

UNIT OPERATING AGREEMENT
NORTHEAST DRINKARD UNIT
LEA COUNTY, NEW MEXICO



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UNIT OPERATING AGREEMENT

NORTHEAST DRINKARD UNIT

LEA COUNTY, NEW MEXICO

THIS AGREEMENT, entered into as of the 1st day of May, 1987, by the parties who have signed the original of this instrument, a counterpart thereof, or other instrument agreeing to be bound by the provisions hereof;

WITNESSETH:

WHEREAS, the parties hereto as Working Interest Owners have executed, as of the date hereof, an agreement entitled "Unit Agreement, Northeast Drinkard Unit, Lea County, New Mexico," herein referred to as "Unit Agreement", which, among other things, provides for a separate agreement to be entered into by Working Interest Owners to provide for Unit Operations as therein defined;

NOW, THEREFORE, in consideration of the mutual agreements herein set forth, it is agreed as follows:

ARTICLE 1

CONFIRMATION OF UNIT AGREEMENT

1.1 Unit Agreement. The Unit Agreement is hereby confirmed and by reference made a part of this agreement. The definitions in the Unit Agreement are adopted for all purposes of this agreement. If there is

any conflict between the Unit Agreement and this agreement, the Unit Agreement shall govern.

ARTICLE 2

EXHIBITS

2.1 Exhibits. The following exhibits are incorporated herein by reference:

2.1.1 Exhibits A, B-1 and B-2 of the Unit Agreement.

2.1.2 Exhibit C, attached hereto, is a schedule showing the Unit Oil and Gas Participations of each Working Interest Owner. Exhibit C, or a revision thereof, shall not be conclusive as to the information therein, except it may be used as showing the Unit Oil and Gas Participations of Working Interest Owners for purposes of this agreement until shown to be in error and revised as herein authorized.

2.1.3 Exhibit D, attached hereto, is the Accounting Procedure applicable to Unit Operations. If there is any conflict between this agreement and Exhibit D, this agreement shall govern.

2.1.4 Exhibit E, attached hereto, contains insurance provisions applicable to Unit Operations.

2.1.5 Exhibit F, attached hereto, is the Gas Balancing Agreement applicable to Unit Operations.

2.1.6 Exhibit G, attached hereto, is the form of indemnity agreement provided for in Article 9 of the Unit Agreement.

2.1.7 Exhibit H, attached hereto, is the non-discrimination agreement provided for in Section 21.2.

2.1.8 Exhibit I, attached hereto, is a list of wells to be delivered to Unit Operator on the Effective Date for use in Unit Operations.

2.2 Revision of Exhibits. Whenever Exhibits A, B-1 and B-2 are revised, Exhibit C shall be revised accordingly and be effective as of the same date. Unit Operator shall also revise Exhibit C from time to time as required to conform to changes in ownership of which Unit Operator has been notified as provided in the Unit Agreement. Working Interest Owners shall be provided a duplicate copy of any exhibit revised as provided herein.

2.3 Reference to Exhibits. When reference is made herein to an exhibit, it is to the exhibit as originally attached, or, if revised, to the last revision.

ARTICLE 3

SUPERVISION OF OPERATIONS BY WORKING INTEREST OWNERS

3.1 Overall Supervision. Working Interest Owners shall exercise overall supervision and control of all matters pertaining to Unit Operations pursuant to this agreement and the Unit Agreement. In the exercise of such authority, each Working Interest Owner shall act solely in its own behalf in the capacity of an individual owner and not on behalf of the owners as an entirety.

3.2 Specific Authority and Duties. The matters with respect to which Working Interest Owners shall decide and take action shall include, but not be limited to, the following:

3.2.1 Method of Operation. The method of operation, including the type or types of secondary or tertiary recovery, or other enhanced recovery program to be employed.

3.2.2 Drilling of Wells. The drilling, deepening, or plugging back of any well whether for production of Unitized Substances, for use as an injection well, or for other purposes.

3.2.3 Well Abandonment, Use, and Conversion. The abandonment of any well; the use of any well for injection, salt water disposal, or for any purpose other than production; or the conversion of the use of any well from one purpose to another. The reactivation of a well which was shut-in or temporarily abandoned to its former use by Unit Operator shall not require prior approval of Working Interest Owners if the estimated expenditure is less than the expenditure limitation specified in Section 3.2.4.

3.2.4 Expenditures. The making of any single expenditure in excess of thirty thousand dollars (\$30,000.00); however, approval by Working Interest Owners of the drilling, reworking, deepening, or plugging back of any well shall include approval of all necessary expenditures required therefor, and for completing, testing, and equipping the well, including necessary flow lines, separators, and lease tankage.

3.2.5 Disposition of Unit Equipment. The selling or otherwise disposing of any major item of surplus Unit Equipment, if the

current price of new equipment similar thereto is ten thousand dollars (\$10,000.00) or more.

3.2.6 Appearance Before a Court or Regulatory Agency. The designating of a representative to appear before any court or regulatory agency in matters pertaining to Unit Operations; however, Unit Operator shall act as such representative in the absence of the designation of a different representative by Working Interest Owners. Such designation shall not prevent any Working Interest Owner from appearing in person or from designating another representative in its own behalf.

3.2.7 Audits. The auditing of the accounts of Unit Operator pertaining to Unit Operations hereunder; however, the audit shall

- (a) not be conducted more than once each year except upon the resignation or removal of Unit Operator, and
- (b) be made upon the approval of the owner or owners of a majority of Working Interest other than that of Unit Operator, at the expense of all Working Interest Owners other than Unit Operator, or
- (c) be made at the expense of those Working Interest Owners requesting such audit, if owners of less than a majority of Working Interest, other than that of Unit Operator, request such an audit, and
- (d) be made upon not less than thirty (30) days' written notice to Unit Operator.

3.2.8 Inventories. The taking of periodic inventories under the terms of Exhibit D.

3.2.9 Technical Services. The authorizing of charges to the joint account for services by consultants or Unit Operator's technical personnel not covered by the overhead charges provided by Exhibit D.

3.2.10 Assignment to Committees. The appointment of committees to study any problems in connection with Unit Operations.

3.2.11 The removal of Unit Operator and the selection of a successor.

3.2.12 The enlargement of the Unit Area.

3.2.13 The adjustment and readjustment of investments.

3.2.14 The termination of the Unit Agreement.

3.2.15 The approval of Cooperative Agreements as provided in Section 7.11 hereof.

ARTICLE 4

MANNER OF EXERCISING SUPERVISION

4.1 Designation of Representatives. Each Working Interest Owner shall inform Unit Operator in writing of the names and addresses of the representative and alternate who are authorized to represent and bind such Working Interest Owner with respect to Unit Operations. The representative or alternate may be changed from time to time by written notice to Unit Operator.

Cooperative
Voting Interest

4.2 Meetings. All meetings of Working Interest Owners shall be called by Unit Operator upon its own motion or at the request of one (1) or more Working Interest Owner having a total Unit Oil Phase II Participation of not less than ten percent (10%). No meeting shall be called on less than fourteen (14) days' advance written notice, with agenda for the meeting attached. Working Interest Owners who attend the meeting may amend items included in the agenda and may act upon an amended item or other items presented at the meeting. The representative of Unit Operator shall be chairman of each meeting.

4.3 Voting Procedure. Working Interest Owners shall decide all matters coming before them as follows:

4.3.1 Voting Interest. Each Working Interest Owner shall have a voting interest equal to its Unit Oil Phase II Participation.

4.3.2 Vote Required. Unless otherwise provided herein or in the Unit Agreement, Working Interest Owners shall determine all matters by the affirmative vote of three (3) or more Working Interest Owners having a combined voting interest of at least sixty-five percent (65%); however, should any one Working Interest Owner have more than thirty-five percent (35%) voting interest, its negative vote or failure to vote shall not defeat a motion and such motion shall pass if approved by Working Interest Owners having a majority voting interest, unless two or more additional Working Interest Owners having a combined voting interest of at least five percent (5%) likewise vote against the motion or fail to vote.

4.3.3 Vote at Meeting by Nonattending Working Interest Owner.

Any Working Interest Owner who is not represented at a meeting may vote on any agenda item by letter or telegram addressed to the representative of Unit Operator if its vote is received prior to the vote at the meeting.

4.3.4 Poll Votes. Working Interest Owners may vote on and decide, by letter or telegram, any matter submitted in writing to Working Interest Owners. If a meeting is not requested, as provided in Section 4.2, within fourteen (14) days after a written proposal is sent to Working Interest Owners, the vote taken by letter or telegram shall become final. Unit Operator will give prompt notice of the results of such voting to all Working Interest Owners.

ARTICLE 5

INDIVIDUAL RIGHTS OF WORKING INTEREST OWNERS

5.1 Reservation of Rights. Working Interest Owners severally reserve to themselves all their rights, except as otherwise provided in this agreement and the Unit Agreement.

5.2 Specific Rights. Each Working Interest Owner shall have, among others, the following specific rights:

5.2.1 Access to Unit Area. Access to the Unit Area at all reasonable times to inspect Unit Operations, all wells, and the records and data pertaining thereto.

6.3 Selection of Successor. Upon the resignation or removal of a Unit Operator, a successor Unit Operator shall be selected by Working Interest Owners. If the Unit Operator that is removed fails to vote or votes only to succeed itself, the successor Unit Operator shall be selected by the affirmative vote of Working Interest Owners having over fifty percent (50%) of the voting interest remaining after excluding the voting interest of the Unit Operator that was removed.

ARTICLE 7

AUTHORITY AND DUTIES OF UNIT OPERATOR

7.1 Exclusive Right to Operate Unit. Subject to the provisions of this agreement and to instructions from Working Interest Owners, Unit Operator shall have the exclusive right and be obligated to conduct Unit Operations.

7.2 Workmanlike Conduct. Unit Operator shall conduct Unit Operations in a good and workmanlike manner as would a prudent operator under the same or similar circumstances. Unit Operator shall freely consult with Working Interest Owners and keep them informed of all matters which Unit Operator, in the exercise of its best judgment, considers important. Unit Operator shall not be liable to Working Interest Owners for damages, unless such damages result from its gross negligence or willful misconduct.

7.3 Liens and Encumbrances. Unit Operator shall endeavor to keep the lands and leases in the Unit Area and Unit Equipment free from all

liens and encumbrances occasioned by Unit Operations, except the lien and security interest of Unit Operator granted hereunder.

7.4 Employees. The number of employees used by Unit Operator in conducting Unit Operations, their selection, hours of labor, and compensation shall be determined by Unit Operator. Such employees shall be the employees of Unit Operator.

7.5 Records. Unit Operator shall keep correct books, accounts, and records of Unit Operations.

7.6 Reports to Working Interest Owners. Unit Operator shall furnish Working Interest Owners periodic reports of Unit Operations. Such reports shall be furnished as frequently as may be determined by Working Interest Owners.

7.7 Gas Vintage. Upon unitization, all Working Interest Owners shall provide the Unit Operator with the gas vintage for each well contributed to the Unit. The Unit Operator shall provide quarterly gas vintage splits to each Working Interest Owner's gas purchaser(s).

7.8 Reports to Governmental Authorities. Unit Operator shall make all reports to governmental authorities that it has the duty to make as Unit Operator.

7.9 Engineering and Geological Information. Unit Operator shall furnish to a Working Interest Owner, upon written request, a copy of all logs and other engineering and geological data pertaining to wells drilled for Unit Operations.

7.10 Expenditures. Unit Operator is authorized to make single expenditures not in excess of thirty thousand dollars (\$30,000.00) without prior approval of Working Interest Owners. If an emergency occurs, Unit Operator may immediately make or incur such expenditures as in its opinion are required to deal with the emergency. Unit Operator shall report to Working Interest Owners, as promptly as possible, the nature of the emergency and the action taken.

7.11 Wells Drilled by Unit Operator. All wells drilled by Unit Operator shall be at the usual rates prevailing in the area. Unit Operator may employ its own tools and equipment, but the charge therefor shall not exceed the usual rates prevailing in the area, and the work shall be performed by Unit Operator under the same terms and conditions as are usual in the area in contracts of independent contractors doing work of a similar nature.

7.12 Cooperative Agreements. Unit Operator may, after approval by Working Interest Owners, enter into cooperative agreements with respect to lands adjacent to the Unit Area for the purpose of coordinating operations.

7.13 Tertiary Recovery Operations. Unit Operator shall conduct tertiary recovery or enhanced recovery operations only with the affirmative vote of Working Interest Owners having seventy-five percent (75%) or more voting interest.