

**UNIT OPERATING AGREEMENT**

**BOBBI STATE WATERFLOOD UNIT**

**LEA COUNTY, NEW MEXICO**

**April 2, 2013**

**BOBBI STATE WATERFLOOD UNIT  
LEA COUNTY, NEW MEXICO**

THIS UNIT OPERATING AGREEMENT ("Agreement"), entered into as of the 2<sup>nd</sup> day of April, 2013, by the parties who have signed the original of this instrument, a counterpart thereof, or other instrument agreeing to become a party hereto (each being hereinafter referred to individually as a "Party" or collectively as the "Parties");

**WITNESSETH:**

WHEREAS, an agreement of even date herewith entitled "Unit Agreement, Bobbi State Waterflood Unit, Lea County, New Mexico" (herein referred to as "Unit Agreement"), has been made which, among other things, provides for a separate agreement to provide for Unit Operations as defined in the Unit Agreement; and

WHEREAS, the Parties desire to enter into this Agreement as contemplated by the Unit Agreement to govern Unit Operations, as defined in the Unit Agreement;

NOW, THEREFORE, it is provided as follows:

**ARTICLE 1  
CONFIRMATION OF UNIT AGREEMENT**

**1.1 Confirmation of 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 or attachment:

**2.1.1** Exhibits A and B of the Unit Agreement.

**2.1.2** Exhibit C, attached hereto, is the Accounting Procedure applicable to Unit Operations. If there is any conflict between this Agreement and Exhibit C, this Agreement shall govern.

**2.1.3** Exhibit D, attached hereto, contains insurance provisions applicable to Unit Operations.

**2.1.4** Exhibit E, attached hereto, is a schedule showing the Working Interest of each Working Interest Owner in each Tract, each Working Interest Owner's Unit Participation attributable to each Tract, and the total Unit Participation of each Working Interest Owner in the Unit Area.

**2.1.5** Exhibit F, attached hereto, is the Unit Agreement.

**2.2 Reference to Exhibits.** When reference is made herein to an exhibit, it is to the original exhibit 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.

**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 of enhanced recovery program to be employed on the Unit.

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

**3.2.3 Well Recompletions and Change of Status.** The recompletion, abandonment, or change of status of any well, or the use of any well for injection, salt water disposal, or other purposes or the acquisition of wells for Unit Operations.

**3.2.4 Unit Operator's Tools and Equipment.** The use by Unit Operator of its own tools and equipment in the drilling of a well or in any other operation in which drilling equipment is required.

**3.2.5 Expenditures.** The making of any single expenditure in excess of Seventy Five Thousand Dollars (\$75,000.00); 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 therefore, and for completing, testing, and equipping the well, including necessary flow lines, separators, and lease tankage.

**3.2.6 Disposition of Unit Equipment.** The selling or otherwise disposing of any item of surplus Unit Equipment, if the current price of new equipment similar thereto is in excess of Fifty Thousand Dollars (\$50,000.00).

**3.2.7 Audit Exceptions.** The settlement of unresolved audit exceptions.

**3.2.8 Inventories.** The taking of periodic inventories as provided by Exhibit C.

**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 charges provided by Exhibit C.

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

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

**3.2.12 Changes and Amendments.** The changing of the Unit Area or the amending of this Agreement or the Unit Agreement as provided by Article 9 of the Unit Agreement.

**3.2.13 Investment Adjustment.** The adjustment and readjustment of investments.

**3.2.14 Termination of Unit Agreement.** The termination of the Unit Agreement as provided therein.

#### **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.

**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 or more Working Interest Owners having a total Unit Participation of not less than forty percent (40%). 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 determine 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 Participation at the time of the vote.

**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 one or more Working Interest Owners having a combined voting interest of at least seventy-five percent (75%).

**4.3.3 Vote at Meeting by Non-attending 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 by letter or telegram on any matter submitted in writing to all Working Interest Owners. If a meeting is not requested, as provided in Section 4.2, within seven (7) days after a written proposal is sent to Working Interest Owners, the vote taken by letter or telegram shall control. Unit Operator shall give prompt notice of the results of such voting to each Working Interest Owner.

## **ARTICLE 5 INDIVIDUAL RIGHTS OF WORKING INTEREST OWNERS**

**5.1 Reservation of Rights.** Working Interest Owners retain all their rights, except as otherwise provided in this Agreement or 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.

**5.2.2 Reports.** The right to receive from Unit Operator, upon written request, copies of all reports to any governmental agency, reports of crude oil runs and stocks, inventory reports, and all other information pertaining to Unit Operations. The cost of gathering and furnishing information not ordinarily furnished by Unit Operator to all Working Interest Owners shall be charged to the Working Interest Owner that requests the information.

**5.2.3 Audits.** The right to audit (at its own cost and expense) the accounts of Unit Operator pertaining to Unit Operations according to the provisions of Exhibit C.

## **ARTICLE 6 UNIT OPERATOR**

**6.1 Unit Operator.** Sundown Energy LP is designated as the initial Unit Operator.

**6.2 Resignation or Removal.** Unit Operator may resign at any time. Unit Operator

may be removed at any time by the affirmative vote of Working Interest Owners having sixty-six percent (66%) or more of the voting interest. Such resignation or removal shall not become effective for a period of three (3) months after the resignation or removal; unless a successor Unit Operator has taken over Unit Operations prior to the expiration of such period.

**6.3 Selection of Successor.** Upon the resignation or removal of Unit Operator, a successor Unit Operator shall be selected by Working Interest Owners owning an interest in the contract area at the time such successor Unit Operator is selected. The successor Unit Operator shall be selected by the affirmative vote of parties owning a majority interest based on ownership; provided, however, if an Unit Operator which has been removed fails to vote or votes only to succeed itself, the successor Unit Operator shall be selected by the affirmative vote of parties owning a majority interest based on ownership 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 those provided for in Article 11.

**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, upon written request, periodic reports of Unit Operations.

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

**7.8 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.

**7.9 Expenditures.** Unit Operator is authorized to make single expenditures not in excess of Seventy Five Thousand Dollars (\$75,000.00) without prior approval of Working Interest Owners. In the event of an emergency, 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.

**7.10 Wells Drilled by Unit Operator.** Wells drilled by Unit Operator shall be at the rates prevailing in the area.

## ARTICLE 8 TAXES

**8.1 Property Taxes.** Beginning with the first calendar year after the Effective Date hereof, Unit Operator shall make and file all necessary property tax renditions and returns with the proper taxing authorities with respect to all property of each Working Interest Owner used or held by Unit Operator for Unit Operations. Unit Operator shall settle assessments arising therefrom. All such property taxes shall be paid by Unit Operator and charged to the joint account.

**8.2 Other Taxes.** Each Working Interest Owner 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 its share of Unitized Substances.

**8.3 Income Tax Election.** 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, then each Person 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. Unit Operator is authorized and directed to execute on behalf of each Person 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 1.761-1 (a). Should there be any requirement that each Person hereby affected give further evidence of this election; each such Person shall execute such documents and furnish such other evidence as may be required or as may be necessary to evidence this election. No such Person 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 of Texas or any future income tax law 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 Person hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such Person states that the income derived by such Person from Unit Operations can be adequately determined without the computation of partnership taxable income.

## ARTICLE 9 INSURANCE

**9.1 Insurance.** Unit Operator, with respect to Unit Operations, shall:

- (a) Comply with the Workmen's Compensation Laws of the state of Texas,
- (b) Comply with Employer's Liability and other insurance requirements of the laws of the state of Texas, and
- (c) Provide insurance or other protection as set forth in Exhibit D.

## ARTICLE 10 ADJUSTMENT OF INVESTMENTS

**10.1 Property Taken Over.** Upon the Effective Date, Working Interest Owners shall deliver to Unit Operator the following:

**10.1.1 Wells.** All wells completed in the Unitized Formation, as shown on Exhibit B.

**10.1.2 Equipment.** The casing and tubing in each such well, the wellhead connections thereon, and all other lease and operating equipment that is used in the

operation of such wells which Unit Operator determines is necessary or desirable for conducting Unit Operations.

**10.1.3 Records.** A copy of all production and well records for such wells.

**10.2 Inventory and Evaluation.** Working Interest Owners shall at Unit Expense inventory and evaluate the wells and equipment taken over. The inventory of equipment shall be limited to those items considered controllable under Exhibit C except, upon determination of Working Interest Owners, items considered noncontrollable may be included in the inventory in order to insure a more equitable adjustment of investment. The method of evaluating wells and equipment shall be determined by Working Interest Owners.

**10.3 Investment Adjustment.** Upon approval by Working Interest Owners of the inventory and evaluation, each Working Interest Owner shall be credited with the value of its interest in all wells and equipment taken over under Section 10.1, and shall be charged with an amount equal to that obtained by multiplying the total value of all wells and equipment taken over under Section 10.1 by such Working Interest Owner's Unit Participation. If the charge against any Working Interest Owner is greater than the amount credited to such Working Interest Owner, the resulting net charge shall be an item of Unit Expense chargeable against such Working Interest Owner. If the credit to any Working Interest Owner is greater than the amount charged against such Working Interest Owner, the resulting net credit shall be paid to such Working Interest Owner by Unit Operator out of funds received by it in settlement of the net charges described above.

**10.4 General Facilities.** The acquisition of warehouses, warehouse stocks, lease houses, camps, facility systems and office buildings necessary for Unit Operations shall be by negotiation by the owners thereof and Unit Operator, subject to the approval of Working Interest Owners.

**10.5 Ownership of Property and Facilities.** Each Working Interest Owner, individually, shall by virtue hereof own an undivided interest, equal to its Unit Participation in all wells, equipment, and facilities taken over or otherwise acquired by Unit Operator pursuant to this Agreement.

## ARTICLE 11 UNIT EXPENSE

**11.1 Basis of Charge to Working Interest Owners.** Unit Operator initially shall pay all Unit Expense. Each Working Interest Owner shall reimburse Unit Operator for its share of Unit Expense. Each Working Interest Owner's share shall be the same as its Unit Participation. All charges, credits, and accounting for Unit Expense shall be in accordance with Exhibit C.

**11.2 Advance Billings.** Unit Operator shall have the right to require Working Interest Owners to advance their respective shares of estimated Unit Expense as provided by Exhibit C.

**11.3 Commingling of Funds.** Funds received by Unit Operator under this Agreement need not be segregated or maintained by it as a separate fund, but may be commingled with its own funds.

**11.4 Unpaid Unit Expense.** If any Working Interest Owner fails or is unable to pay its share of Unit Expense within sixty (60) days after rendition of a statement therefor by Unit Operator, the non-defaulting Working Interest Owners shall, upon request by Unit Operator, pay the unpaid amount as if it were Unit Expense in the proportion that the Unit Participation of each such Working Interest Owner bears to the Unit Participation of all such Working Interest Owners. Each Working Interest Owner so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in Section 11.5 of this Agreement.

**11.5 Lien and Security Interest.** Each Working Interest Owner grants Unit Operator a lien upon its oil and gas rights in each Unitization Tract, a security interest in its share of

Unitized Substances when extracted and its interest in all Unitization Equipment, to secure payment of its share of Unitization Expense, with interest thereon at the rate set forth on Exhibit C, or the maximum interest rate allowed by law, whichever is the lesser. Unit Operator grants a like lien and security interest to Working Interest Owners to secure payment of Unit Operator's proportionate share of Unitization Expense. To the extent Unit Operator or Working Interest Owners have a security interest under the Uniform Commercial Code (the "Code") of the State of Texas, in which the Unitization is located, Unit Operator or Working Interest Owners shall be entitled to exercise the rights and remedies of a secured Working Interest Owner under the Code. The bringing of a suit and obtaining a judgment by Unit Operator or Working Interest Owners for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for payment. In addition, on default by any Working Interest Owner or the Unit Operator in the payment of its share of Unitization Expense, Unit Operator or Working Interest Owner shall have the right, without prejudice to other rights or remedies, to collect from the purchaser of production the proceeds from the sale of the Working Interest Owner's or Unit Operator's share of Unitized Substances until the amount owed by the Working Interest Owner or Unit Operator, plus interest, has been paid. Each purchaser shall be entitled to rely on Unit Operator's or Working Interest Owner's written statement concerning the amount of any default.

**11.6 Carved-out Interests.** Any overriding royalty, production payment, net proceeds interest, carried interest or any other interest carved out of a Working Interest shall be subject to this Agreement. If a Working Interest Owner does not pay its share of Unit Expense and the proceeds from the sale of Unitized Substances under Section 11.5 are insufficient for that purpose, the security rights provided for therein may be applied against the carved-out interests with which such Working Interest is burdened. In such event, the owner of such carved-out interest shall be subrogated to the security rights granted by Section 11.5.

**11.7 Default.** If any Working Interest Owner does not pay its share of Unit Expense when due, the Unit Operator may give such Working Interest Owner notice that unless payment is made within fifteen (15) days, such Working Interest Owner shall be in default. A Working Interest Owner shall be in default when payment is not made by the Working Interest Owner pursuant to this Agreement. Any Working Interest Owner in default shall not be entitled to vote on any matter until such time as said Working Interest Owner's payments are current. The voting interest of each Working Interest Owner entitled to vote on any issue shall be in the proportion its Unit Participation bears to the Unit Participation of all non-defaulting Working Interest Owners at the time. A Working Interest Owner in default will remain subject to the rights and obligations of this Agreement.

## ARTICLE 12 NONUNITIZED FORMATIONS

**12.1 Right to Operate.** Any Working Interest Owner that now has or hereafter acquires the right to drill for and produce oil, gas, or other minerals, from a formation underlying the Unit Area other than the Unitized Formation, shall have the right to do so notwithstanding this Agreement or the Unit Agreement. In exercising the right, however, such Working Interest Owner shall exercise care to prevent unreasonable interference with Unit Operations. No Person other than Unit Operator shall produce Unitized Substances. If any Working Interest Owner drills any well into or through the Unitized Formation, the Unitized Formation shall be protected in a manner satisfactory to Working Interest Owners so that the production of Unitized Substances will not be affected adversely.

**12.2 Multiple-completion Wells.** A Working Interest Owner who contributes a well completed in a non-unitized formation shall, prior to delivery of the well to Working Interest Owners and at its sole risk and expense, segregate such formation in a manner satisfactory to Working Interest Owners. Each Working Interest Owner reserves the right to use the well for the purpose of exploring, developing, and operating such other formations as may overlie or underlie the Unitized Formation pursuant to such conditions as Working Interest Owners may prescribe. A workover, reconditioning, or redrilling of a multiple completion well for the benefit of the non-unitized formation shall be at the sole risk and expense of the Working Interest

Owners who participate in production from the non-unitized formation. Operations for the benefit of the Unitized Formation shall be at the risk and expense of all Working Interest Owners; provided that, if extra expense is incurred in such an operation because of a multiple completion, the extra expense shall be borne by the Working Interest Owners who participate in production from the non-unitized formation. The term "extra expense" as used herein shall mean the difference between the normal charges incurred in such an operation and the normal charges for doing the same work on a well which is not a multiple completion. Unit Operator shall furnish the Working Interest Owners who participate in production from the non-unitized formation with an estimate of such charges prior to commencement of the work. Before any Working Interest Owner shall commence such an operation the permission of the Working Interest Owners must be secured. The interests of the unit shall prevail in the event of any conflict. Neither Working Interest Owners nor Unit Operator shall be liable for any damage to or loss of production from the non-unitized formation nor for damage to the property, equipment, or facilities used in development and operation of a multiple-completion well.

### **ARTICLE 13 LIABILITY, CLAIMS, AND SUITS**

**13.1 Individual Liability.** The duties, obligations, and liabilities of Working Interest Owners shall be several and not joint or collective; and nothing herein shall ever be construed as creating a partnership of any kind, joint venture, association, or trust among Working Interest Owners.

**13.2 Settlements.** Unit Operator may settle any single damage claim or suit involving Unit Operations if the expenditure does not exceed Fifty Thousand Dollars (\$50,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, Working Interest Owners shall determine the further handling of the claim or suit. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be an item of Unit Expense, subject to such limitation as is set forth in Exhibit C. If a claim is made against any Working Interest Owner or if any Working Interest Owner is sued on account of any matter arising from Unit Operations over which such Working Interest Owner individually has no control because of the rights given Working Interest Owners and Unit Operator by this Agreement and the Unit Agreement, the Working Interest Owner shall immediately notify Unit Operator, and the claim or suit shall be treated as any other claim or suit involving Unit Operations.

**13.3 Notice of Loss.** Unit Operator shall report to Working Interest Owners as soon as practicable after each occurrence, damage or loss to Unit Equipment, and each accident, occurrence, claim, or suit involving third party bodily injury or property damage not covered by insurance carried for the benefit of Working Interest Owners.

### **ARTICLE 14 NONDISCRIMINATION**

**14.1 Nondiscrimination.** During the performance of work under this Agreement, Unit Operator agrees to comply with all the provisions of subsections (1) through (7) of Section 202, Executive Order 11246 of September 24, 1965, as amended by Executive Order 11375 of October 13, 1967, and as subsequently amended, which are hereby incorporated by reference in this Agreement.

### **ARTICLE 15 NOTICES**

**15.1 Notices.** All notices required hereunder shall be in writing and shall be deemed to have been properly served when sent by mail, telegram or e-mail to the address of the representative of each Working Interest Owner as furnished to Unit Operator in accordance with Article 4.

**ARTICLE 16**  
**WITHDRAWAL OF WORKING INTEREST OWNER**

**16.1 Withdrawal.** A Working Interest Owner may withdraw from this Agreement by transferring, without warranty of title either express or implied, to the Working Interest Owners who do not desire to withdraw all its Oil and Gas Rights, exclusive of Royalty Interests, together with its interest in all Unit Equipment and in all wells used in Unit Operations, provided that such transfer shall not relieve such Working Interest Owner from any obligation or liability incurred prior to the first day of the month following receipt by Unit Operator of such transfer. The delivery of the transfer shall be made to Unit Operator for the transferees. The transferred interest shall be owned by the transferees in proportion to their respective Unit Participations. The transferees, in proportion to the respective interests so acquired, shall pay the transferor for its interest in Unit Equipment, the salvage value thereof less its share of the estimated cost of salvaging same and of plugging and abandoning all wells then being used or held for Unit Operations, as determined by Working Interest Owners. In the event such withdrawing owner's interest in the aforesaid salvage value is less than such owner's share of such estimated costs, the withdrawing owner, as a condition precedent to withdrawal, shall pay the Unit Operator, for the benefit of Working Interest Owners succeeding to its interest, a sum equal to the deficiency. Within sixty (60) days after receiving delivery of the transfer, Unit Operator shall render a final statement to the withdrawing owner for its share of Unit Expense, including any deficiency in salvage value, as determined by Working Interest Owners, incurred as of the first day of the month following the date of receipt of the transfer. Provided all Unit Expense, including any deficiency hereunder, due from the withdrawing owner has been paid in full within thirty (30) days after the rendering of such final statement by the Unit Operator, the transfer shall be effective the first day of the month following its receipt by Unit Operator and, as of such effective date, withdrawing owner shall be relieved from all further obligations and liabilities hereunder and under the Unit Agreement, and the rights of the withdrawing Working Interest Owner hereunder and under the Unit Agreement shall cease insofar as they existed by virtue of the interest transferred.

**16.2 Limitation on Withdrawal.** Notwithstanding anything set forth in Section 16.1, Working Interest Owners may refuse to permit the withdrawal of a Working Interest Owner if its Working Interest is burdened by any royalties, overriding royalties, production payments, net proceeds interest, carried interest, or any other interest created out of the Working Interest in excess of one-eighth (1/8) lessor's royalty, unless the other Working Interest Owners willing to accept the assignment agree to accept the Working Interest subject to such burdens.

**ARTICLE 17**  
**ABANDONMENT OF WELLS**

**17.1 Rights of Former Owners.** If Working Interest Owners determine to permanently abandon any well within the Unit Area prior to termination of the Unit Agreement, Unit Operator shall give written notice thereof to the Working Interest Owners of the Tract on which the well is located, and they shall have the option for a period of sixty (60) days after the sending of such notice to notify Unit Operator in writing of their election to take over and own the well. Within ten (10) days after the Working Interest Owners of the Tract have notified Unit Operator of their election to take over the well, they shall pay Unit Operator, for credit to the joint account, the amount determined by Working Interest Owners to be the net salvage value of the casing and equipment, through the wellhead, in and on the well. The Working Interest Owners of the Tract, by taking over the well, agree to seal off the Unitized Formation, and upon abandonment to plug the well in compliance with applicable laws and regulations.

**17.2 Plugging.** If the Working Interest Owners of a Tract do not elect to take over a well located within the Unit Area that is proposed for abandonment, Unit Operator shall plug and abandon the well in compliance with applicable laws and regulations.

**ARTICLE 18**  
**EFFECTIVE DATE AND TERM**

**18.1 Effective Date.** This Agreement shall become effective when the

Unit Agreement becomes effective.

**18.2 Term.** This Agreement shall continue in effect so long as the Unit Agreement remains in effect, and thereafter until (a) all Unit wells have been plugged and abandoned or turned over to Working Interest Owners in accordance with Article 19; (b) all Unit Equipment and real property acquired for the joint account have been disposed of by Unit Operator in accordance with instructions of Working Interest Owners; and (c) there has been a final accounting.

## **ARTICLE 19 ABANDONMENT OF OPERATIONS**

**19.1 Termination.** Upon termination of the Unit Agreement, the following will occur:

**19.1.1 Oil and Gas Rights.** Oil and Gas Rights in and to each separate Tract shall no longer be affected by this Agreement, and thereafter the parties shall be governed by the terms and provisions of the leases, contracts, and other instruments affecting the separate Tracts.

**19.1.2 Right to Operate.** Working Interest Owners of any Tract that desire to take over and continue to operate wells located thereon may do so by paying Unit Operator, for credit to the joint account, the net salvage value, as determined by Working Interest Owners, of the casing and equipment, through the wellhead, in and on the wells taken over and by agreeing upon abandonment to plug each well in compliance with applicable laws and regulations.

**19.1.3 Salvaging Wells.** Unit Operator shall salvage as much of the casing and equipment in or on wells not taken over by Working Interest Owners of separate Tracts as can economically and reasonably be salvaged, and shall cause the wells to be plugged and abandoned in compliance with applicable laws and regulations.

**19.1.4 Cost of Abandonment.** The cost of abandonment of Unit Operations shall be Unit Expense.

**19.1.5 Distribution of Assets.** Working Interest Owners shall share in the distribution of Unit Equipment, or the proceeds thereof, in proportion to their Unit Participations.

## **ARTICLE 20 APPROVAL**

**20.1 Original, Counterpart, or Other Instrument.** An owner of a Working Interest may approve this Agreement and become a party to the same by signing the original, a counterpart thereof, or other instrument approving this Agreement. The signing of any such instrument shall have the same effect as if all Persons had signed the same instrument.

## **ARTICLE 21 SUCCESSORS AND ASSIGNS**

**21.1 Successors and Assigns.** This Agreement shall extend to, be binding upon, and inure to the benefit of the Persons hereto and their respective heirs, devisees, legal representatives, successors, and assigns, and shall constitute a covenant running with the lands, leases, and interests covered hereby.

IN WITNESS WHEREOF, the Persons hereto have approved this Agreement on the dates under their respective signatures.



Exhibit "A"

Attached to and made a part of that certain Unit Agreement covering the  
BOBBI STATE WATERFLOOD UNIT  
LEA COUNTY, NM

DESCRIPTION OF TRACTS AND TRACT PARTICIPATION

The Bobbi State Waterflood Unit covers all of the below described lands insofar as they overlay the Unitized Formation as defined in Article 1.11 of the Unit Agreement to which this exhibit is attached and are designated by the Tract Letters assigned below, to-wit:

Tract 1

Tract Participation 0.05357143

Tract Description The Northeast Quarter (NE/4) and the East Half of the Southeast Quarter (E/2 SE/4), of Section 20, T18S, R36E, containing 240 acres, more or less.  
State of New Mexico Lease V0-8283-0001

Tract 2

Tract Participation 0.00892857

Tract Description The Northeast Quarter of the Northwest Quarter (NE/4 NW/4) of Section 20, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease LG-1869-0001

Tract 3

Tract Participation 0.00892857

Tract Description The Southwest Quarter of the Northwest Quarter (SW/4 NW/4) of Section 20, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease LG-1869-0001

Tract 4

Tract Participation 0.13972957

Tract Description The Southwest of the Northwest Quarter (SW/4 NW/4), of Section 20, T18S, R35E, containing 40 acres, more or less.  
State of New Mexico Lease LG-1869-0001

Tract 5

Tract Participation 0.00892857

Tract Description The Northeast Quarter of the Northwest Quarter (NE/4 NW/4), of Section 20, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease LG-1869-0001

Tract 6

Tract Participation 0.04736739

Tract Description The Northwest Quarter of the Southeast Quarter (NW/4 SE/4) of Section 20, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease V0-8283-0001

Tract 7

Tract Participation 0.00892857

Tract Description The Northeast Quarter of the Southwest Quarter (NE/4 SW/4) of Section 20, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease LG-1869-0001

Tract 8

Tract Participation 0.05813176

Tract Description The Northwest Quarter of the Southwest Quarter (NW/4 SW/4), of Section 20, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease LG-1869-0001

Tract 9

Tract Participation 0.00892857

Tract Description The Southwest Quarter of the Southwest Quarter (SW/4 SW/4), of Section 20, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease LG-1869-0001

Tract 10

Tract Participation 0.16001447

Tract Description The Southeast Quarter of the Southwest Quarter (SE/4 SW/4) of Section 20, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease LG-1869-0001

Tract 11

Tract Participation 0.07398855

Tract Description The Southwest Quarter of the Southeast Quarter (SW/4 SE/4) of Section 20, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease V0-8283-0001

Tract 12

Tract Participation 0.00892857

Tract Description The Northeast Quarter of the Northeast Quarter (NE/4 NE/4), of Section 29, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease B-2317-0013

Tract 13

Tract Participation 0.13954063

Tract Description The Northwest Quarter of the Northeast Quarter (NW/4 NE/4), of Section 29, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease B-2317-0013

Tract 14

Tract Participation 0.11709552

Tract Description The Northeast Quarter of the Northwest Quarter (NE/4 NW/4) of Section 29, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease B-2317-0013

Tract 15

Tract Participation 0.00892857

Tract Description The Northwest Quarter of the Northwest Quarter (NW/4 NW/4), of Section 29, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease B-2317-0013

Tract 16

Tract Participation 0.00892857

Tract Description The Southwest Quarter of the Northwest Quarter (SW/4 NW/4), of Section 29, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease B-2317-0013

Tract 17

Tract Participation 0.00892857

Tract Description The Southeast Quarter of the Northwest Quarter (SE/4 NW/4), of Section 29, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease B-2317-0013

Tract 18

Tract Participation 0.00892857

Tract Description The Southwest Quarter of the Northeast Quarter (SW/4 NE/4), of Section 29, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease B-2317-0013

Tract 19

Tract Participation 0.00892857

Tract Description The Southeast Quarter of the Northeast Quarter (SE/4 NE/4), of Section 29, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease B-2317-0013

Tract 20

Tract Participation 0.02678571

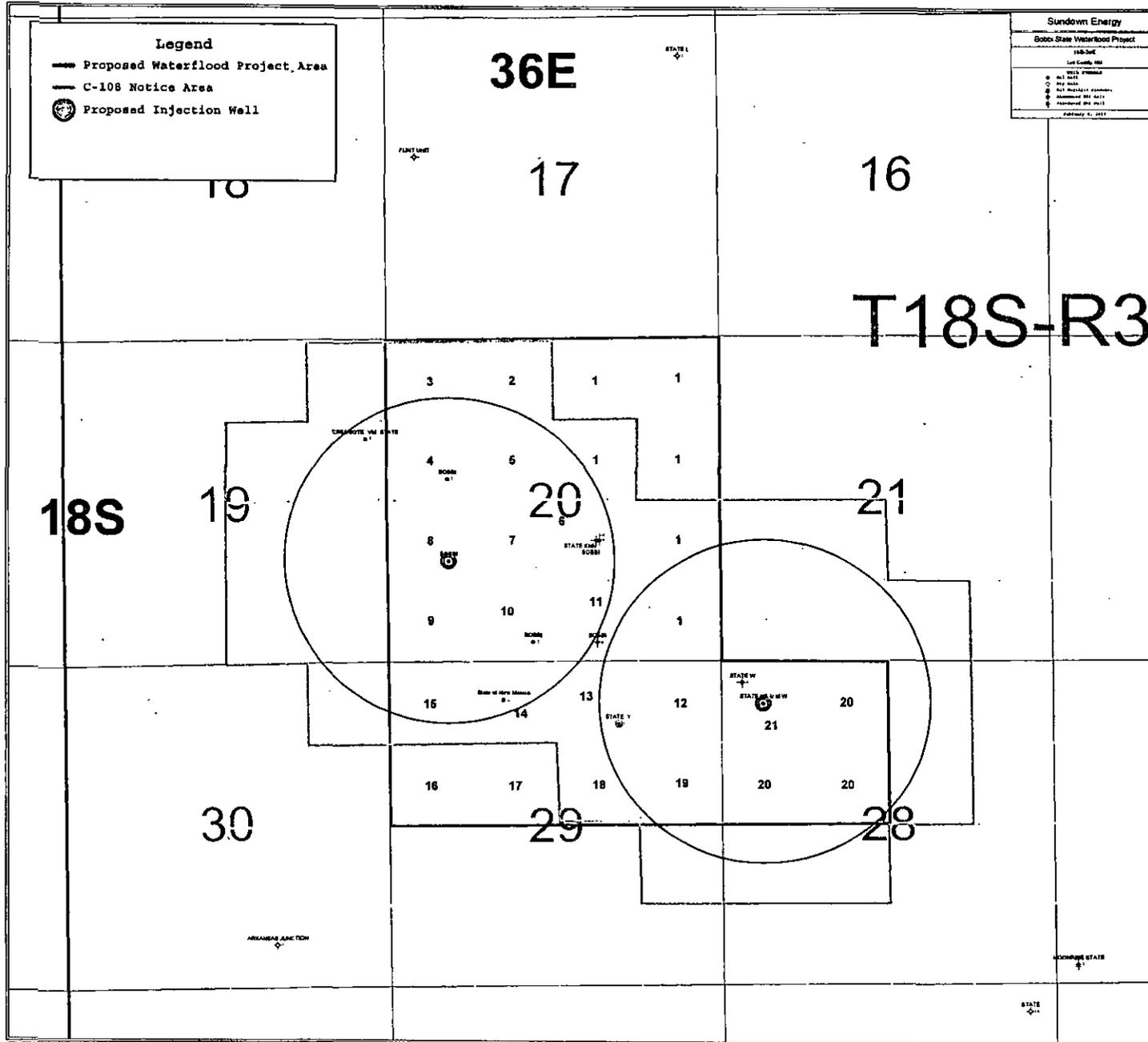
Tract Description The Northeast Quarter of the Northwest Quarter (NE/4 NW/4) and the South Half of the Northwest Quarter (S/2 NW/4), of Section 28, T18S, R36E, containing 120 acres, more or less.  
State of New Mexico Lease VB-2050-0001

Tract 21

Tract Participation 0.08556069

Tract Description The Northwest Quarter of the Northwest Quarter (NW/4 NW/4), of Section 28, T18S, R36E, containing 40 acres, more or less.  
State of New Mexico Lease VB-1968-0000

Exhibit "B"



## EXHIBIT " C "

### ACCOUNTING PROCEDURE JOINT OPERATIONS

1 Attached to and made part of that certain Unit Operating Agreement dated May 2, 2013, covering the Bobbi State Waterflood Unit, Lea County,  
2 New Mexico.

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#### I. GENERAL PROVISIONS

8 **IF THE PARTIES FAIL TO SELECT EITHER ONE OF COMPETING "ALTERNATIVE" PROVISIONS, OR SELECT ALL THE**  
9 **COMPETING "ALTERNATIVE" PROVISIONS, ALTERNATIVE 1 IN EACH SUCH INSTANCE SHALL BE DEEMED TO HAVE**  
10 **BEEN ADOPTED BY THE PARTIES AS A RESULT OF ANY SUCH OMISSION OR DUPLICATE NOTATION.**

12 **IN THE EVENT THAT ANY "OPTIONAL" PROVISION OF THIS ACCOUNTING PROCEDURE IS NOT ADOPTED BY THE**  
13 **PARTIES TO THE AGREEMENT BY A TYPED, PRINTED OR HANDWRITTEN INDICATION, SUCH PROVISION SHALL NOT**  
14 **FORM A PART OF THIS ACCOUNTING PROCEDURE, AND NO INFERENCE SHALL BE MADE CONCERNING THE INTENT**  
15 **OF THE PARTIES IN SUCH EVENT.**

#### 1. DEFINITIONS

19 All terms used in this Accounting Procedure shall have the following meaning, unless otherwise expressly defined in the Agreement:

21 "Affiliate" means for a person, another person that controls, is controlled by, or is under common control with that person. In this  
22 definition, (a) control means the ownership by one person, directly or indirectly, of more than fifty percent (50%) of the voting securities  
23 of a corporation or, for other persons, the equivalent ownership interest (such as partnership interests), and (b) "person" means an  
24 individual, corporation, partnership, trust, estate, unincorporated organization, association, or other legal entity.

26 "Agreement" means the operating agreement, farmout agreement, or other contract between the Parties to which this Accounting  
27 Procedure is attached.

29 "Controllable Material" means Material that, at the time of acquisition or disposition by the Joint Account, as applicable, is so classified  
30 in the Material Classification Manual most recently recommended by the Council of Petroleum Accountants Societies (COPAS).

32 "Equalized Freight" means the procedure of charging transportation cost to the Joint Account based upon the distance from the nearest  
33 Railway Receiving Point to the property.

35 "Excluded Amount" means a specified excluded trucking amount most recently recommended by COPAS.

37 "Field Office" means a structure, or portion of a structure, whether a temporary or permanent installation, the primary function of which is  
38 to directly serve daily operation and maintenance activities of the Joint Property and which serves as a staging area for directly chargeable  
39 field personnel.

41 "First Level Supervision" means those employees whose primary function in Joint Operations is the direct oversight of the Operator's  
42 field employees and/or contract labor directly employed On-site in a field operating capacity. First Level Supervision functions may  
43 include, but are not limited to:

- 45 • Responsibility for field employees and contract labor engaged in activities that can include field operations, maintenance,  
46 construction, well remedial work, equipment movement and drilling
- 47 • Responsibility for day-to-day direct oversight of rig operations
- 48 • Responsibility for day-to-day direct oversight of construction operations
- 49 • Coordination of job priorities and approval of work procedures
- 50 • Responsibility for optimal resource utilization (equipment, Materials, personnel)
- 51 • Responsibility for meeting production and field operating expense targets
- 52 • Representation of the Parties in local matters involving community, vendors, regulatory agents and landowners, as an incidental  
53 part of the supervisor's operating responsibilities
- 54 • Responsibility for all emergency responses with field staff
- 55 • Responsibility for implementing safety and environmental practices
- 56 • Responsibility for field adherence to company policy
- 57 • Responsibility for employment decisions and performance appraisals for field personnel
- 58 • Oversight of sub-groups for field functions such as electrical, safety, environmental, telecommunications, which may have group  
59 or team leaders.

61 "Joint Account" means the account showing the charges paid and credits received in the conduct of the Joint Operations that are to be  
62 shared by the Parties, but does not include proceeds attributable to hydrocarbons and by-products produced under the Agreement.

64 "Joint Operations" means all operations necessary or proper for the exploration, appraisal, development, production, protection,  
65 maintenance, repair, abandonment, and restoration of the Joint Property.



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**"Joint Property"** means the real and personal property subject to the Agreement.

**"Laws"** means any laws, rules, regulations, decrees, and orders of the United States of America or any state thereof and all other governmental bodies, agencies, and other authorities having jurisdiction over or affecting the provisions contained in or the transactions contemplated by the Agreement or the Parties and their operations, whether such laws now exist or are hereafter amended, enacted, promulgated or issued.

**"Material"** means personal property, equipment, supplies, or consumables acquired or held for use by the Joint Property.

**"Non-Operators"** means the Parties to the Agreement other than the Operator.

**"Offshore Facilities"** means platforms, surface and subsea development and production systems, and other support systems such as oil and gas handling facilities, living quarters, offices, shops, cranes, electrical supply equipment and systems, fuel and water storage and piping, heliport, marine docking installations, communication facilities, navigation aids, and other similar facilities necessary in the conduct of offshore operations, all of which are located offshore.

**"Off-site"** means any location that is not considered On-site as defined in this Accounting Procedure.

**"On-site"** means on the Joint Property when in direct conduct of Joint Operations. The term "On-site" shall also include that portion of Offshore Facilities, Shore Base Facilities, fabrication yards, and staging areas from which Joint Operations are conducted, or other facilities that directly control equipment on the Joint Property, regardless of whether such facilities are owned by the Joint Account.

**"Operator"** means the Party designated pursuant to the Agreement to conduct the Joint Operations.

**"Parties"** means legal entities signatory to the Agreement or their successors and assigns. Parties shall be referred to individually as "Party."

**"Participating Interest"** means the percentage of the costs and risks of conducting an operation under the Agreement that a Party agrees, or is otherwise obligated, to pay and bear.

**"Participating Party"** means a Party that approves a proposed operation or otherwise agrees, or becomes liable, to pay and bear a share of the costs and risks of conducting an operation under the Agreement.

**"Personal Expenses"** means reimbursed costs for travel and temporary living expenses.

**"Railway Receiving Point"** means the railhead nearest the Joint Property for which freight rates are published, even though an actual railhead may not exist.

**"Shore Base Facilities"** means onshore support facilities that during Joint Operations provide such services to the Joint Property as a receiving and transshipment point for Materials; debarkation point for drilling and production personnel and services; communication, scheduling and dispatching center; and other associated functions serving the Joint Property.

**"Supply Store"** means a recognized source or common stock point for a given Material item.

**"Technical Services"** means services providing specific engineering, geoscience, or other professional skills, such as those performed by engineers, geologists, geophysicists, and technicians, required to handle specific operating conditions and problems for the benefit of Joint Operations; provided, however, Technical Services shall not include those functions specifically identified as overhead under the second paragraph of the introduction of Section III (*Overhead*). Technical Services may be provided by the Operator, Operator's Affiliate, Non-Operator, Non-Operator Affiliates, and/or third parties.

**2. STATEMENTS AND BILLINGS**

The Operator shall bill Non-Operators on or before the last day of the month for their proportionate share of the Joint Account for the preceding month. Such bills shall be accompanied by statements that identify the AFE (authority for expenditure), lease or facility, and all charges and credits summarized by appropriate categories of investment and expense. Controllable Material shall be separately identified and fully described in detail, or at the Operator's option, Controllable Material may be summarized by major Material classifications. Intangible drilling costs, audit adjustments, and unusual charges and credits shall be separately and clearly identified.

The Operator may make available to Non-Operators any statements and bills required under Section 1.2 and/or Section 1.3.A (*Advances and Payments by the Parties*) via email, electronic data interchange, internet websites or other equivalent electronic media in lieu of paper copies. The Operator shall provide the Non-Operators instructions and any necessary information to access and receive the statements and bills within the timeframes specified herein. A statement or billing shall be deemed as delivered twenty-four (24) hours (exclusive of weekends and holidays) after the Operator notifies the Non-Operator that the statement or billing is available on the website and/or sent via email or electronic data interchange transmission. Each Non-Operator individually shall elect to receive statements and billings electronically, if available from the Operator, or request paper copies. Such election may be changed upon thirty (30) days prior written notice to the Operator.



## 3. ADVANCES AND PAYMENTS BY THE PARTIES

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- A. Unless otherwise provided for in the Agreement, the Operator may require the Non-Operators to advance their share of the estimated cash outlay for the succeeding month's operations within fifteen (15) days after receipt of the advance request or by the first day of the month for which the advance is required, whichever is later. The Operator shall adjust each monthly billing to reflect advances received from the Non-Operators for such month. If a refund is due, the Operator shall apply the amount to be refunded to the subsequent month's billing or advance, unless the Non-Operator sends the Operator a written request for a cash refund. The Operator shall remit the refund to the Non-Operator within fifteen (15) days of receipt of such written request.
- B. Except as provided below, each Party shall pay its proportionate share of all bills in full within fifteen (15) days of receipt date. If payment is not made within such time, the unpaid balance shall bear interest compounded monthly at the prime rate published by the *Wall Street Journal* on the first day of each month the payment is delinquent, plus three percent (3%), per annum, or the maximum contract rate permitted by the applicable usury Laws governing the Joint Property, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts. If the *Wall Street Journal* ceases to be published or discontinues publishing a prime rate, the unpaid balance shall bear interest compounded monthly at the prime rate published by the Federal Reserve plus three percent (3%), per annum. Interest shall begin accruing on the first day of the month in which the payment was due. Payment shall not be reduced or delayed as a result of inquiries or anticipated credits unless the Operator has agreed. Notwithstanding the foregoing, the Non-Operator may reduce payment, provided it furnishes documentation and explanation to the Operator at the time payment is made, to the extent such reduction is caused by:
- (1) being billed at an incorrect working interest or Participating Interest that is higher than such Non-Operator's actual working interest or Participating Interest, as applicable; or
  - (2) being billed for a project or AFE requiring approval of the Parties under the Agreement that the Non-Operator has not approved or is not otherwise obligated to pay under the Agreement; or
  - (3) being billed for a property in which the Non-Operator no longer owns a working interest, provided the Non-Operator has furnished the Operator a copy of the recorded assignment or letter in-lieu. Notwithstanding the foregoing, the Non-Operator shall remain responsible for paying bills attributable to the interest it sold or transferred for any bills rendered during the thirty (30) day period following the Operator's receipt of such written notice; or
  - (4) charges outside the adjustment period, as provided in Section I.4 (*Adjustments*).

## 7 4. ADJUSTMENTS

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- A. Payment of any such bills shall not prejudice the right of any Party to protest or question the correctness thereof; however, all bills and statements, including payout statements, rendered during any calendar year shall conclusively be presumed to be true and correct, with respect only to expenditures, after twenty-four (24) months following the end of any such calendar year, unless within said period a Party takes specific detailed written exception thereto making a claim for adjustment. The Operator shall provide a response to all written exceptions, whether or not contained in an audit report, within the time periods prescribed in Section I.5 (*Expenditure Audits*).
- B. All adjustments initiated by the Operator, except those described in items (1) through (4) of this Section I.4.B, are limited to the twenty-four (24) month period following the end of the calendar year in which the original charge appeared or should have appeared on the Operator's Joint Account statement or payout statement. Adjustments that may be made beyond the twenty-four (24) month period are limited to adjustments resulting from the following:
- (1) a physical inventory of Controllable Material as provided for in Section V (*Inventories of Controllable Material*), or
  - (2) an offsetting entry (whether in whole or in part) that is the direct result of a specific joint interest audit exception granted by the Operator relating to another property, or
  - (3) a government/regulatory audit, or
  - (4) a working interest ownership or Participating Interest adjustment.

## 7 5. EXPENDITURE AUDITS

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- A. A Non-Operator, upon written notice to the Operator and all other Non-Operators, shall have the right to audit the Operator's accounts and records relating to the Joint Account within the twenty-four (24) month period following the end of such calendar year in which such bill was rendered; however, conducting an audit shall not extend the time for the taking of written exception to and the adjustment of accounts as provided for in Section I.4 (*Adjustments*). Any Party that is subject to payout accounting under the Agreement shall have the right to audit the accounts and records of the Party responsible for preparing the payout statements, or of the Party furnishing information to the Party responsible for preparing payout statements. Audits of payout accounts may include the volumes of hydrocarbons produced and saved and proceeds received for such hydrocarbons as they pertain to payout accounting required under the Agreement. Unless otherwise provided in the Agreement, audits of a payout account shall be conducted within the twenty-four (24) month period following the end of the calendar year in which the payout statement was rendered.

Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct a joint audit in a manner that will result in a minimum of inconvenience to the Operator. The Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator. The audits shall not be conducted more than once each year without prior approval of the Operator, except upon the resignation or removal of the Operator, and shall be made at the expense of



COPAS those Non-Operators approving such audit.

The Non-Operator leading the audit (hereinafter "lead audit company") shall issue the audit report within ninety (90) days after completion of the audit testing and analysis; however, the ninety (90) day time period shall not extend the twenty-four (24) month requirement for taking specific detailed written exception as required in Section 1.4.A (*Adjustments*) above. All claims shall be supported with sufficient documentation.

A timely filed written exception or audit report containing written exceptions (hereinafter "written exceptions") shall, with respect to the claims made therein, preclude the Operator from asserting a statute of limitations defense against such claims, and the Operator hereby waives its right to assert any statute of limitations defense against such claims for so long as any Non-Operator continues to comply with the deadlines for resolving exceptions provided in this Accounting Procedure. If the Non-Operators fail to comply with the additional deadlines in Section 1.5.B or 1.5.C, the Operator's waiver of its rights to assert a statute of limitations defense against the claims brought by the Non-Operators shall lapse, and such claims shall then be subject to the applicable statute of limitations, provided that such waiver shall not lapse in the event that the Operator has failed to comply with the deadlines in Section 1.5.B or 1.5.C.

B. The Operator shall provide a written response to all exceptions in an audit report within one hundred eighty (180) days after Operator receives such report. Denied exceptions should be accompanied by a substantive response. If the Operator fails to provide substantive response to an exception within this one hundred eighty (180) day period, the Operator will owe interest on that exception or portion thereof, if ultimately granted, from the date it received the audit report. Interest shall be calculated using the rate set forth in Section 1.3.B (*Advances and Payments by the Parties*).

C. The lead audit company shall reply to the Operator's response to an audit report within ninety (90) days of receipt, and the Operator shall reply to the lead audit company's follow-up response within ninety (90) days of receipt; provided, however, each Non-Operator shall have the right to represent itself if it disagrees with the lead audit company's position or believes the lead audit company is not adequately fulfilling its duties. Unless otherwise provided for in Section 1.5.E, if the Operator fails to provide substantive response to an exception within this ninety (90) day period, the Operator will owe interest on that exception or portion thereof, if ultimately granted, from the date it received the audit report. Interest shall be calculated using the rate set forth in Section 1.3.B (*Advances and Payments by the Parties*).

D. If any Party fails to meet the deadlines in Sections 1.5.B or 1.5.C or if any audit issues are outstanding fifteen (15) months after Operator receives the audit report, the Operator or any Non-Operator participating in the audit has the right to call a resolution meeting, as set forth in this Section 1.5.D or it may invoke the dispute resolution procedures included in the Agreement, if applicable. The meeting will require one month's written notice to the Operator and all Non-Operators participating in the audit. The meeting shall be held at the Operator's office or mutually agreed location, and shall be attended by representatives of the Parties with authority to resolve such outstanding issues. Any Party who fails to attend the resolution meeting shall be bound by any resolution reached at the meeting. The lead audit company will make good faith efforts to coordinate the response and positions of the Non-Operator participants throughout the resolution process; however, each Non-Operator shall have the right to represent itself. Attendees will make good faith efforts to resolve outstanding issues, and each Party will be required to present substantive information supporting its position. A resolution meeting may be held as often as agreed to by the Parties. Issues unresolved at one meeting may be discussed at subsequent meetings until each such issue is resolved.

If the Agreement contains no dispute resolution procedures and the audit issues cannot be resolved by negotiation, the dispute shall be submitted to mediation. In such event, promptly following one Party's written request for mediation, the Parties to the dispute shall choose a mutually acceptable mediator and share the costs of mediation services equally. The Parties shall each have present at the mediation at least one individual who has the authority to settle the dispute. The Parties shall make reasonable efforts to ensure that the mediation commences within sixty (60) days of the date of the mediation request. Notwithstanding the above, any Party may file a lawsuit or complaint (1) if the Parties are unable after reasonable efforts, to commence mediation within sixty (60) days of the date of the mediation request, (2) for statute of limitations reasons, or (3) to seek a preliminary injunction or other provisional judicial relief, if in its sole judgment an injunction or other provisional relief is necessary to avoid irreparable damage or to preserve the status quo. Despite such action, the Parties shall continue to try to resolve the dispute by mediation.

E.  (*Optional Provision – Forfeiture Penalties*)

*If the Non-Operators fail to meet the deadline in Section 1.5.C, any unresolved exceptions that were not addressed by the Non-Operators within one (1) year following receipt of the last substantive response of the Operator shall be deemed to have been withdrawn by the Non-Operators. If the Operator fails to meet the deadlines in Section 1.5.B or 1.5.C, any unresolved exceptions that were not addressed by the Operator within one (1) year following receipt of the audit report or receipt of the last substantive response of the Non-Operators, whichever is later, shall be deemed to have been granted by the Operator and adjustments shall be made, without interest, to the Joint Account.*

6. APPROVAL BY PARTIES

A. GENERAL MATTERS

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, the



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.

This Section 1.6.A applies to specific situations of limited duration where a Party proposes to change the accounting for charges from that prescribed in this Accounting Procedure. This provision does not apply to amendments to this Accounting Procedure, which are covered by Section 1.6.B.

**B. AMENDMENTS**

If the Agreement to which this Accounting Procedure is attached contains no contrary provisions in regard thereto, this Accounting Procedure can be amended by an affirmative vote of two (2) or more Parties, one of which is the Operator, having a combined working interest of at least Seventy Five percent (75 %), which approval shall be binding on all Parties, provided, however, approval of at least one (1) Non-Operator shall be required.

**C. AFFILIATES**

For the purpose of administering the voting procedures of Sections 1.6.A and 1.6.B, if Parties to this Agreement are Affiliates of each other, then such Affiliates shall be combined and treated as a single Party having the combined working interest or Participating Interest of such Affiliates.

For the purposes of administering the voting procedures in Section 1.6.A, if a Non-Operator is an Affiliate of the Operator, votes under Section 1.6.A shall require the majority in interest of the Non-Operator(s) after excluding the interest of the Operator's Affiliate.

**II. DIRECT CHARGES**

The Operator shall charge the Joint Account with the following items:

**1. RENTALS AND ROYALTIES**

Lease rentals and royalties paid by the Operator, on behalf of all Parties, for the Joint Operations.

**2. LABOR**

A. Salaries and wages, including incentive compensation programs as set forth in COPAS MFI-37 ("Chargeability of Incentive Compensation Programs"), for:

- (1) Operator's field employees directly employed On-site in the conduct of Joint Operations,
- (2) Operator's employees directly employed on Shore Base Facilities, Offshore Facilities, or other facilities serving the Joint Property if such costs are not charged under Section II.6 (*Equipment and Facilities Furnished by Operator*) or are not a function covered under Section III (*Overhead*),
- (3) Operator's employees providing First Level Supervision,
- (4) Operator's employees providing On-site Technical Services for the Joint Property if such charges are excluded from the overhead rates in Section III (*Overhead*),
- (5) Operator's employees providing Off-site Technical Services for the Joint Property if such charges are excluded from the overhead rates in Section III (*Overhead*).

Charges for the Operator's employees identified in Section II.2.A may be made based on the employee's actual salaries and wages, or in lieu thereof, a day rate representing the Operator's average salaries and wages of the employee's specific job category.

Charges for personnel chargeable under this Section II.2.A who are foreign nationals shall not exceed comparable compensation paid to an equivalent U.S. employee pursuant to this Section II.2, unless otherwise approved by the Parties pursuant to Section 1.6.A (*General Matters*).

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 Section II.2.A, excluding severance payments or other termination allowances. Such costs under this Section II.2.B 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 Section II.2.A. 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 that are applicable to costs chargeable to the Joint Account under Sections II.2.A and B.



**COPAS** Personal Expenses of personnel whose salaries and wages are chargeable to the Joint Account under Section II.2.A when the expenses are incurred in connection with directly chargeable activities.

- E. Reasonable relocation costs incurred in transferring to the Joint Property personnel whose salaries and wages are chargeable to the Joint Account under Section II.2.A. Notwithstanding the foregoing, relocation costs that result from reorganization or merger of a Party, or that are for the primary benefit of the Operator, shall not be chargeable to the Joint Account. Extraordinary relocation costs, such as those incurred as a result of transfers from remote locations, such as Alaska or overseas, shall not be charged to the Joint Account unless approved by the Parties pursuant to Section I.6.A (*General Matters*).
- F. Training costs as specified in COPAS MFI-35 ("Charging of Training Costs to the Joint Account") for personnel whose salaries and wages are chargeable under Section II.2.A. This training charge shall include the wages, salaries, training course cost, and Personal Expenses incurred during the training session. The training cost shall be charged or allocated to the property or properties directly benefiting from the training. The cost of the training course shall not exceed prevailing commercial rates, where such rates are available.
- G. Operator's current cost of established plans for employee benefits, as described in COPAS MFI-27 ("Employee Benefits Chargeable to Joint Operations and Subject to Percentage Limitation"), applicable to the Operator's labor costs chargeable to the Joint Account under Sections II.2.A and B based on the Operator's actual cost not to exceed the employee benefits limitation percentage most recently recommended by COPAS.
- H. Award payments to employees, in accordance with COPAS MFI-49 ("Awards to Employees and Contractors") for personnel whose salaries and wages are chargeable under Section II.2.A.

### 3. MATERIAL

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

### 4. TRANSPORTATION

- A. Transportation of the Operator's, Operator's Affiliate's, or contractor's personnel necessary for Joint Operations.
- B. Transportation of Material between the Joint Property and another property, or from the Operator's warehouse or other storage point to the Joint Property, shall be charged to the receiving property using one of the methods listed below. Transportation of Material from the Joint Property to the Operator's warehouse or other storage point shall be paid for by the Joint Property using one of the methods listed below:
  - (1) If the actual trucking charge is less than or equal to the Excluded Amount the Operator may charge actual trucking cost or a theoretical charge from the Railway Receiving Point to the Joint Property. The basis for the theoretical charge is the per hundred weight charge plus fuel surcharges from the Railway Receiving Point to the Joint Property. The Operator shall consistently apply the selected alternative.
  - (2) If the actual trucking charge is greater than the Excluded Amount, the Operator shall charge Equalized Freight. Accessorial charges such as loading and unloading costs, split pick-up costs, detention, call out charges, and permit fees shall be charged directly to the Joint Property and shall not be included when calculating the Equalized Freight.

### 5. SERVICES

The cost of contract services, equipment, and utilities used in the conduct of Joint Operations, except for contract services, equipment, and utilities covered by Section III (*Overhead*), or Section II.7 (*Affiliates*), or excluded under Section II.9 (*Legal Expense*). Awards paid to contractors shall be chargeable pursuant to COPAS MFI-49 ("Awards to Employees and Contractors").

The costs of third party Technical Services are chargeable to the extent excluded from the overhead rates under Section III (*Overhead*).

### 6. EQUIPMENT AND FACILITIES FURNISHED BY OPERATOR

In the absence of a separately negotiated agreement, equipment and facilities furnished by the Operator will be charged as follows:

- A. The Operator shall charge the Joint Account for use of Operator-owned equipment and facilities, including but not limited to production facilities, Shore Base Facilities, Offshore Facilities, and Field Offices, at rates commensurate with the costs of ownership and operation. The cost of Field Offices shall be chargeable to the extent the Field Offices provide direct service to personnel who are chargeable pursuant to Section II.2.A (*Labor*). Such rates may include labor, maintenance, repairs, other operating expense, insurance, taxes, depreciation using straight line depreciation method, and interest on gross investment less accumulated depreciation not to exceed twelve percent (12%) per annum; provided, however, depreciation shall not be charged when the



equipment and facilities investment have been fully depreciated. The rate may include an element of the estimated cost for abandonment, reclamation, and dismantlement. Such rates shall not exceed the average commercial rates currently prevailing in the immediate area of the Joint Property.

B. In lieu of charges in Section II.6.A above, the Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property, less twenty percent (20%). If equipment and facilities are charged under this Section II.6.B, the Operator shall adequately document and support commercial rates and shall periodically review and update the rate and the supporting documentation. For automotive equipment, the Operator may elect to use rates published by the Petroleum Motor Transport Association (PMTA) or such other organization recognized by COPAS as the official source of rates.

**7. AFFILIATES**

A. Charges for an Affiliate's goods and/or services used in operations requiring an AFE or other authorization from the Non-Operators may be made without the approval of the Parties provided (i) the Affiliate is identified and the Affiliate goods and services are specifically detailed in the approved AFE or other authorization, and (ii) the total costs for such Affiliate's goods and services billed to such individual project do not exceed \$ 125% of the amount specified on the AFE / ~~If the total costs for an Affiliate's goods and services charged to such individual project are not specifically detailed in the approved AFE or authorization or exceed such amount, charges for such Affiliate shall require approval of the Parties, pursuant to Section I.6.A (General Matters).~~

B. For an Affiliate's goods and/or services used in operations not requiring an AFE or other authorization from the Non-Operators, charges for such Affiliate's goods and services shall require approval of the Parties, pursuant to Section I.6.A (General Matters), if the charges exceed \$ 50,000 in a given calendar year.

C. The cost of the Affiliate's goods or services shall not exceed average commercial rates prevailing in the area of the Joint Property, unless the Operator obtains the Non-Operators' approval of such rates. The Operator shall adequately document and support commercial rates and shall periodically review and update the rate and the supporting documentation; provided, however, documentation of commercial rates shall not be required if the Operator obtains Non-Operator approval of its Affiliate's rates or charges prior to billing Non-Operators for such Affiliate's goods and services. Notwithstanding the foregoing, direct charges for Affiliate-owned communication facilities or systems shall be made pursuant to Section II.12 (Communications).

If the Parties fail to designate an amount in Sections II.7.A or II.7.B, in each instance the amount deemed adopted by the Parties as a result of such omission shall be the amount established as the Operator's expenditure limitation in the Agreement. If the Agreement does not contain an Operator's expenditure limitation, the amount deemed adopted by the Parties as a result of such omission shall be zero dollars (\$ 0.00).

**8. DAMAGES AND LOSSES TO JOINT PROPERTY**

All costs or expenses necessary for the repair or replacement of Joint Property resulting from damages or losses incurred, except to the extent such damages or losses result from a Party's or Parties' gross negligence or willful misconduct, in which case such Party or Parties shall be solely liable.

The Operator shall furnish the Non-Operator written notice of damages or losses incurred as soon as practicable after a report has been received by the Operator.

**9. LEGAL EXPENSE**

Recording fees and costs of handling, settling, or otherwise discharging litigation, claims, and liens incurred in or resulting from operations under the Agreement, or necessary to protect or recover the Joint Property, to the extent permitted under the Agreement. Costs of the Operator's or Affiliate's legal staff or outside attorneys, including fees and expenses, are not chargeable unless approved by the Parties pursuant to Section I.6.A (General Matters) or otherwise provided for in the Agreement.

Notwithstanding the foregoing paragraph, costs for procuring abstracts, fees paid to outside attorneys for title examinations (including preliminary, supplemental, shut-in royalty opinions, division order title opinions), and curative work shall be chargeable to the extent permitted as a direct charge in the Agreement.

**10. TAXES AND PERMITS**

All taxes and permitting fees of every kind and nature, assessed or levied upon or in connection with the Joint Property, or the production therefrom, and which have been paid by the Operator for the benefit of the Parties, including penalties and interest, except to the extent the penalties and interest result from the Operator's gross negligence or willful misconduct.

If ad valorem taxes paid by the Operator are based in whole or in part upon separate valuations of each Party's working interest, then notwithstanding any contrary provisions, the charges to the Parties will be made in accordance with the tax value generated by each Party's working interest.



**COPAS** Costs of tax consultants or advisors, the Operator's employees, or Operator's Affiliate employees in matters regarding ad valorem or other tax matters, are not permitted as direct charges unless approved by the Parties pursuant to Section 1.6.A (*General Matters*).

Charges to the Joint Account resulting from sales/use tax audits, including extrapolated amounts and penalties and interest, are permitted, provided the Non-Operator shall be allowed to review the invoices and other underlying source documents which served as the basis for tax charges and to determine that the correct amount of taxes were charged to the Joint Account. If the Non-Operator is not permitted to review such documentation, the sales/use tax amount shall not be directly charged unless the Operator can conclusively document the amount owed by the Joint Account.

**11. INSURANCE**

Net premiums paid for insurance required to be carried for Joint Operations for the protection of the Parties. If Joint Operations are conducted at locations where the Operator acts as self-insurer in regard to its worker's compensation and employer's liability insurance obligation, the Operator shall charge the Joint Account manual rates for the risk assumed in its self-insurance program as regulated by the jurisdiction governing the Joint Property. In the case of offshore operations in federal waters, the manual rates of the adjacent state shall be used for personnel performing work On-site, and such rates shall be adjusted for offshore operations by the U.S. Longshoreman and Harbor Workers (USL&H) or Jones Act surcharge, as appropriate.

**12. COMMUNICATIONS**

Costs of acquiring, leasing, installing, operating, repairing, and maintaining communication facilities or systems, including satellite, radio and microwave facilities, between the Joint Property and the Operator's office(s) directly responsible for field operations in accordance with the provisions of COPAS MFI-44 ("Field Computer and Communication Systems"). If the communications facilities or systems serving the Joint Property are Operator-owned, charges to the Joint Account shall be made as provided in Section 11.6 (*Equipment and Facilities Furnished by Operator*). If the communication facilities or systems serving the Joint Property are owned by the Operator's Affiliate, charges to the Joint Account shall not exceed average commercial rates prevailing in the area of the Joint Property. The Operator shall adequately document and support commercial rates and shall periodically review and update the rate and the supporting documentation.

**13. ECOLOGICAL, ENVIRONMENTAL, AND SAFETY**

Costs incurred for Technical Services and drafting to comply with ecological, environmental and safety Laws or standards recommended by Occupational Safety and Health Administration (OSHA) or other regulatory authorities. All other labor and functions incurred for ecological, environmental and safety matters, including management, administration, and permitting, shall be covered by Sections 11.2 (*Labor*), 11.5 (*Services*), or Section III (*Overhead*), as applicable.

Costs to provide or have available pollution containment and removal equipment plus actual costs of control and cleanup and resulting responsibilities of oil and other spills as well as discharges from permitted outfalls as required by applicable Laws, or other pollution containment and removal equipment deemed appropriate by the Operator for prudent operations, are directly chargeable.

**14. ABANDONMENT AND RECLAMATION**

Costs incurred for abandonment and reclamation of the Joint Property, including costs required by lease agreements or by Laws.

**15. OTHER EXPENDITURES**

Any other expenditure not covered or dealt with in the foregoing provisions of this Section II (*Direct Charges*), or in Section III (*Overhead*) and which is of direct benefit to the Joint Property and is incurred by the Operator in the necessary and proper conduct of the Joint Operations. Charges made under this Section 11.15 shall require approval of the Parties, pursuant to Section 1.6.A (*General Matters*).

**III. OVERHEAD**

As compensation for costs not specifically identified as chargeable to the Joint Account pursuant to Section II (*Direct Charges*), the Operator shall charge the Joint Account in accordance with this Section III.

Functions included in the overhead rates regardless of whether performed by the Operator, Operator's Affiliates or third parties and regardless of location, shall include, but not be limited to, costs and expenses of:

- warehousing, other than for warehouses that are jointly owned under this Agreement
- design and drafting (except when allowed as a direct charge under Sections 11.13, 11.1.A(ii), and 11.2, Option B)
- inventory costs not chargeable under Section V (*Inventories of Controllable Material*)
- procurement
- administration
- accounting and auditing
- gas dispatching and gas chart integration





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(b) Charges for any well undergoing any type of workover, recompletion, and/or abandonment for a period of five (5) or more consecutive work-days shall be made at the Drilling Well Rate. Such charges shall be applied for the period from date operations, with rig or other units used in operations, commence through date of rig or other unit release, except that no charges shall be made during suspension of operations for fifteen (15) or more consecutive calendar days.

(3) Application of Overhead—Producing Well Rate shall be as follows:

- (a) An active well that is produced, injected into for recovery or disposal, or used to obtain water supply to support operations for any portion of the month shall be considered as a one-well charge for the entire month.
- (b) Each active completion in a multi-completed well shall be considered as a one-well charge provided each completion is considered a separate well by the governing regulatory authority.
- (c) A one-well charge shall be made for the month in which plugging and abandonment operations are completed on any well, unless the Drilling Well Rate applies, as provided in Sections III.1.B.(2)(a) or (b). This one-well charge shall be made whether or not the well has produced.
- (d) An active gas well shut in because of overproduction or failure of a purchaser, processor, or transporter to take production shall be considered as a one-well charge provided the gas well is directly connected to a permanent sales outlet.
- (e) Any well not meeting the criteria set forth in Sections III.1.B.(3) (a), (b), (c), or (d) shall not qualify for a producing overhead charge.

(4) The well rates shall be adjusted on the first day of April each year following the effective date of the Agreement, provided, however, if this Accounting Procedure is attached to or otherwise governing the payout accounting under a farmout agreement, the rates shall be adjusted on the first day of April each year following the effective date of such farmout agreement. The adjustment shall be computed by applying the adjustment factor most recently published by COPAS. The adjusted rates shall be the initial or amended rates agreed to by the Parties increased or decreased by the adjustment factor described herein, for each year from the effective date of such rates, in accordance with COPAS MFI-47 ("Adjustment of Overhead Rates").

~~C. OVERHEAD—PERCENTAGE BASIS~~

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

- ~~(a) Development Rate \_\_\_\_\_ percent (\_\_\_\_\_) % of the cost of development of the Joint Property, exclusive of costs provided under Section II.9 (Legal Expense) and all Material salvage credits.~~
- ~~(b) Operating Rate \_\_\_\_\_ percent (\_\_\_\_\_) % of the cost of operating the Joint Property, exclusive of costs provided under Sections II.1 (Rentals and Royalties) and II.9 (Legal Expense); all Material salvage credits; the value of substances purchased for enhanced recovery; all property and ad valorem taxes, and any other taxes and assessments that 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:~~

- ~~(a) The Development Rate shall be applied to all costs in connection with:
 
  - ~~[i] drilling, redrilling, sidetracking, or deepening of a well~~
  - ~~[ii] a well undergoing plugback or workover operations for a period of five (5) or more consecutive work days~~
  - ~~[iii] preliminary expenditures necessary in preparation for drilling~~
  - ~~[iv] expenditures incurred in abandoning when the well is not completed as a producer~~
  - ~~[v] construction or installation of fixed assets, the expansion of fixed assets and any other project clearly discernible as a fixed asset other than Major Construction or Catastrophe as defined in Section III.2 (Overhead Major Construction and Catastrophe).~~~~
- ~~(b) The Operating Rate shall be applied to all other costs in connection with Joint Operations, except those subject to Section III.2 (Overhead Major Construction and Catastrophe).~~

**2. OVERHEAD—MAJOR CONSTRUCTION AND CATASTROPHE**

To compensate the Operator for overhead costs incurred in connection with a Major Construction project or Catastrophe, the Operator shall either negotiate a rate prior to the beginning of the project, or shall charge the Joint Account for overhead based on the following rates for any Major Construction project in excess of the Operator's expenditure limit under the Agreement, or for any Catastrophe regardless of the amount. If the Agreement to which this Accounting Procedure is attached does not contain an expenditure limit, Major Construction Overhead shall be assessed for any single Major Construction project costing in excess of \$100,000 gross.



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Major Construction shall mean 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, or in the dismantlement, abandonment, removal, and restoration of platforms, production equipment, and other operating facilities.

Catastrophe is defined as a sudden calamitous event bringing damage, loss, or destruction to property or the environment, such as an oil spill, blowout, explosion, fire, storm, hurricane, or other disaster. The overhead rate shall be applied to those costs necessary to restore the Joint Property to the equivalent condition that existed prior to the event.

A. If the Operator absorbs the engineering, design and drafting costs related to the project:

- (1)   5   % of total costs if such costs are less than \$100,000; plus
- (2)   3   % of total costs in excess of \$100,000 but less than \$1,000,000; plus
- (3)   1   % of total costs in excess of \$1,000,000.

B. If the Operator charges engineering, design and drafting costs related to the project directly to the Joint Account:

- (1)   5   % of total costs if such costs are less than \$100,000; plus
- (2)   3   % of total costs in excess of \$100,000 but less than \$1,000,000; plus
- (3)   1   % 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 Major Construction project shall not be treated separately, and the cost of drilling and workover wells and purchasing and installing pumping units and downhole artificial lift equipment shall be excluded. For Catastrophes, the rates shall be applied to all costs associated with each single occurrence or event.

On each project, the Operator shall advise the Non-Operator(s) in advance which of the above options shall apply.

For the purposes of calculating Catastrophe Overhead, the cost of drilling relief wells, substitute wells, or conducting other well operations directly resulting from the catastrophic event shall be included. Expenditures to which these rates apply shall not be reduced by salvage or insurance recoveries. Expenditures that qualify for Major Construction or Catastrophe Overhead shall not qualify for overhead under any other overhead provisions.

In the event of any conflict between the provisions of this Section III.2 and the provisions of Sections II.2 (*Labor*), II.5 (*Services*), or II.7 (*Affiliates*), the provisions of this Section III.2 shall govern.

### 3. AMENDMENT OF OVERHEAD RATES

The overhead rates provided for in this Section III may be amended from time to time if, in practice, the rates are found to be insufficient or excessive, in accordance with the provisions of Section I.6.B (*Amendments*).

## IV. MATERIAL PURCHASES, TRANSFERS, AND DISPOSITIONS

The Operator is responsible for Joint Account Material and shall make proper and timely charges and credits for direct purchases, transfers, and dispositions. The Operator shall provide all Material for use in the conduct of Joint Operations; however, Material may be supplied by the Non-Operators, at the Operator's option. Material furnished by any Party shall be furnished without any express or implied warranties as to quality, fitness for use, or any other matter.

### 1. DIRECT PURCHASES

Direct purchases shall be charged to the Joint Account at the price paid by the Operator after deduction of all discounts received. The Operator shall make good faith efforts to take discounts offered by suppliers, but shall not be liable for failure to take discounts except to the extent such failure was the result of the Operator's gross negligence or willful misconduct. A direct purchase shall be deemed to occur when an agreement is made between an Operator and a third party for the acquisition of Material for a specific well site or location. Material provided by the Operator under "vendor stocking programs," where the initial use is for a Joint Property and title of the Material does not pass from the manufacturer, distributor, or agent until usage, is considered a direct purchase. If Material is found to be defective or is returned to the manufacturer, distributor, or agent for any other reason, credit shall be passed to the Joint Account within sixty (60) days after the Operator has received adjustment from the manufacturer, distributor, or agent.



2. TRANSFERS

1 A transfer is determined to occur when the Operator (i) furnishes Material from a storage facility or from another operated property, (ii) has  
2 assumed liability for the storage costs and changes in value, and (iii) has previously secured and held title to the transferred Material.  
3 Similarly, the removal of Material from the Joint Property to a storage facility or to another operated property is also considered a transfer;  
4 provided, however, Material that is moved from the Joint Property to a storage location for safe-keeping pending disposition may remain  
5 charged to the Joint Account and is not considered a transfer. Material shall be disposed of in accordance with Section IV.3 (*Disposition of  
6 Surplus*) and the Agreement to which this Accounting Procedure is attached.

7 A. PRICING

8 The value of Material transferred to/from the Joint Property should generally reflect the market value on the date of physical transfer.  
9 Regardless of the pricing method used, the Operator shall make available to the Non-Operators sufficient documentation to verify the  
0 Material valuation. When higher than specification grade or size tubulars are used in the conduct of Joint Operations, the Operator  
1 shall charge the Joint Account at the equivalent price for well design specification tubulars, unless such higher specification grade or  
2 sized tubulars are approved by the Parties pursuant to Section I.6.A (*General Matters*). Transfers of new Material will be priced  
3 using one of the following pricing methods; provided, however, the Operator shall use consistent pricing methods, and not alternate  
4 between methods for the purpose of choosing the method most favorable to the Operator for a specific transfer:

- 5
- 6 (1) Using published prices in effect on date of movement as adjusted by the appropriate COPAS Historical Price Multiplier (HPM)  
7 or prices provided by the COPAS Computerized Equipment Pricing System (CEPS).
    - 8 (a) For oil country tubulars and line pipe, the published price shall be based upon eastern mill carload base prices (Houston,  
9 Texas, for special end) adjusted as of date of movement, plus transportation cost as defined in Section IV.2.B (*Freight*).  
0
    - 1 (b) For other Material, the published price shall be the published list price in effect at date of movement, as listed by a Supply  
2 Store nearest the Joint Property where like Material is normally available, or point of manufacture plus transportation  
3 costs as defined in Section IV.2.B (*Freight*).  
4
  - 5 (2) Based on a price quotation from a vendor that reflects a current realistic acquisition cost.
  - 6 (3) Based on the amount paid by the Operator for like Material in the vicinity of the Joint Property within the previous twelve (12)  
7 months from the date of physical transfer.
  - 8 (4) As agreed to by the Participating Parties for Material being transferred to the Joint Property, and by the Parties owning the  
9 Material for Material being transferred from the Joint Property.  
0

1 B. FREIGHT

2 Transportation costs shall be added to the Material transfer price using the method prescribed by the COPAS Computerized  
3 Equipment Pricing System (CEPS). If not using CEPS, transportation costs shall be calculated as follows:

- 4
- 5 (1) Transportation costs for oil country tubulars and line pipe shall be calculated using the distance from eastern mill to the  
6 Railway Receiving Point based on the carload weight basis as recommended by the COPAS MFI-38 ("Material Pricing  
7 Manual") and other COPAS MFIs in effect at the time of the transfer.
  - 8 (2) Transportation costs for special mill items shall be calculated from that mill's shipping point to the Railway Receiving Point.  
9 For transportation costs from other than eastern mills, the 30,000-pound interstate truck rate shall be used. Transportation costs  
0 for macaroni tubing shall be calculated based on the interstate truck rate per weight of tubing transferred to the Railway  
1 Receiving Point.
  - 2 (3) Transportation costs for special end tubular goods shall be calculated using the interstate truck rate from Houston, Texas, to the  
3 Railway Receiving Point.
  - 4 (4) Transportation costs for Material other than that described in Sections IV.2.B.(1) through (3), shall be calculated from the  
5 Supply Store or point of manufacture, whichever is appropriate, to the Railway Receiving Point  
6

7 Regardless of whether using CEPS or manually calculating transportation costs, transportation costs from the Railway Receiving Point  
8 to the Joint Property are in addition to the foregoing, and may be charged to the Joint Account based on actual costs incurred. All  
9 transportation costs are subject to Equalized Freight as provided in Section II.4 (*Transportation*) of this Accounting Procedure.  
0

1 C. TAXES

2 Sales and use taxes shall be added to the Material transfer price using either the method contained in the COPAS Computerized  
3 Equipment Pricing System (CEPS) or the applicable tax rate in effect for the Joint Property at the time and place of transfer. In either  
4 case, the Joint Account shall be charged or credited at the rate that would have governed had the Material been a direct purchase.  
5  
6





**DISPOSITION OF SURPLUS**

Surplus Material is that Material, whether new or used, that is no longer required for Joint Operations. The Operator may purchase, but shall be under no obligation to purchase, the interest of the Non-Operators in surplus Material.

Dispositions for the purpose of this procedure are considered to be the relinquishment of title of the Material from the Joint Property to either a third party, a Non-Operator, or to the Operator. To avoid the accumulation of surplus Material, the Operator should make good faith efforts to dispose of surplus within twelve (12) months through buy/sale agreements, trade, sale to a third party, division in kind, or other dispositions as agreed to by the Parties.

Disposal of surplus Materials shall be made in accordance with the terms of the Agreement to which this Accounting Procedure is attached. If the Agreement contains no provisions governing disposal of surplus Material, the following terms shall apply:

- The Operator may, through a sale to an unrelated third party or entity, dispose of surplus Material having a gross sale value that is less than or equal to the Operator's expenditure limit as set forth in the Agreement to which this Accounting Procedure is attached without the prior approval of the Parties owning such Material.
- If the gross sale value exceeds the Agreement expenditure limit, the disposal must be agreed to by the Parties owning such Material.
- Operator may purchase surplus Condition "A" or "B" Material without approval of the Parties owning such Material, based on the pricing methods set forth in Section IV.2 (*Transfers*).
- Operator may purchase Condition "C" Material without prior approval of the Parties owning such Material if the value of the Materials, based on the pricing methods set forth in Section IV.2 (*Transfers*), is less than or equal to the Operator's expenditure limitation set forth in the Agreement. The Operator shall provide documentation supporting the classification of the Material as Condition C.
- Operator may dispose of Condition "D" or "E" Material under procedures normally utilized by Operator without prior approval of the Parties owning such Material.

**4. SPECIAL PRICING PROVISIONS**

**A. PREMIUM PRICING**

Whenever Material is available only at inflated prices due to national emergencies, strikes, government imposed foreign trade restrictions, or other unusual causes over which the Operator has no control, for direct purchase the Operator may charge the Joint Account for the required Material at the Operator's actual cost incurred in providing such Material, making it suitable for use, and moving it to the Joint Property. Material transferred or disposed of during premium pricing situations shall be valued in accordance with Section IV.2 (*Transfers*) or Section IV.3 (*Disposition of Surplus*), as applicable.

**B. SHOP-MADE ITEMS**

Items fabricated by the Operator's employees, or by contract laborers under the direction of the Operator, shall be priced using the value of the Material used to construct the item plus the cost of labor to fabricate the item. If the Material is from the Operator's scrap or junk account, the Material shall be priced at either twenty-five percent (25%) of the current price as determined in Section IV.2.A (*Pricing*) or scrap value, whichever is higher. In no event shall the amount charged exceed the value of the item commensurate with its use.

**C. MILL REJECTS**

Mill rejects purchased as "limited service" casing or tubing shall be priced at eighty percent (80%) of K-55/J-55 price as determined in Section IV.2 (*Transfers*). Line pipe converted to casing or tubing with casing or tubing couplings attached shall be priced as K-55/J-55 casing or tubing at the nearest size and weight.

**V. INVENTORIES OF CONTROLLABLE MATERIAL**

The Operator shall maintain records of Controllable Material charged to the Joint Account, with sufficient detail to perform physical inventories.

Adjustments to the Joint Account by the Operator resulting from a physical inventory of Controllable Material shall be made within twelve (12) months following the taking of the inventory or receipt of Non-Operator inventory report. Charges and credits for overages or shortages will be valued for the Joint Account in accordance with Section IV.2 (*Transfers*) and shall be based on the Condition "B" prices in effect on the date of physical inventory unless the inventorying Parties can provide sufficient evidence another Material condition applies.



**V.1. DIRECTED INVENTORIES**

Physical inventories shall be performed by the Operator upon written request of a majority in working interests of the Non-Operators (hereinafter, "directed inventory"); provided, however, the Operator shall not be required to perform directed inventories more frequently than once every five (5) years. Directed inventories shall be commenced within one hundred eighty (180) days after the Operator receives written notice that a majority in interest of the Non-Operators has requested the inventory. All Parties shall be governed by the results of any directed inventory.

Expenses of directed inventories will be borne by the Joint Account; provided, however, costs associated with any post-report follow-up work in settling the inventory will be absorbed by the Party incurring such costs. The Operator is expected to exercise judgment in keeping expenses within reasonable limits. Any anticipated disproportionate or extraordinary costs should be discussed and agreed upon prior to commencement of the inventory. Expenses of directed inventories may include the following:

- A. A per diem rate for each inventory person, representative of actual salaries, wages, and payroll burdens and benefits of the personnel performing the inventory or a rate agreed to by the Parties pursuant to Section 1.6.A (*General Matters*). The per diem rate shall also be applied to a reasonable number of days for pre-inventory work and report preparation.
- B. Actual transportation costs and Personal Expenses for the inventory team.
- C. Reasonable charges for report preparation and distribution to the Non-Operators.

**2. NON-DIRECTED INVENTORIES**

**A. OPERATOR INVENTORIES**

Physical inventories that are not requested by the Non-Operators may be performed by the Operator, at the Operator's discretion. The expenses of conducting such Operator-initiated inventories shall not be charged to the Joint Account.

**B. NON-OPERATOR INVENTORIES**

Subject to the terms of the Agreement to which this Accounting Procedure is attached, the Non-Operators may conduct a physical inventory at reasonable times at their sole cost and risk after giving the Operator at least ninety (90) days prior written notice. The Non-Operator inventory report shall be furnished to the Operator in writing within ninety (90) days of completing the inventory fieldwork.

**C. SPECIAL INVENTORIES**

The expense of conducting inventories other than those described in Sections V.1 (*Directed Inventories*), V.2.A (*Operator Inventories*), or V.2.B (*Non-Operator Inventories*), shall be charged to the Party requesting such inventory; provided, however, inventories required due to a change of Operator shall be charged to the Joint Account in the same manner as described in Section V.1 (*Directed Inventories*).

EXHIBIT "D"

INSURANCE TO BE CARRIED

Attached to and made a part of that certain Unit Operating Agreement dated May 2, 2013, covering the Bobbi State Waterflood Unit, Lea County, New Mexico.

- A. Workman's Compensation Insurance to cover liability imposed by the laws of the state having jurisdiction, with Employer's Liability Insurance of at least \$1,000,000 per occurrence.
- B. Public Liability Insurance covering all operations (including Contractual Liability) with Bodily Injury and Property Limits of not less than \$1,000,000 combined single limit per occurrence and not less than \$2,000,000 combined single limit for the general aggregate and \$1,000,000 combined single limit for the products/completed operations aggregate.
- C. Automobile Public Liability (including all owned, non-owned and hired cars) and Property Damage Insurance in amount of not less than \$1,000,000 combined single limit per occurrence and aggregate.
- D. Umbrella Liability Insurance in excess of A., B., & C. above in an amount of not less than \$10,000,000 per occurrence.
- E. Control of Well - Operator's Extra Expense Insurance in the minimum amount of \$5,000,000 with a maximum \$100,000 deductible per occurrence. Non-Operating working interest owners that elect not to participate to the extent of their respective working interest percentages are required to provide written notice to Operator of said election prior to the commencement of actual operation on any well drilled hereunder. Failure by any Non-Operator working interest owner to provide said required written election in a timely manner shall be deemed an election to participate in same. A proportionate part of the premiums associated with this insurance shall be charged to the Joint Account on an equitable basis consistent with Operator's practices.
- F. All losses and expenditures caused or incurred by Operator as a result of operations under this Operating Agreement for which Operator is not required to carry insurance shall be charged to the Joint Account.
- G. Each party shall have the right to acquire at its own cost such additional insurance as it desires to protect itself against any liability not covered by the insurance described above which is maintained by Operator for the joint account. All insurance maintained by any party to this Agreement shall contain a waiver by the insurance company of all rights of subrogation in favor of the parties hereto. Liability, except that covered by insurance carried by Operator for the joint account, against any of the parties hereto for damages to property of third persons or injury to or death of third persons arising out of the joint operations, including expenses incurred in defending claims or actions asserting liability of this character, shall be borne severally and not jointly by the parties hereto (or their respective insurers) in proportion to their respective undivided interests in the joint operation. All insurance carried by Operator hereunder for the joint account shall be considered primary in relation to any other insurance carried by any party hereto.
- H. Fire, windstorm, tornado, explosion, vandalism, malicious mischief, or other extended perils insurance will not be carried by Operator to protect the joint interests. Therefore, the account of the parties shall be charged with all expenditures incurred as a result of fire, windstorm, tornado, explosion, vandalism, malicious mischief, or other casualties for which insurance is not required hereunder.
- I. Inasmuch as Operator has agreed with each party to this Agreement to acquire, construct, operate and maintain the joint account operations on a cost basis without profit to Operator, each such party hereby releases Operator from all claims for loss by or damage to, such party arising out of, in connection with, or as an incident to, any act or omission, including negligence (but excluding gross negligence, willful misconduct, or intentional breach of any provision of the Operating Agreement) of Operator or its employees, agents or contractors, in acquiring, operating or maintaining the joint account. The obligations of each party under this Agreement are several and not joint with any other party hereto.
- J. Operator shall require contractors and subcontractors performing work for the joint account to provide such insurance as deemed necessary by operator in relation to the work to be performed by said contractors or subcontractors.
- K. Non-Operators shall each be included as an additional insured under all policies of insurance carried by Operator pursuant hereto. Certificates of such insurance shall be obtained by Operator and furnished to Non-Operators. Each such certificate shall provide that the insurance described therein may not be cancelled without notice of at least thirty (30) days being given to Non-Operators prior to the date of the intended cancellation.
- L. Each party, at its sole cost, shall have the right to acquire and maintain at its own cost the insurance described in clause D. above with respect to its interest hereunder, provided that the limits maintained are not less than the limits actually maintained by Operator and that such insurance is provided by reputable insurers, not affiliated with the insured party, with financial standing satisfactory to Operator. Any party electing to acquire such insurance shall furnish a certificate or certificates thereof executed by the insurers providing such insurance certifying that the required coverages are in full force and effect and will not be terminated, modified or cancelled without at least thirty (30) days written notice to Operator. Any party which acquired and maintains at its own cost the insurance described in clause D. above and provides Operator certificates thereof shall not be charged for the insurance maintained by Operator pursuant to clause D. hereof as long as such insurance maintained by such party remains in effect.

END OF EXHIBIT "D"

