposed settlement under the pending litigation referred to immediately above.

Under the Addresses and Interests of the Parties section of the Exhibit "A" attached hereto, the interests of SRC and B-B are in dispute between the parties named in this Article XV.B, and this article shall apply only as to SRC and B-B.

In the interest of mutual cooperation, SRC and B-B agree that their interests as set out in the Exhibit "A" attached hereto are based upon SRC's title examination, are not consistent with the interests B-B's title examination reflects and are subject to change pending the ultimate resolution of the pending litigation cited above. The parties further agree that to allow drilling operations to proceed, they will each accept and agree to the following:

1. During the drilling of the well provided for under Article VI.A hereof, the parties will participate in the costs of operations on the basis of their ownership as set out in Exhibit "A" hereto, which act shall not dimish nor enhance either party's position in the referenced litigation nor serve as an admission or an acceptance of title to oil and gas rights.

2. In the event the test well is completed as a producing well and the referenced litigation is not resolved, SRC shall, out of the interest credited to it on Exhibit "A" attached hereto, establish a suspense account for the proceeds from production equal to the interest credited to B-B in the Exhibit "A" hereto.

3. Upon the final resolution of the pending litigation, should the interests as set out in Exhibit "A" be ruled VALID, then and in that event, SRC shall own and be entitled to receive the proceeds of the suspense account and this Article XV.B shall be of no further force and effect.

4. In the event the interests shown in Exhibit "A" are ultimately found to be incorrect by a court of competent jurisdiction, then a revised Exhibit "A" shall be prepared pursuant to the final ruling of the court and shall be signed and accepted by the parties hereto and shall supercede the original Exhibit "A".

5. In the case of either a commercial well or a dry hole being the result of the test well, and should the events set out under XV.B.4 above occur, then and in that event, the parties agree to equitably reconcile the costs originally paid toward the drilling, testing, completing and operating the test well in accordance with the interests of the Revised Exhibit "A". Likewise, accrued proceeds from production, if any, together with any earnings accrued thereto shall be apportioned out of the suspense account described in Article XV.B.2, to the end that all costs and revenues shall be distributed as if the ultimate interests were in effect upon commencement of operations for the drilling of the test well.

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of 22nd day of September, 19 80.

OPERATOR

SOUTHLAND ROYALTY COMPANY

By: C. E. Mear

NON-OPERATORS

BASSETT-BIRNEY OIL CORPORATION

By:

TENNECO OIL EXPLORATION & PRODUCTION

By:

ROBERT E. McKEE CO.

By:

FEATHERSTONE FARMS, LTD.

By:

CORPORATION ACKNOWLEDGMENT

THE STATE OF TEXAS X
X
COUNTY OF Midland X

BEFORE ME, the undersigned authority, on this day personally appeared C. E. Mear, known to me to be the person whose name is subscribed to the foregoing instrument, as Attorney-in-Fact of Southland Royalty Company, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the 22nd day of Sept A.D. 1980.

My Commission Expires:
Oct. 31, 1980

Teresa Harrell
Notary Public in and for Midland County, Texas

CORPORATION ACKNOWLEDGMENT

THE STATE OF TEXAS X
X
COUNTY OF X

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing instrument, as _____ of _____, a corporation, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity stated, and as the act and deed of said corporation.

Given under my hand and seal of office this the _____ day of _____ A.D. 19____.

My Commission Expires:

SINGLE ACKNOWLEDGEMENT

THE STATE OF X
X
COUNTY OF X

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person__ whose name__ are/is subscribed to the foregoing instrument and acknowledged to me that ____ he ____ executed the same for the purposes and consideration therein expressed.

GIVEN UNDER MY HAND AND SEAL OF OFFICE this the _____ day of _____ A.D., 19_____.

My Commission Expires:
_____

_____
Notary Public in and for _____ County, _____

SINGLE ACKNOWLEDGEMENT

THE STATE OF X
X
COUNTY OF X

BEFORE ME, the undersigned authority, on this day personally appeared _____, known to me to be the person__ whose name__ are/is subscribed to the foregoing instrument and acknowledged to me that ____ he ____ executed the same for the purposes and consideration therein expressed.

GIVEN UNDER MY HAND AND SEAL OF OFFICE this the _____ day of _____ A.D., 19_____.

My Commission Expires:
_____

_____
Notary Public in and for _____ County, _____

EXHIBIT "A"

Attached to and made a part of Operating Agreement dated September 22, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration and Production and Bassett-Birney Oil Corporation, Non-Operators.

LANDS SUBJECT TO AGREEMENT

W/2 of Section 35, T18S, R29E, Eddy County, New Mexico, below the base of the San Andres formation;

*NE/4SW/4, of Section 35, T18S, R29E, Eddy County, New Mexico, insofar as it covers the depths from the surface of the earth to the base of the San Andres formation.

ADDRESSES AND INTERESTS OF PARTIES:

	WI (BPO)	WI (APO)
Southland Royalty Company 1100 Wall Towers West Midland, Texas 79701	.55604883	.27802442
Tenneco Oil Exploration & Production 6800 Park Ten Blvd., Suite 200 No. San Antonio, Texas 78213	.25368638	.25368638
Bassett-Birney Oil Corp. 202 South Fourth Street Artesia, New Mexico 88210	.19026479	.19026479
Robert E. McKee Co. P. O. Box 20562 El Paso, Texas 79998	-0-	.09513239
Featherstone Farms, Ltd. 1717 W. Second Street Roswell, New Mexico 88201	-0-	.18289202
	1.0000000	1.0000000

*In the event that the said "Initial Well" to be drilled under the provisions of Article VI, DRILLING & DEVELOPMENT, is not completed between the depths from the surface of the earth to the base of the San Andres formation, then and in that event, this acreage shall no longer be subject to this Operating Agreement.

EXHIBIT "B"

Attached to and made a part of Operating Agreement dated September 22, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration and Production and Bassett-Birney Oil Corporation, Non-Operators.

OIL AND GAS LEASE

THIS AGREEMENT made this_____day of_____19___, between_____

_____

as Lessor, and_____ as Lessee, WITNESSETH:

1. Lessor in consideration of Ten and No/100 Dollars ($10.00) in hand paid of the royalties herein provided, and of the agreements of Lessor herein contained, hereby grants, leases and lets exclusively unto Lessee for the purpose of investigating, exploring, producing, drilling and mining for and producing oil and gas, laying pipe lines, building roads, tanks, power stations, telephone lines and other structures thereon to produce, care, take care of, treat, transport, and own said products, the following

described land in_____County, Texas, to-wit:

and containing_____acres, more or less. In the event a resurvey of said lands shall reveal the existance of excess and/or vacant lands lying adjacent to the lands above described and the Lessor, his heirs, or assigns, shall by virtue of its ownership of the lands above described, have preference right to acquire said excess and/or vacant lands, then in that event this lease shall cover and include all such excess and/or vacant lands which the Lessor, its successors or assigns, shall have the preference right to acquire by virtue of its ownership of the lands above described as and when acquired by the Lessor; and the Lessee shall pay the Lessor for such excess and/or vacant lands at the same rate per acre as the cash consideration paid for the acreage hereinabove mentioned.

2. Subject to the other provisions herein contained, this lease shall be for a term of_____from this date (called "primary term") and as long thereafter as oil or gas is produced from said land hereunder.

3. The royalties to be paid Lessor are: (a) on oil one-fourth (1/4) of that produced and saved from said land, the same to be delivered at the wells or to the credit of Lessor into the pipe line to which the wells may be connected; Lessee may from time to time purchase any royalty oil in its possession, paying the market price therefor prevailing for the field where produced on the date of purchase; and (b) on gas, including casinghead gas or other gaseous substance, produced from said land and sold or used off the premises or in the manufacture of gasoline or other products therefrom, the market value at the well of one-fourth (1/4) of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-fourth (1/4) of the amount realized from such sale; where gas from a well producing gas only is not sold or used, Lessee may pay as annual royalty, commencing ninety (90) days after such well is first shut in, the sum of_____ per well per year, and upon such payment it will be considered that gas is being produced within the meaning of Paragraph 2 hereof; provided, however, that such shut in payments shall not continue this lease in force for any consecutive period of more than_____ years. Lessee shall have free use of oil, gas and water from said land, except water from Lessor's wells, for all operations hereunder, and the royalty on oil, gas or water shall be computed after deducting any so used.

4. If prior to discovery of oil or gas on said land, Lessee should drill a dry hole or holes thereon, or if after discovery of oil or gas, the production thereof should cease from any cause, this lease shall not terminate if Lessee commences additional drilling or re-working operations within sixty (60) days thereafter. If at the expiration of the primary term, oil or gas is not being produced on said land, but Lessee is then engaged in drilling or re-working operations thereon, the lease shall remain in force so long as operations on said well or for drilling or re-working of any additional well are prosecuted with no cessation of more than sixty (60) consecutive days and if they result in the production of oil or gas so long thereafter as oil or gas is produced from said land. In the event a well or wells producing oil or gas in paying quantities should be brought in on adajacent land and draining the leased premises, Lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.

5. Lessee shall have the right at any time until six months after the expiration of this lease to remove all property and fixtures placed by Lessee on said land, including the right to draw and remove all casing. When required by Lessor, Lessee will bury all pipe lines below ordinary plow depth, and no well shall be drilled within two hundred (200) feet of any residence or barn now on said land without Lessor's consent.

6. The rights of either party hereunder may be assigned in whole or in part and the provisions hereof shall extend to the heirs, successors and assigns, but no change or division in ownership of the land, or royalties, however accomplished, shall operate to enlarge the obligations or diminish the rights of Lessor. No sale or enlargement by either party shall be binding on the other party hereto until such party shall have been furnished with a certified copy of recorded instrument evidencing same. If six or more parties become entitled to royalty hereunder, Lessee may withold payment thereof unless and until furnished with a recordable instrument executed by all such parties designating an agent to receive payment for all.

7. Lessor herein makes no warranty of title, either express or implied. Lessor hereby agrees that Lessee at its option may discharge any tax, martgage or other lien upon said land and in the event Lessee does so, it shall be subrogated to such lien with the right to enforce same and apply royalties accruing hereunder toward satisfying same. It is agreed that if Lessor owns an interest in said land less than the entire fee simple, then the royalties to be paid Lessor shall be reduced proportionately.

8. If any operations permitted or required hereunder or the performance by Lessee of any covenant, agreement or requirement hereof is delayed or interrupted directly or indirectly by any past or future acts, orders, regulations, or requirements of the Government of the United States or of any state or other governmental body, or any agent, officer, representative or authority of any of them, the period of such Delay or Interruption shall not be counted against the Lessee, and the primary term of this lease shall automatically be extended after the expiration of the primary term set forth in Section 2 above so long as the cause or causes for such delay or interruption continue and for a period of six (6) months thereafter; and such extended term shall constitute and shall be considered for the purposes of this lease as a part of the primary term hereof. The Lessee shall not be liable to Lessor in damages for failure to perform any operation permitted or required hereunder or to comply with any covenant, agreement or requirement hereof during the time Lessee is relieved from the obligations to comply with such covenants, agreements, or requirements.

IN WITNESS WHEREOF, this instrument is executed on the date first above written.

_____

EXHIBIT "C"

Attached to and made a part of Operating Agreement dated September 22, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration & Production and Bassett-Birney Oil Corporation, Non-Operators.

ACCOUNTING PROCEDURE
JOINT OPERATIONS

I. GENERAL PROVISIONS

1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

2. Statement and Billings

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

3. Advances and Payments by Non-Operators

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

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

4. Adjustments

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

5. Audits

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

6. Approval by Non-Operators

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

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. Rentals and Royalties

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

2. Labor

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

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

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

B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II. Such costs under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 2A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.

C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II.

D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II.

3. Employee Benefits

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

4. Material

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

5. Transportation

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

A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by the Parties.

B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.

C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking cost of $200 or less excluding accessorial charges.

6. Services

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

7. Equipment and Facilities Furnished by Operator

A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on investment not to exceed eight per cent (8%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.

B. In lieu of charges in Paragraph 7A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

8. Damages and Losses to Joint Property

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

9. Legal Expense

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

10. Taxes

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

11. Insurance

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

12. Other Expenditures

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

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

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

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

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

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

A. Overhead - Fixed Rate Basis

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

Drilling Well Rate $ 3,000.00
Producing Well Rate $ 300.00

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

(a) Drilling Well Rate

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

[2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days

[3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

[1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.

[2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.

[3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.

[4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.

[5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

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

~~B. Overhead - Percentage Basis~~

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

(a) Development

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

(b) Operating

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

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

2. Overhead - Major Construction

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess of $ 25,000.00 :

A. 5.0 % of total costs if such costs are more than $ 25,000.00 but less than $ 100,000.00 ; plus

B. 2.0 % of total costs in excess of $ 100,000.00 but less than $1,000,000; plus

C. 2.0 % of total costs in excess of $1,000,000.

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

3. Amendment of Rates

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

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

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

1. Purchases

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

2. Transfers and Dispositions

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

A. New Material (Condition A)

(1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.

(2) Line Pipe

(a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.

(b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.

(3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

B. Good Used Material (Condition B)

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

(1) Material moved to the Joint Property

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

(2) Material moved from the Joint Property

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

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

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

C. Other Used Material (Condition C and D)

(1) Condition C

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

(2) Condition D

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

D. Obsolete Material

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

E. Pricing Conditions

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

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

3. Premium Prices

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

4. Warranty of Material Furnished by Operator

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

V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

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

3. Special Inventories

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

4. Expense of Conducting Periodic Inventories

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

EXHIBIT "D"

INSURANCE

Attached to and made a part of Operating Agreement dated September 22, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration and Production and Bassett-Birney Oil Corporation, Non-Operators.

(a) Operator shall at all times during the terms of this Agreement carry insurance to protect the parties hereto as follows:

(1) Workmen's compensation and occupational disease insurance as required by the laws of the state or states in which operations will be conducted and employer's liability insurance with a limit of not less than $100,000.

(2) Comprehensive general public liability insurance, excluding products liability insurance, with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident and $100,000 aggregate limit applicable to all loss of or damage to property during the policy period.

(3) Automotive public liability insurance covering all automotive equipment used in performance of work under this Agreement with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident.

(b) Operator shall require all contractors performing work under this Agreement to carry the following insurance:

(1) Workmen's compensation and occupational disease insurance as required by the laws of the state or states in which operations will be conducted and employers' liability insurance with a limit of not less than $100,000.

(2) Comprehensive general liability insurance with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident and $100,000 aggregate limit applicable to all loss of or damage to property during the policy period.

(3) Automotive public liability insurance covering all automotive equipment used in performance of work under this Agreement with limits of not less than: $100,000 applicable to bodily injury, sickness or death of any one person and $300,000 for more than one person in any one accident, and $100,000 for loss of or damage to property in any one accident.

EXHIBIT "E"

GAS BALANCING AGREEMENT

Attached to and made a part of Operating Agreement dated September 22, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration and Production and Bassett-Birney Oil Corporation, Non-Operators.

The parties to the Operating Agreement to which this agreement is attached, own working interest in the gas rights underlying the Unit Area covered by such Operating Agreement in accordance with the percentages of participation as set forth in Exhibit "A" to said Agreement.

In accordance with the terms of the Operating Agreement, each party thereto has the right to take in kind its share of gas produced from the Unit Area and market or otherwise dispose of same. In the event any party hereto is not at any time taking or marketing its share of gas, or has contracted to sell its share of gas produced from the Unit Area to a purchaser which does not at any time take the full share of gas attributable to the interest of such party, the terms of this agreement shall automatically become operative.

During the period when any party hereto is not marketing or otherwise disposing of its share of gas produced from any proration unit within the Unit Area, the other parties hereto shall be entitled to produce, in addition to their own share of production, that portion of such other party's share of production which said party is unable to market or otherwise dispose of and shall be entitled to take such gas production and deliver same to its or their purchaser(s). All parties hereto shall share in and own the liquid hydrocarbons recovered from such gas by lease equipment in accordance with their respective interests, and subject to the aforesaid Operating Agreement, but the party or parties taking such gas shall own all of such gas delivered to its or their purchaser(s).

An account shall be established for each party not marketing or otherwise disposing of its share of the gas produced, which account shall be credited with an amount of gas equal to such party's full share of the gas produced, less its share of gas used in lease operations, vented or lost, and less that portion marketed or otherwise disposed of by such party. The Operator will maintain a current over and under account of the gas balance between the parties and will furnish all parties hereto monthly statements showing the total quantity of gas produced, the amount used in lease operations, vented or lost, the total quantity of liquid hydrocarbons recovered therefrom, and the monthly and cumulative over and under account of each party.

Each party hereto will make settlement with the royalty owners to whom it is accountable, just as if such party were marketing or otherwise disposing of its share, and its share only, of such gas production. Each party hereto agrees to hold each other harmless from any and all claims for royalty payments asserted by royalty owners to whom each party is accountable. The term "royalty owner" shall include owners of royalty, overriding royalties, production payments and similar interests.

After notice to the Operator, any party at any time may begin marketing or otherwise disposing of its share of the gas produced from a proration unit with respect to which it has an under account balance. In addition to such share, said party, until it has balanced the gas account as to its interest, shall be entitled to take a share of gas determined by multiplying thirty-three and one-third percent (33 1/3%) of the interest in the current gas production of the party or parties having an over account balance by a fraction, the numerator of which is the interest in the proration unit of such party with the under account balance and the denominator of which is the total percentage interest in such proration unit of all parties having an under account balance and who are currently marketing or otherwise disposing of a portion of their under account balance in addition to their share of gas.

Each party marketing or otherwise disposing of gas shall pay the production taxes due on such gas.

Nothing herein shall be construed to deny any party the right, from time to time, to produce and deliver to its purchaser its full share of the allowable gas production to meet the deliverability tests required by its purchaser.

Should production of gas from a proration unit be permanently discontinued before the gas account is balanced, settelement will be made between those parties credited with under account and over account balances. In making such settlement, the party or parties credited with an under account balance will be paid by the party or parties credited with an over account balance a sum of money equal to that received attributable to such over account, less applicable taxes theretofore paid. For gas sold or delivered into intrastate commerce said sum shall be computed at the price received for sale of the gas. For gas sold or delivered into interstate commerce said sum shall be computed at the rate collected, not subject to possible refund, as provided by the Federal Energy Regulatory Commission, plus any additional collected amount which is ultimately not required to be refunded, such additional collected amount to be accounted for at such time as final determination is made with respect thereto.

Nothing herein shall change or affect each party's obligation to pay its proportionate share of all costs and liabilities incurred, as provided in the aforesaid Operating Agreement.

This agreement shall constitute a separate agreement as to each proration unit within the Unit Area. It shall inure to the benefit of and be binding upon the parties hereto, their successors, legal representatives and assigns. It shall become effective in accordance with its terms and shall remain in force and effect as long as the Operating Agreement to which it is attached remains in effect.

EXHIBIT "F"

Attached to and made a part of Operating Agreement dated September 22, 1980, by and between Southland Royalty Company, Operator, and Tenneco Oil Exploration and Production and Bassett-Birney Oil Corporation, Non-Operators.

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 will 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 origin 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 non-discrimination 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 orders 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 (EE01) 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 requested.