MONTGOMERY
& ANDREWS
LAW FIRM

J. Scott Hall
Office: (505) 982-3873
Email: shall@montand.com
Reply To: Santa Fe Office
www.montand.com

June 16, 2014

Ms. Jami Bailey, Director
New Mexico Oil Conservation Division
1220 S. St. Francis Drive
Santa Fe, NM 87505

Hand Delivered

Re: NMOCD Case No. 15157: Application of Read Operating Company, LLC for Compulsory Pooling and Designation as Operator, Lea County, New Mexico

Dear Ms. Bailey:

On behalf of Magnum Hunter Production, Inc., and Cimarex Energy Co. of Colorado, enclosed for filing is an original and one copy of the following:

1. Motion to Dismiss; and
2. Motion for Continuance.

Thank you.

Very truly yours,
/s/ Loretta Baca, Assistant to J. Scott Hall

Enclosures

574758

325 Paseo de Peralta
Santa Fe, New Mexico 87501

T: 505.982.3873
F: 505.982.4289

P.O. Box 2307
Santa Fe, New Mexico 87504-2307

STATE OF NEW MEXICO
DEPARTMENT OF ENERGY, MINERALS AND NATURAL RESOURCES
OIL CONSERVATION DIVISION

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APPLICATION OF READ OPERATING COMPANY, LLC FOR COMPULSORY POOLING AND DESIGNATION AS OPERATOR, LEA COUNTY, NEW MEXICO

Case No. 15157

MOTION TO DISMISS

Magnum Hunter Production, Inc. ("Magnum Hunter") moves the Division enter its order dismissing the Application for Compulsory Pooling and Designation of Operator filed on behalf of Read Operating Company, LLC ("ROC") in this matter. In support of its motion, Magnum Hunter states:

By its Application in this matter, ROC asks the Division to enter an order pooling the interests of Magnum Hunter and fifteen others in the W/2 E/2 of Section 9, Township 20 South, Range 34 East, NMPM in Lea County. ROC's Application must be dismissed for two separate but equally compelling reasons: (1) The lands and formation described in the application are subject to a pre-existing Joint Operating Agreement and are not available to be force pooled. (2) ROC failed to include in its Application, notice or advertisement any request for an exception to the acreage dedication requirements of the applicable pool rules or for approval of a non-standard spacing and proration unit.

BACKGROUND FACTS

ROC seeks an order pooling certain "contractual working interests" in the Bone Spring formation in the W/2 E/2 of Section 9. ROC's Application identifies Read Operating Company, LLC as being an affiliate of Read & Stevens, Inc.

Magnum Hunter Production, Inc., through its affiliate, Cimarex Energy Co. of Colorado, both wholly owned subsidiaries of Cimarex Energy Co., is the designated successor operator of Section 9 and other lands described under that Operating Agreement dated August 1, 1979, by and between Estoril Producing Corporation, as Operator, and Fred M. Allison, et al, as Non-Operators (the "1979 JOA"). In 2004 Magnum Hunter acquired the interests of Unocal and became successor operator under the JOA.

The JOA covers the following Contract Area located in Township 20 South, Range 34 East in Lea County, New Mexico:

Section 4 S/2

Section 5 S/2

Section 8 All

Section 9 All

Section 10 SW/4 - Since removed from Contract Area

"Limited from 5,000 feet below the surface down to and including the base of the Morrow formation"

A copy of the 1979 JOA is attached hereto as Exhibit 1. Article XIII. TERM OF AGREEMENT provides under Option No. 1, that the term of the JOA shall last "So long as any of the oil and gas leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise, and or so long as oil and/or gas production continues from any lease or oil and gas interest." A schedule showing all of the wells drilled under the JOA is attached

as Exhibit 2. These wells have produced or continue to produce, maintaining the JOA and the Contract Area oil and gas leases in effect.

Article VI. DRILLING AND DEVELOPMENT at subpart B authorizes any party to the JOA to submit a written proposal to the other parties for the drilling of any well on the Contract Area. Such wells are to be drilled by Operator designated in Article V.

ROC did not submit a valid well proposal as specified under the 1979 JOA. Instead, by letter dated April 25, 2014, ROC and Read & Stevens, Inc. proposed to drill the Lea 9 Fed No. 2H horizontal well in the Bone Spring formation underlying the W/2 E/2 of Section 9, T20S R34E. The well proposal was accompanied by a proposed operating agreement dated April 15, 2014 describing the E/2 and W/2 of Section 9 as Contract Areas "A" and "B", but with the same vertical limits as the 1979 JOA. The proposed JOA shows ROC as Operator, but ROC and Read & Stevens are the only signatories. (The well proposal and cover page of the proposed JOA are attached as Exhibit 3.)

On May 21, 2014, Magnum Hunter sent a letter to Read & Stevens and ROC objecting to ROC's April 25, 2014 well proposal (Exhibit 4). Read & Stevens and ROC did not reply. On June 12, 2014, Magnum Hunter wrote to Read & Stevens and the other parties and proposed the drilling of the Union Federal 9 No. 2H well under the 1979 JOA. Magnum Hunter's Union Federal 9 No. 2H is to be drilled horizontally to the Bone Spring formation underlying the W/2 E/2 of Section 9 T20S R34E. (Exhibit 5). Again, Read & Stevens did not reply to Magnum Hunter, applying instead to the Division for a compulsory pooling order.

1. **The Lands In Section 9 Are Not Available To Be Force Pooled.**

Under the operation of NMSA § 70-2-17(C) and established Division precedent, there is no basis for the exercise of the Division's compulsory pooling authority in this case, and consequently, ROC's Application must be dismissed.

Under the pooling statute, ROC has the burden of affirmatively proving that the owners of mineral interests in a spacing unit "have not agreed to pool their interests...". Such a showing is a mandatory pre-condition to the exercise of the Division's authority to pool property interests under § 70-2-17(C). It is a showing that ROC cannot make and therefore the only proper course of action for the Division is the dismissal of ROC's Application.

I. SECTION 70-2-17 REQUIRES THE DIVISION TO DETERMINE WHETHER OR NOT A VOLUNTARY AGREEMENT EXISTS BEFORE IT CAN FORCE POOL THESE WORKING INTERESTS.

The Division must necessarily address the voluntary agreement issue before it exercises its police powers to consolidate real property interests under the compulsory pooling statute. Typically, the compulsory pooling orders that the Division issues contain an express finding to the following effect:

> "(_) There are interest owners in the subject proration unit
> that have not agreed to pool their interests."

Such a finding have been included in hundreds of compulsory pooling orders for decades now, and the industry has come to rely on the Division's manner of interpreting and exercising its authority under the pooling statute. As such, the Division's consistent interpretation and application of the pooling statute is established as a form of legal

precedent.[1] The Division's standard practice of considering evidence of and making a finding on the voluntary agreement issue fulfills the directive under the pooling statute. In other words, the Division does not exercise its authority until it first makes a finding that "[the] owners have not agreed to pool their interests and develop their lands as a unit."[2] *See Sims v. Mechem,* 72 N.M. 186, 382 P.2d 183 (1963): ("Unquestionably, the [Division] is authorized to require pooling of property *when such pooling has not been agreed upon by the parties.*" *Emphasis added.*) Notably, ROC's application implicitly recognizes the existing agreement when it identifies the "contractual" working interest owners it seeks to pool as those parties to the 1979 Operating Agreement. Application, ¶5. Magnum Hunter asks that the Division do nothing more than make a proper finding that these working interests are not subject to pooling as they are voluntarily committed under a pre-existing operating agreement. Conversely, a finding that the parties have not agreed to pool their interests would operate as an effective nullification of a private agreement that far exceeds the invocation of the Divisions authority under § 70-2-17 (C).

Disputes of this nature are not new to the Division. Precedent orders from a number of compulsory pooling cases support the dismissal of ROC's Application in this case. Examples:

Case No. 8606: Order No. R-8013: *Application of Doyle Hartman for Simultaneous Dedication and Compulsory Pooling, Lea County, New Mexico.* In 1985, the Applicant, Doyle Hartman sought to force pool lands that were subject to a 1951

[1] See Chisolm v. Defense Logistics Agency 656 F.2d 42,47 (3'd. Cir. 1981).
[2] Section 70-2-17(C) says, in part, "Where, however, such owner or owners have not agreed to pool their interests...the division...shall pool all or any part of such lands or interest or both in the spacing or proration unit as a unit."

Operating Agreement entered into by the parties' predecessors in interest. The compulsory pooling portion of the application was denied due to the Applicant's failure to provide evidence to refute that the operating agreement was not binding.

Case No. 10658: Order No. R-9841: *Application of Mewbourne Oil Company for Compulsory Pooling, Eddy County, New Mexico.* In 1993, the Applicant, Mewbourne Oil Company, sought to pool the interests of Devon Energy Corporation. Devon opposed the application on the grounds that the parties were bound to operating agreements entered into by their predecessors in 1953 and 1958. Mewbourne argued that the compulsory pooling was justified because the terms of the operating agreement were "unfavorable". Order No. R-9841 dismissing the Application provided as follows: "*FINDING: Since under the "force pooling" statutes (Chapter 70-2-17 of the NMSA 1978) there exists in this matter an agreement between the two parties owning undivided interests in a proposed 320-acre gas spacing and proration unit, an order from the Division pooling said parties is unnecessary.*" The comments of the Division's counsel in the transcript of hearing are notable as it is expressed that, in such cases, the Division makes no determination on the merits of the terms of the operating agreement, but determines only whether the agreement exists.

Case No. 11434: Order No. R-10545: *Application of Meridian Oil, Inc. for Compulsory Pooling and Unorthodox Well Location, San Juan County, New Mexico.* In 1995, the applicant, Meridian Oil, Inc., sought to force pool the working interests of Doyle Hartman, Four Star Oil & Gas (Texaco) and others. Hartman and Four Star opposed the application on the grounds that the lands were subject to a pre-existing 1953 Communitization Agreement and an Operating Agreement pooling their interests and

governing the drilling and development of the lands. The hearing examiner recognized the applicability of the 1953 agreements and dismissed the case due to the applicant's failure to exercise good faith in negotiations.

Consolidated Cases No. 11877, 11960, No. 11927: *Application of Redstone Oil and Gas Company for Compulsory Pooling and Unorthodox Well Location, Eddy County, New Mexico (Consolidated for hearing with Case No. 11927; Application of Fasken Land & Minerals, Ltd. for Compulsory Pooling, etc.; and Case No. 11877; Application of Fasken Land & Minerals, Ltd. for Compulsory Pooling, etc.)* These 1998 cases involved the efforts of the applicants to force pool lands into 640 and 320 acre spacing and proration units that were covered, in part, by a 1970 operating agreement governing Contract Area lands in the Rock Tank Unit and certain adjoining leases. Whether the 1970 agreements were applicable was a threshold issue to be decided before the Division exercised its compulsory pooling authority. Prior to the issuance of the final orders in these cases, the parties were able to negotiate an agreement for the development of the acreage and consequently, the compulsory pooling portions of the cases were dismissed.

Case No. 13877; Order No. R-12747-A: *Application of Bold Energy, LP for Approval of an Application for Permit to Drill and to Allow Two Operators On A Well Unit, Eddy County, New Mexico.* Although not a compulsory pooling matter, in Case No. 13877 Bold Energy sought an APD for a well it proposed to drill although it was not the operator under an applicable joint operating agreement. The Artesia District's Office denied the APD when Oxy, the designated operator under the JOA, objected. In Order No. R-12747-A, the Division recognized the JOA and found that Bold Energy's right to

operate a well was subject to a condition precedent under the JOA that had not been fulfilled. It upheld the denial of Bold's APD and further found that Bold Energy LP, was unable to show a good faith basis to assert that it had "a present legal right" to even enter onto the property to drill the proposed well. Order R-12747-A, ¶ 19. Under the circumstances of this case, it is clear that only Magnum Hunter has the right to enter onto Section 9 to drill the well on the W/2 E/2 it has properly proposed under the 1979 JOA.

Copies of the orders referenced above are attached together as Exhibit 6.

Where the evidence clearly supports a finding that the commitment of working interests is governed by an operating agreement, farmout, communitization or other similar agreement, then those interests are not subject to compulsory pooling. In each of the compulsory pooling cases referenced above, the applicant failed to make the showing required by the statute. Each time, the applicant either failed to obtain the compulsory pooling relief sought or the application was denied outright. This case is no different and the Division should not hesitate to deny the forced pooling of the interests involved here.

2. <u>The Non-standard Unit</u>.

ROC's Application proposes to dedicate to its proposed Bone Spring formation well approximately 160 ± acres comprised of the W/2 E/2 of Section 9. According to the Division's District 1 office, these lands are located within the proposed expansion area for the Lea Bone Spring-South oil pool (37580). The pool rules for this defined oil pool require that wells be located on spacing and proration units consisting of approximately 40 contiguous acres in accordance with statewide rules. (See Rule 19.15.15.19 A.) ROC's proposed spacing unit violates these rules. ROC must therefore seek an

exception to these rules or alternatively apply for Division approval of a non-standard spacing and proration unit. Making application under Rule 19.15.16.15 alone is insufficient. Under the established practice of the Division, ROC must also comply with the notice requirements of Rules 19.15.15.11 B. ROC's Application, notice and advertisement for this case are defective. ROC's Application must therefore be dismissed.

For the foregoing reasons, Magnum Hunter Production, Inc. requests that the Division enter its order dismissing and otherwise denying Read Operating Company LLC's Application for Compulsory Pooling and Designation of Operator.

Respectfully submitted,

J. Scott Hall, Esq.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served to counsel of record by electronic mail this 16th day of June, 2014.

Joel Carson III
Elizabeth A. Ryan
Carson Ryan LLC
P.O. Box 1612
Roswell, NM 88202
Tele (575) 291-7606
Email: beth@carsonryan.com
Joel@carsonryan.com
Attorneys for Read Operating Company, LLC

J.E. Gallegos
Michael J. Condon
460 St. Michael's Drive, Bldg. 300
Santa Fe, New Mexico 87505
Tele (505) 983-6686
Email: jeg@gallegoslawfirm.net
mjc@gallegoslawfirm.net
Attorneys for Read & Stevens and Read Operating Company, LLC

J. Scott Hall

West Lea Prospect
NM01-01

A.A.P.L. FORM 610 - 1977

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

August 1, 19 79,

OPERATOR ESTORIL PRODUCING CORPORATION

CONTRACT AREA S/2 Section 4, S/2 Section 5, Section 8, Section 9 and SW/4 Section 10, all in Township 20 South, Range 34 East, LIMITED from 5,000 feet below the surface down to and including the base of the Morrow formation.

COUNTY ~~OR PARISH~~ OF Lea STATE OF New Mexico

Exhibit
1

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between Estoril Producing Corporation hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators."

WITNESSETH:

WHEREAS, the parties to this agreement are owners of oil and gas leases and or oil and gas interests in the land identified in Exhibit "A", and the parties hereto have reached an agreement to explore and develop these leases and or oil and gas interests for the production of oil and gas to the extent and as hereinafter provided.

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.
DEFINITIONS

As used in this agreement, the following words and terms shall have the meanings here ascribed to them:

A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith unless an intent to limit the inclusiveness of this term is specifically stated.

B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.

D. The term "Contract Area" shall mean all of the land, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".

E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.

F. The term "drillsite" shall mean the oil and gas lease or interest on which a well is to be located.

G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.

H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II.
EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

[X] A. Exhibit "A", shall include the following information:
(1) Identification of lands subject to agreement,
(2) Restrictions, if any, as to depths or formations,
(3) Percentages or fractional interests of parties to this agreement,
(4) Oil and gas leases and or oil and gas interests subject to this agreement,
(5) Addresses of parties for notice purposes.

~~[ ] B. Exhibit "B", Form of Lease.~~

[X] C. Exhibit "C", Accounting Procedure.

[X] D. Exhibit "D", Insurance.

[X] E. Exhibit "E", Gas Balancing Agreement.

~~[ ] F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.~~

If any provision of any exhibit, except Exhibit "B", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

ARTICLE III.
INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an unleased oil and gas interest in the Contract Area, that interest shall be treated for the purpose of this agreement and during the term hereof as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B". As to such interest, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the lessee interest.

B. Interest of Parties in Costs and Production:

Exhibit "A" lists all of the parties and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and material acquired in operations on the Contract Area shall be owned by the parties as their interests are shown in Exhibit "A". All production of oil and gas from the Contract Area, subject to the payment of lessor's royalties which will be borne by the Joint Account, shall also be owned by the parties in the same manner during the term hereof; provided, however, this shall not be deemed an assignment or cross-assignment of interests covered hereby.

ARTICLE IV.
TITLES

A. Title Examination:

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and/or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and/or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including Federal Lease Status Reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

☐ ~~Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be a part of the administrative overhead as provided in Exhibit "C," and shall not be a direct charge, whether performed by Operator's staff attorneys or by outside attorneys.~~

☒ Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Exhibit "A". Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection with leases or oil and gas interests contributed by such party. The Operator shall be responsible for the preparation and recording of Pooling Designations or Declarations as well as the conduct of hearings before Governmental Agencies for the securing of spacing or pooling orders. This shall not prevent any party from appearing on its own behalf at any such hearing.

No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to participate in the drilling of the well.

B. Loss of Title:

1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A", this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests, and

(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development

on operating costs which it may have theretofore paid, but there shall be an immediate liability on its part to the other parties hereto for drilling, development, operating or other similar costs by reason of such title failure; and

(b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract Area by the amount of the interest lost; and

(c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract Area is increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such interests (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well; and

(d) Should any person not a party to this agreement, who is determined to be the owner of any interest in the title which has failed, pay in any manner any part of the cost of operation, development, or equipment, such amount shall be paid to the party or parties who bore the costs which are so refunded; and

(e) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be borne by the party or parties in the same proportions in which they shared in such prior production; and

(f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in connection therewith.

2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, is not paid or is erroneously paid, and as a result a lease or interest therein terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new lease covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties shall be revised on an acreage basis, effective as of the date of termination of the lease involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the lease or interest which has terminated. In the event the party who failed to make the required payment shall not have been fully reimbursed, at the time of the loss, from the proceeds of the sale of oil and gas attributable to the lost interest, calculated on an acreage basis, for the development and operating costs theretofore paid on account of such interest, it shall be reimbursed for unrecovered actual costs theretofore paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost interest, on an acreage basis, up to the amount of unrecovered costs;

(b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an acreage basis, of that portion of oil and gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such lease termination, would be attributable to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said portion of the oil and gas to be contributed by the other parties in proportion to their respective interests; and

(c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall not be considered failure of title but shall be joint losses and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of the Contract Area.

ARTICLE V.
OPERATOR

A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:

Estoril Producing Corporation shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

B. Resignation or Removal of Operator and Selection of Successor

1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operators, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the Parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed, shall be determined by Operator, and all such employees shall be the employees of Operator.

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well: NOT APPLICABLE

~~On or before the _____ day of _____, 19__, Operator shall commence the drilling of a well for oil and gas at the following location:~~

~~and shall thereafter continue the drilling of the well with due diligence to~~

~~unless granite or other practically impenetrable substance or condition in the hole, which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.~~

~~Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.~~

~~If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E. hereof.~~

B. **Subsequent Operations:**

1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday or legal holidays. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or response given by telephone shall be promptly confirmed in writing.

2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, within sixty (60) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period where the drilling rig is on location, as the case may be) actually commence work on the proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest of the parties approving such operation, and (b) its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A", or (b) carry its proportionate part of Non-Consenting Parties' interest. The proposing party, at its election, may withdraw such proposal if there is insufficient participation, and shall promptly notify all parties of such decision.

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk, and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or market value thereof if such share is not sold (after deducting production taxes, royalty, overriding royalty and other interests existing on the effective date hereof, payable out of or measured by the production from such well accruing with respect to such interest until it reverts) shall equal the total of the following:

(a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to each Non-Consenting Party had it participated in the well from the beginning of the operation; and

(b) 300 % of that portion of the costs and expenses of drilling, reworking, deepening, or plugging back, testing and completing, after deducting any cash contributions received under Article VIII.C., and

300% of that portion of the cost of newly acquired equipment in the well (to and including the well-head connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's election, shall be sold to its purchaser, if available, under the terms of its existing gas sales contract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from such sale direct to the Consenting Parties until the amounts provided for in this Article are recovered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not contracted for sale of its gas at the time such gas is available for delivery, or has not made the election as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-Consenting Party's share of gas as hereinabove provided during the recoupment period.

During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production.

In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.

Within sixty (60) days after the completion of any operation under this Article, the party conducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas produced during any month, Consenting Parties shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs of the work done and of the equipment purchased, in determining when the interest of such Non-Consenting Party shall revert to it as above provided; and if there is a credit balance, it shall be paid to such Non-Consenting party.

If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent of all parties, no wells shall be completed in or produced from a source of supply from which a well located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such source of supply.

The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b) to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article VI.A.

C. **Right to Take Production in Kind:**

Each party shall have the right to take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating oil for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any

party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment direct from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate commerce, of any other party's share of gas production without first giving such other party thirty (30) days notice of such intended sale.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and/or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any Gas Balancing Agreement between the parties hereto, whether such Agreement is attached as Exhibit "E", or is a separate Agreement.

D. Access to Contract Area and Information:

Each party shall have access to the Contract Area at all reasonable times, at its sole risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the information.

E. Abandonment of Wells:

1. Abandonment of Dry Holes: Except for any well drilled pursuant to Article VI.B.2., any well which has been drilled under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday or legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling of such well. Any party who objects to the plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and/or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well which has been drilled or reworked pursuant to Article VI.B.2. hereof for which the Consenting Parties have not been fully reimbursed as therein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of such well, all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one year and so long thereafter as oil and/or gas is produced from the interval or inter-

vals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentages of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interest in the remaining portion of the Contract Area.

Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned well.

ARTICLE VII.
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.

B. Liens and Payment Defaults:

Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share of oil and or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon at the rate provided in the Accounting Procedure attached hereto as Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the State, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's share of oil and or gas until the amount owed by such Non-Operator, plus interest has been paid. Each purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.

If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.

C. Payments and Accounting:

Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in the Accounting Procedure attached hereto as Exhibit "C". Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Limitation of Expenditures:

1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this Agreement, it being understood that the consent to the drilling or deepening shall include:

~~☐ Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and equipping of the well, including necessary tankage and/or surface facilities.~~

☒ Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its authorized depth, and all tests have been completed, Operator shall give immediate notice to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion attempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, including necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less than all parties.

2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agreement, it being understood that the consent to the reworking or plugging back of a well shall include consent to all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage and/or surface facilities.

3. Other Operations: Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Fifteen Thousand Dollars ($ 15,000.00) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares "Authority for Expenditures" for its own use, Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project costing in excess of Fifteen Thousand Dollars ($ 15,000.00).

E. Royalties, Overriding Royalties and Other Payments:

Each party shall pay or deliver, or cause to be paid or delivered, all royalties and overriding royalties ~~to the extent of~~ _____ due on its share of production and shall hold the other parties free from any liability therefor. If the interest of any party in any oil and gas lease covered by this agreement is subject to any royalty, overriding royalty, production payment, or other charge over and above the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account for or cause to be accounted for, such interest to the owners thereof.

No party shall ever be responsible, on any price basis higher than the price received by such party, to any other party's lessor or royalty owner; and if any such other party's lessor or royalty owner should demand and receive settlements on a higher price basis, the party contributing such lease shall bear the royalty burden insofar as such higher price is concerned.

F. Rentals, Shut-in Well Payments and Minimum Royalties:

Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.3.

Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sunday and holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments

of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

G. Taxes:

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. Operator shall bill other parties for their proportionate share of all tax payments in the manner provided in Exhibit "C".

If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final determination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint account, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as provided in Exhibit "C".

Each party shall pay or cause to be paid all production, severance, gathering and other taxes imposed upon or with respect to the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.

H. Insurance:

At all times while operations are conducted hereunder, Operator shall comply with the Workmen's Compensation Law of the State where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be an amount equivalent to the premium which would have been paid had such insurance been obtained. Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the Workmen's Compensation Law of the State where the operations are being conducted and to maintain such other insurance as Operator may require.

In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's fully owned automotive equipment.

ARTICLE VIII.
ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

A. Surrender of Leases:

The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole or in part unless all parties consent thereto.

However, should any party desire to surrender its interest in any lease or in any portion thereof, and other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not desiring to surrender it. If the interest of the assigning party includes an oil and gas interest, the assigning party shall execute and deliver to the party or parties not desiring to surrender an oil and gas lease covering such oil and gas interest for a term of one year and so long thereafter as oil and/or gas is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B". Upon such assignment, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the acreage assigned and the operation of any well thereon, and the assigning party shall have no further interest in the lease assigned and its equipment and production other than the royalties retained in any lease made under the terms of this Article. The parties assignee shall pay to the party assignor the reasonable salvage value of the latter's interest in any wells and equipment on the assigned acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. If the assignment is in favor of more than one party, the assigned interest shall

be shared by the parties assignee in the proportions that the interest of each bears to the interest of all parties assignee.

Any assignment or surrender made under this provision shall not reduce or change the assignor's or surrendering parties' interest, as it was immediately before the assignment, in the balance of the Contract Area; and the acreage assigned or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this agreement.

B. Renewal or Extension of Leases:

If any party secures a renewal of any oil and gas lease subject to this Agreement, all other parties shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area.

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this agreement.

The provisions in this Article shall apply also and in like manner to extensions of oil and gas leases.

C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash toward the drilling of a well or any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. If all parties hereto are Drilling Parties and accept such tender, such acreage shall become a part of the Contract Area and be governed by the provisions of this agreement. If less than all parties hereto are Drilling Parties and accept such tender, such acreage shall not become a part of the Contract Area. Each party shall promptly notify all other parties of all acreage or money contributions it may obtain in support of any well or any other operation on the Contract Area.

If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Subsequently Created Interest:

Notwithstanding the provisions of Article VIII.E. and VIII.G., if any party hereto shall, subsequent to execution of this agreement, create an overriding royalty, production payment, or net proceeds interest, which such interests are hereinafter referred to as "subsequently created interest", such subsequently created interest shall be specifically made subject to all of the terms and provisions of this agreement, as follows:

1. If non-consent operations are conducted pursuant to any provision of this agreement, and the party conducting such operations becomes entitled to receive the production attributable to the interest out of which the subsequently created interest is derived, such party shall receive same free and clear of such subsequently created interest. The party creating same shall bear and pay all such subsequently created interests and shall indemnify and hold the other parties hereto free and harmless from any and all liability resulting therefrom.

2. If the owner of the interest from which the subsequently created interest is derived (1) fails to pay, when due, its share of expenses chargeable hereunder, or (2) elects to abandon a well under provisions of Article VI.E. hereof, or (3) elects to surrender a lease under provisions of Article VIII.A. hereof, the subsequently created interest shall be chargeable with the pro rata portion of all expenses hereunder in the same manner as if such interest were a working interest. For purposes of collecting such chargeable expenses, the party or parties who receive assignments as a result of (2) or (3) above shall have the right to enforce all provisions of Article VII.B. hereof against such subsequently created interest.

E. Maintenance of Uniform Interest:

Any party creating the necessity for separate measurement facilities shall alone bear all costs of installing and maintaining such facilities.

Every ~~such~~ sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the right of the other parties.

If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such party's interests within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds hereof.

F. Waiver of Right to Partition:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

G. Preferential Right to Purchase:

~~Should any party desire to sell all or any part of its interests under this agreement, or its rights and~~ interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which any one party owns a majority of the stock.

ARTICLE IX.
INTERNAL REVENUE CODE ELECTION

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No

such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from Operations hereunder can be adequately determined without the computation of partnership taxable income.

ARTICLE X.
CLAIMS AND LAWSUITS

Operator may settle any single damage claim or suit arising from operations hereunder if the expenditure does not exceed Ten Thousand Dollars ($ 10,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, the party shall immediately notify Operator, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

ARTICLE XI.
FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure. The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

ARTICLE XII.
NOTICES

All notices authorized or required between the parties, and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by United States mail or Western Union telegram, postage or charges prepaid, or by teletype, and addressed to the party to whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed, and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid, or when sent by teletype. Each party shall have the right to change its address at any time, and from time to time, by giving written notice hereof to all other parties.

ARTICLE XIII.
TERM OF AGREEMENT

This agreement shall remain in full force and effect as to the oil and gas leases and/or oil and gas interests subjected hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any lease, or oil and gas interest contributed by any other party beyond the term of this agreement.

X Option No. 1: So long as any of the oil and gas leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise, and/or so long as oil and/or gas production continues from any lease or oil and gas interest.

~~Option No. 3: In the event the well described in Article VI.A., or any subsequent well drilled~~ under any provision of this agreement, results in production of oil and/or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of _ _ _days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling or reworking a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and or gas from the Contract Area, this agreement shall terminate unless drilling or reworking operations are commenced within _____days from the date of abandonment of said well.

It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

ARTICLE XIV.
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the conservation laws of the state in which the committed acreage is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and orders.

B. Governing Law:

The essential validity of this agreement and all matters pertaining thereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state where most of the land in the Contract Area is located shall govern.

ARTICLE XV.
OTHER PROVISIONS

A. This Operating Agreement is subject to the terms and provisions of that certain Farmout Agreement dated June 12, 1978, as amended, by and between Union Oil Company of California and Hilco Company as ratified and amended by Jake L. Hamon, Edwin L. Cox, Individually and as *Trustee, Executor and Agent*, Edward R. Hudson, *Jr. and* William A. Hudson, II, both Individually and as Executors and Trustees, William A. Hudson, Roxie E. Hudson, B. D. Moore, Jr., David W. Moore, Eleanor Moore, Mary Lee Moore, Carol Pauls Moore, John Knox Hutchings Moore, *Jr.*, Donald B. Moore, Anita G. Moore, Kilburn G. Moore, Individually and as Attorney-in-Fact and First Hutchings-Sealy National Bank of Galveston as Agent, Attorney-in-Fact and Trustee.

B. The interests of Estoril Producing Corporation, Fred M. Allison, Stringer Oil & Gas, Lario Oil & Gas Company and Resources Investment Corporation are subject to that certain Letter Agreement dated December 11, 1978 by and between Hilco Company, et al and Estoril Producing Corporation, et al and that certain Operating Agreement dated December 20, 1978 by and between Estoril Producing Corporation as Operator and Stringer Oil & Gas, et al as Non-Operators.

ARTICLE XVI.
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of 1st day of August, 1979.

OPERATOR

ESTORIL PRODUCING CORPORATION

ATTEST:

Assistant Secretary

By: _____
Phillip D. Dunford
Executive Vice President

NON-OPERATORS

_____

_____
Fred M. Allison

STRINGER OIL & GAS

_____
J. Frank Stringer, President

LARIO OIL & GAS COMPANY

ATTEST:

By: _____
Title: _____

_____
D. E. O'Shaughnessy, President

RESOURCES INVESTMENT CORPORATION

ATTEST:

By: _____
Title: _____

_____
James M. Massell, Vice Pres.-Land

UNION OIL COMPANY OF CALIFORNIA

_____
John Hansen, Attorney-in-Fact

_____
Jake L. Hamon

_____
Nancy B. Hamon

_____
Edwin L. Cox, Individually and as Trustee and Executor of the Estate of Edwin B. Cox, and as Agent for Elizabeth Lockridge Cox

Edward R. Hudson, Jr., Executor
and Trustee u/w Edward R. Hudson

William A. Hudson, II, Executor
and Trustee u/w Edward R. Hudson

William A. Hudson

Roxie E. Hudson

Edward R. Hudson, Jr., Agent and Attorney-in-Fact for: Anita G. Moore, B. D. Moore, Jr. and wife, Eleanor Moore; David W. Moore and wife, Mary Lee Moore; Carol Pauls Moore; John Knox Hutchings Moore, Jr; Donald Bartlett Moore; Anita G. Moore and Kilburn G. Moore, Individually and as Attorney-in-Fact for Anita Moore Doyle, W. Lamar Doyle, Charles H. Moore, III, Paul Cooke Moore and Bartlett G. Moore; First Hutchings-Sealy National Bank of Galveston, Trustee under Trust Indenture dated 12/23/77 from Frances Moore Shelton as Trustor (Trust #1 and Trust #2); and First Hutchings-Sealy National Bank of Galveston, Agent and Attorney-in-Fact for the Grandchildren of Frances B. Moore.

ACKNOWLEDGEMENTS

THE STATE OF TEXAS §

COUNTY OF MIDLAND §

The foregoing instrument was acknowledged before me this 10th day of August, A.D. 1979, by PHILLIP D. DUNFORD, EXECUTIVE VICE PRESIDENT of ESTORIL PRODUCING CORPORATION, Midland, Texas, a Texas corporation, on behalf of said corporation.

(SEAL)

Doris E. Hembree
Notary Public in and for
Midland County, Texas

Doris E. Hembree

My Commission expires: 7-1-81

THE STATE OF TEXAS §

COUNTY OF MIDLAND §

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by FRED N. ALLISON.

(SEAL)

_____
Notary Public in and for
Midland County, Texas

My commission expires:_____ (Type Name)_____

THE STATE OF TEXAS §

COUNTY OF §

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by J. FRANK STRINGER, PRESIDENT of STRINGER OIL & GAS, San Angelo, Texas, a _____ corporation, on behalf of said corporation.

(SEAL)

_____
Notary Public in and for
_____ County, Texas

My commission expires:_____ (Type Name)_____

THE STATE OF TEXAS §

COUNTY OF MIDLAND §

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by D. E. O'SHAUGHNESSY, PRESIDENT of LARIO OIL & GAS COMPANY, Midland, Texas, a _____corporation, on behalf of said corporation.

(SEAL)

_____
Notary Public in and for
Midland County, Texas

My commission expires:_____ (Type Name)_____

THE STATE OF

COUNTY OF

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by JAMES M. MASSELL, VICE-PRESIDENT-LAND of RESOURCES INVESTMENT CORPORATION, Denver, Colorado, a _____ corporation, on behalf of said corporation.

(SEAL)

_____
Notary Public in and for
_____ County, Colorado

My commission expires:_____ (Type Name)_____

THE STATE OF

COUNTY OF

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by JOHN HANSEN, as Attorney-in-Fact for Union Oil Company of California, in the capacity herein stated.

(SEAL)

_____
Notary Public in and for
_____ County, Colorado

My commission expires:_____ (Type Name)

THE STATE OF

COUNTY OF

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by JAKE L. HAMON.

(SEAL)

_____
Notary Public in and for
_____ County,_____
My commission expires:_____ (Type name)_____

THE STATE OF

COUNTY OF

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by NANCY B. HAMON.

(SEAL)

_____
Notary Public in and for
_____County, _____
My commission expires:_____ (Type name)_____

THE STATE OF

COUNTY OF

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by EDWIN L. COX, Individually and as Trustee and Executor of the Estate of Edwin B. Cox and as Agent for Elizabeth Lockridge Cox, in the capacity herein stated.

(SEAL)

_____
Notary Public in and for
_____County, _____
My commission expires:_____ (Type name)_____

THE STATE OF

COUNTY OF

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by EDWARD R. HUDSON, JR., as Executor and Trustee u/w Edward R. Hudson, in the capacity herein stated.

(SEAL)

_____
Notary Public in and for
_____County, _____
My commission expires:_____ (Type Name)_____

THE STATE OF

COUNTY OF

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by WILLIAM A. HUDSON, II, Executor and Trustee u/w Edward R. Hudson, in the capacity herein stated.

(SEAL)

_____
Notary Public in and for
_____County, _____

My commission expires:_____

(Type Name)_____

THE STATE OF

COUNTY OF

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by WILLIAM A. HUDSON.

(SEAL)

_____
Notary Public in and for
_____County, _____

My commission expires:_____

(Type Name)_____

THE STATE OF

COUNTY OF

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by ROXIE E. HUDSON.

(SEAL)

_____
Notary Public in and for
_____County, _____

My commission expires:_____

(Type Name)_____

THE STATE OF

COUNTY OF

The foregoing instrument was acknowledged before me this _____ day of _____, A.D. 1979, by EDWARD R. HUDSON, JR., Agent and Attorney-in-Fact, in the capacity herein stated.

(SEAL)

_____
Notary Public in and for
_____County, _____

My commission expires:_____

(Type Name)_____

WEST LEA PROSPECT

REVISED (1)
05-01-88

EXHIBIT "A"

ATTACHED to and made a part of that certain Operating Agreement dated August 1, 1979, by and between Estoril Producing Corporation as Operator and Fred M. Allison, et. al. as Non-Operators.

ALL LANDS ARE LOCATED IN TOWNSHIP 20 SOUTH, RANGE 34 EAST, LEA COUNTY, NEW MEXICO and LIMITED FROM 5,000 FEET BELOW THE SURFACE DOWN TO AND INCLUDING THE BASE OF THE MORROW FORMATION.

I. CONTRACT AREA

A. SE/4 of Section 9
B. SW/4 of Section 10
C. S/2 of Section 4, S/2 of Section 5, All of Section 8, N/2 and SW/4 of Section 9

II. OIL AND GAS LEASES

A. Lease No. LC-064194 dated October 1, 1947, between The United States of America, Lessor, and L. B. Hodges, Lessee, INSOFAR AND ONLY INSOFAR as said lease covers the following described land, to-wit:

S/2 of Section 4, S/2 of Section 5, All of Section 8 and All of Section 9

B. Lease No. NM-14799 dated February 1, 1972, between The United States of America, Lessor, and James N. McTighe, Lessee, INSOFAR AND ONLY INSOFAR as said lease covers the following described land, to-wit:

SW/4 of Section 10

III. INTERESTS OF THE PARTIES IN THE CONTRACT AREA

A. SE/4 of Section 9

	BEFORE PAYOUT OF UNION FEDERAL #1*	AFTER PAYOUT OF UNION FEDERAL #1*
Estoril	22.916667%	13.750000%
Allison	6.250000%	3.750000%
Bistate	26.041666%	15.625000%
Stringer	19.791667%	11.875000%
Lario	25.000000%	15.000000%
Unocal	00.000000%	19.230679%
Hamon	00.000000%	4.615385%
Cox (Edwin L.)	00.000000%	0.576923%
Cox (Elizabeth L.)	00.000000%	0.576923%
Cox Estate	00.000000%	1.153846%
Hudson (William A.)	00.000000%	5.884615%
Hudson Estate	00.000000%	5.884615%
Moore Family Interests	00.000000%	2.076924%
	100.000000%	100.000000%

B. SW/4 of Section 10

(1.) Operations pertaining to the Union Federal "A" #1

Estoril	10.107271%
Allison	3.665625%
Bistate	19.308606%

Stringer	8.951467%
Lario	15.000000%
Unocal	19.230769%
Hamon	6.593407%
Graham Royalty	2.197801%
Lakeview	1.098900%
Hudson (William A.)	5.884615%
Hudson Estate	5.884615%
Moore Family Interests	2.076924%
	100.000000%

(2.) Operations pertaining to the Union Federal "A" #2 and all other operations in the SW/4 of Section 10 (excluding operations pertaining to the Union Federal "A" #1)

	UNION FEDERAL "A" #2 BEFORE PAYOUT**	UNION FEDERAL "A" #2 AFTER PAYOUT ** & ALL OTHER OPERATIONS
Estoril	10.949543%	10.829218%
Allison	3.971094%	3.927455%
Bistate	19.308606%	19.308606%
Stringer	9.697423%	9.590858%
Lario	16.250000%	16.071429%
Unocal	23.779379%	23.129579%
Graham Royalty	2.197801%	2.197801%
Lakeview	00.000000%	1.098900%
Hudson (William A.)	5.884615%	5.884615%
Hudson Estate	5.884615%	5.884615%
Moore Family Int.	2.076924%	2.076924%
Hamon***	00.000000%	00.000000%

C. S/2 of Section 4, S/2 of Section 5, all of Section 8 and the N/2 and SW/4 of Section 9

Estoril	4.094323%
Allison	4.094322%
Bistate	3.750000%
Stringer	4.197574%
Lario	15.750000%
Unocal	21.959935%
Cox (Edwin L.)	0.576923%
Cox (Elizabeth L.)	0.576923%
Cox Estate	1.153846%
Hudson (William A.)	5.884615%
Hudson Estate	5.884615%
Moore Family Interests	2.076924%
Hamon ***	0.000000%
Resources	30.000000%

*Payout is defined in that certain Letter Agreement dated June 12, 1978, as amended, by and between Union Oil Company of California and Hilco Company. Union Oil Company of California, et. al., own the right to convert overriding royalty interests to working interests after payout of the Union Federal #1. The after payout interests shown above assume all parties will convert to working interests and will be adjusted accordingly at payout.

**Lakeview elected not to participate in the Union Federal "A" #2 well pursuant to the non-consent provisions of Article VI(B.)

herein and payout will be calculated in accordance with said Article.

***Pursuant to that certain Letter Agreement dated February 1, 1988, as amended, by and between Hamon and Estoril, Hamon farmed-out its interest in these lands to Estoril, Allison, Stringer, Lario and Unocal. The interest figures shown under B.(2.) and C. above assume that at the time operations are conducted upon the applicable lands, said Letter Agreement will be in full force and effect.

IV. ADDRESSES OF THE PARTIES

Estoril Producing Corporation
400 West Illinois, Suite 1600
Midland, Texas 79701

Mr. Fred M. Allison
P. O. Box 4815
Midland, Texas 79704-4815

Bistate Oil Company, Inc.
502 Park Avenue
28th Floor
New York, New York 10022

Stringer Oil and Gas
P. O. Box 3037
San Angelo, Texas 76901

Lario Oil and Gas Company
301 South Market Street
Wichita, Kansas 67202

Union Oil Company of California
P. O. Box 3100
Midland, Texas 79702

Hamon Operating Company
RepublicBank Tower
325 St. Paul, Suite 3900
Dallas, Texas 75201

Edwin L. Cox
3800 Interfirst One
Dallas, Texas 75202

Elizabeth L. Cox
3800 First National Bank
Dallas, Texas 75202

Estate of Edwin B. Cox
3800 First National Bank
Dallas, Texas 75202

William A. Hudson
616 Texas Street
Ft. Worth, Texas 76102

Estate of Edward R. Hudson
616 Texas Street
Ft. Worth, Texas 76102

Edward R. Hudson, Jr.,
Agent and Attorney-in-
Fact for Anita G.
Moore, et. al. (Moore
Family Interests)
616 Texas Street
Ft. Worth, Texas 76102

Graham Royalty, Ltd.
5429 LBJ Freeway
Suite 5501
Dallas, Texas 75240

Lakeview Partners, L.P.,
a Texas Limited
Partnership
c/o Valley View Energy
Corporation
1401 Elm Street
Suite 1400
Dallas, Texas 75202

EXHIBIT "A"

ATTACHED TO AND MADE A PART OF THAT CERTAIN OPERATING AGREEMENT DATED AUGUST 1, 1979, BY AND BETWEEN ESTORIL PRODUCING CORPORATION AS OPERATOR, AND FRED M. ALLISON, ET AL, AS NON-OPERATORS

ALL LANDS ARE LOCATED IN TOWNSHIP 20 SOUTH, RANGE 34 EAST, LEA COUNTY, NEW MEXICO and LIMITED FROM 5,000 FEET BELOW THE SURFACE DOWN TO AND INCLUDING THE BASE OF THE MORROW FORMATION.

I. CONTRACT AREA

A. SE/4 of Section 9
B. S/2 of Section 4, S/2 of Section 5, All of Section 8, N/2 and SW/4 of Section 9 and SW/4 Section 10

II. OIL AND GAS LEASES

A. Lease No. LC-064194 dated October 1, 1947, between The United States of America, Lessor, and L. B. Hodges, Lessee, INSOFAR AND ONLY INSOFAR as said lease covers the following described land, to-wit:

S/2 of Section 4, S/2 of Section 5, All of Section 8 and All of Section 9

B. Lease No. NM-14799 dated February 1, 1972, between The United States of America, Lessor, and James N. McTighe, Lessee, INSOFAR AND ONLY INSOFAR as said lease covers the following descrbied land, to-wit:

SW/4 of Section 10

III. WORKING INTERESTS

A. SE/4 of Section 9	Before Payout of Union Federal #1*	After Payout of Union Federal #1
Estoril Producing Corp.	6.25%	3.750%
Fred M. Allison	6.25%	3.750%
Stringer Oil & Gas	12.50%	7.500%
Lario Oil and Gas Co.	25.00%	15.000%
Resources Investment Corp.	50.00%	30.000%
Union Oil Co of CA	-0-	19.230769%
Jake L. Hamon	-0-	4.615385%
Edwin L. Cox	-0-	0.576923%
Elizabeth L. Cox	-0-	0.576923%
Estate of Edwin B. Cox	-0-	1.153846%
William A. Hudson	-0-	5.884615%
Estate of Edward R. Hudson	-0-	5.884615%
Edward R. Hudson, Jr., Agent and Attorney-in-Fact for Anita G. Moore, et al (Moore Family Interests)	-0-	2.076924%
	100.00%	100.000000%

*Payout is defined in that certain Letter Agreement dated June 12, 1978, as amended, by and between Union Oil Company of California and Hilco Company. Union Oil Company of California, et al, own the right to convert overriding royalty interests to working interests after payout of the Union Federal #1. The after payout interests shown above assume all parties will convert to working interests and will be adjusted accordingly at payout.

B. S/2 of Section 4, S/2 of Section 5, All of Section 8, N/2 and SW/4 of Section 9 and SW/4 of Section 10

Estoril Producing Corp.	3.750%
Fred M. Allison	3.750%
Stringer Oil & Gas	7.500%
Lario Oil and Gas Co.	15.000%
Resources Investment Corp.	30.000%
Union Oil Co of CA	19.230769%
Jake L. Hamon	4.615385%
Edwin L. Cox	0.576923%
Elizabeth L. Cox	0.576923%
Estate of Edwin B. Cox	1.153846%
William A. Hudson	5.884615%
Estate of Edward R. Hudson	5.884615%
Edward R. Hudson, Jr., Agent and Attorney-in-Face for Anita G. Moore, et al (Moore Family Interests)	2.076924%
	100.000000%

60%

40%

IV. ADDRESSES

Estoril Producing Corporation
Eleventh Floor-Vaughn Building
Midland, Texas 79701
Attn: Phillip D. Dunford

Fred M. Allison
Eleventh Floor-Vaughn Building
Midland, Texas 79701

Stringer Oil & Gas
8700 Crownhill Blvd., Suite 403
San Antonio, Texas 78209
Attn: Richard McCullough

Lario Oil and Gas Company
P.O. Box 155
Midland, Texas 79702
Attn: Stanley Fox

Resources Investment Corporation
800-B West Wall
Midland, Texas 79701
Attn: Jeff Smith

Union Oil Company of California
P.O. Box 671
Midland, Texas 79702
Attn: Robert V. Lockhart

Jake L. Hamon
P.O. Box 663
Dallas, Texas 75221

Edwin L. Cox, Elizabeth L. Cox and
Estate of Edwin B. Cox
3800 First National Bank Building
Dallas, Texas 75202

William A. Hudson and
Estate of Edward R. Hudson
1000 First National Building
Fort Worth, Texas 76102
Attn: Edward R. Hudson, Jr.

Edward R. Hudson, Jr., Agent and
Attorney-in-Fact for Anita G. Moore,
et al (Moore Family Interests)
1000 First National Building
Fort Worth, Texas 76102

THERE IS NO EXHIBIT "B" TO THIS AGREEMENT.

Kraftbilt 601, TULSA 74101

Recommended by the Council of Petroleum Accountants Societies of North America

EXHIBIT "C"

Attached to and made a part of THAT CERTAIN OPERATING AGREEMENT DATED AUGUST 1, 1979 BY AND BETWEEN ESTORIL PRODUCING CORPORATION AS OPERATOR AND FRED M. ALLISON, ET AL AS NON-OPERATORS.

ACCOUNTING PROCEDURE
JOINT OPERATIONS

I. GENERAL PROVISIONS

1. Definitions

"Joint Property" shall mean the real and personal property subject to the agreement to which this Accounting Procedure is attached.

"Joint Operations" shall mean all operations necessary or proper for the development, operation, protection and maintenance of the Joint Property.

"Joint Account" shall mean the account showing the charges paid and credits received in the conduct of the Joint Operations and which are to be shared by the Parties.

"Operator" shall mean the party designated to conduct the Joint Operations.

"Non-Operators" shall mean the parties to this agreement other than the Operator.

"Parties" shall mean Operator and Non-Operators.

"First Level Supervisors" shall mean those employees whose primary function in Joint Operations is the direct supervision of other employees and/or contract labor directly employed on the Joint Property in a field operating capacity.

"Technical Employees" shall mean those employees having special and specific engineering, geological or other professional skills, and whose primary function in Joint Operations is the handling of specific operating conditions and problems for the benefit of the Joint Property.

"Personal Expenses" shall mean travel and other reasonable reimbursable expenses of Operator's employees.

"Material" shall mean personal property, equipment or supplies acquired or held for use on the Joint Property.

"Controllable Material" shall mean Material which at the time is so classified in the Material Classification Manual as most recently recommended by the Council of Petroleum Accountants Societies of North America.

2. Statement and Billings

Operator shall bill Non-Operators on or before the last day of each month for their proportionate share of the Joint Account for the preceding month. Such bills will be accompanied by statements which identify the authority for expenditure, lease or facility, and all charges and credits, summarized by appropriate classifications of investment and expense except that items of Controllable Material and unusual charges and credits shall be separately identified and fully described in detail.

3. Advances and Payments by Non-Operators

Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the rate of twelve percent (12%) per annum or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts.

4. Adjustments

Payment of any such bills shall not prejudice the right of any Non-Operator to protest or question the correctness thereof; provided, however, all bills and statements rendered to Non-Operators by Operator during any calendar year shall conclusively be presumed to be true and correct after twenty-four (24) months following the end of any such calendar year, unless within the said twenty-four (24) month period a Non-Operator takes written exception thereto and makes claim on Operator for adjustment. No adjustment favorable to Operator shall be made unless it is made within the same prescribed period. The provisions of this paragraph shall not prevent adjustments resulting from a physical inventory of Controllable Material as provided for in Section V.

5. Audits

A. Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct joint or simultaneous audits in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator.

6. Approval by Non-Operators

Where an approval or other agreement of the Parties or Non-Operators is expressly required under other sections of this Accounting Procedure and if the agreement to which this Accounting Procedure is attached contains no contrary provisions in regard thereto, Operator shall notify all Non-Operators of the Operator's proposal, and the agreement or approval of a majority in interest of the Non-Operators shall be controlling on all Non-Operators.

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. **Rentals and Royalties**

   Lease rentals and royalties paid by Operator for the Joint Operations.

2. **Labor**

   A. (1) Salaries and wages of Operator's field employees directly employed on the Joint Property in the conduct of Joint Operations.

   (2) Salaries of First Level Supervisors in the field.

   (3) Salaries and wages of Technical Employees directly employed on the Joint Property if such charges are excluded from the Overhead rates.

   B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II. Such costs under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 2A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.

   C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II.

   D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II.

3. **Employee Benefits**

   Operator's current costs of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II shall be Operator's actual cost not to exceed twenty per cent (20%).

4. **Material**

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

5. **Transportation**

   Transportation of employees and Material necessary for the Joint Operations but subject to the following limitations:

   A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by the Parties.

   B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.

   C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking cost of $200 or less excluding accessorial charges.

6. **Services**

   The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 9 of Section II and Paragraph 1. ii of Section III. The cost of professional consultant services and contract services of technical personnel directly engaged on the Joint Property if such charges are excluded from the Overhead rates. The cost of professional consultant services or contract services of technical personnel not directly engaged on the Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.

7. **Equipment and Facilities Furnished by Operator**

   A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on investment not to exceed eight per cent (8%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.

   B. In lieu of charges in Paragraph 7A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

8. **Damages and Losses to Joint Property**

   All costs or expenses necessary for the repair or replacement of Joint Property made necessary because of damages or losses incurred by fire, flood, storm, theft, accident, or other cause, except those resulting from Operator's gross negligence or willful misconduct. Operator shall furnish Non-Operator written notice of damages or losses incurred as soon as practicable after a report thereof has been received by Operator.

9. **Legal Expense**

   Expense of handling, investigating and settling litigation or claims, discharging of liens, payment of judgments and amounts paid for settlement of claims incurred in or resulting from operations under the agreement or necessary to protect or recover the Joint Property. ~~except that no charge for services of Operator's legal staff or fees or expense of outside attorneys shall be made unless previously agreed to by the Parties.~~ No legal expense is considered to be covered by the overhead provisions of Section III unless otherwise agreed to by the Parties, except as provided in Section I, Paragraph 3.

10. **Taxes**

All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof, or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties.

11. **Insurance**

Net premiums paid for insurance required to be carried for the Joint Operations for the protection of the Parties. In the event Joint Operations are conducted in a state in which Operator may act as self-insurer for Workmen's Compensation and/or Employers Liability under the respective state's laws, Operator may, at its election, include the risk under its self-insurance program and in that event, Operator shall include a charge at Operator's cost not to exceed manual rates.

12. **Other Expenditures**

Any other expenditure not covered or dealt with in the foregoing provisions of this Section II, or in Section III, and which is incurred by the Operator in the necessary and proper conduct of the Joint Operations.

III. OVERHEAD

1. **Overhead - Drilling and Producing Operations**

i. As compensation for administrative, supervision, office services and warehousing costs, Operator shall charge drilling and producing operations on either:

(X) Fixed Rate Basis, Paragraph 1A, or
~~( ) Percentage Basis, Paragraph 1B.~~

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 2A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the Overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property ~~shall ( )~~ shall not (X) be covered by the Overhead rates.

A. Overhead - Fixed Rate Basis

(1) Operator shall charge the Joint Account at the following rates per well per month:

Drilling Well Rate $ 2483.00
Producing Well Rate $ 293.00

(2) Application of Overhead - Fixed Rate Basis shall be as follows:

(a) Drilling Well Rate

[1] Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.

[2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days

[3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

[1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.

[2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.

[3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.

[4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.

[5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

(3) The well rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Fields Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

B. Overhead - Percentage Basis

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

(a) Development

_____ Percent (%) of the cost of Development of the Joint Property exclusive of costs provided under Paragraph 9 of Section II and all salvage credits.

(b) Operating

_____ Percent (%) of the cost of Operating the Joint Property exclusive of costs provided under Paragraphs 1 and 9 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.

(2) Application of Overhead - Percentage Basis shall be as follows:
For the purpose of determining charges on a percentage basis under Paragraph 1B of this Section III, development shall include all costs in connection with drilling, redrilling, deepening or any remedial operations on any or all wells involving the use of drilling crew and equipment; also, preliminary expenditures necessary in preparation for drilling and expenditures incurred in abandoning when the well is not completed as a producer, and original cost of construction or installation of fixed assets, the expansion of fixed assets and any other project clearly discernible as a fixed asset, except Major Construction as defined in ~~Paragraph 2 of this Section III. All other costs shall be considered as Operating.~~

2. **Overhead - Major Construction**

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall ~~either~~ negotiate a rate prior to the beginning of construction, ~~or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess~~ of $_____:

A. _____% of total costs if such costs are more than $_____ but less than $_____; plus

B. _____% of total costs in excess of $_____ but less than $1,000,000; plus

C. _____% of total costs in excess of $1,000,000.

Total cost ~~shall mean~~ the gross cost of any one project. For the purpose of this paragraph, the component parts ~~of a single project shall not be treated separately and the cost of drilling and workover wells shall be excluded.~~

3. **Amendment of Rates**

The Overhead rates provided for in this Section III may be amended from time to time only by mutual agreement between the Parties hereto if, in practice, the rates are found to be insufficient or excessive.

IV. PRICING OF JOINT ACCOUNT MATERIAL PURCHASES, TRANSFERS AND DISPOSITIONS

Operator is responsible for Joint Account Material and shall make proper and timely charges and credits for all material movements affecting the Joint Property. Operator shall provide all Material for use on the Joint Property; however, at Operator's option, such Material may be supplied by the Non-Operator. Operator shall make timely disposition of idle and/or surplus Material, such disposal being made either through sale to Operator or Non-Operator, division in kind, or sale to outsiders. Operator may purchase, but shall be under no obligation to purchase, interest of Non-Operators in surplus condition A or B Material. The disposal of surplus Controllable Material not purchased by the Operator shall be agreed to by the Parties.

1. **Purchases**

Material purchased shall be charged at the price paid by Operator after deduction of all discounts received. In case of Material found to be defective or returned to vendor for any other reason, credit shall be passed to the Joint Account when adjustment has been received by the Operator.

2. **Transfers and Dispositions**

Material furnished to the Joint Property and Material transferred from the Joint Property or disposed of by the Operator, unless otherwise agreed to by the Parties, shall be priced on the following bases exclusive of cash discounts:

A. New Material (Condition A)

(1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.

(2) Line Pipe

(a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.

(b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.

(3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

B. Good Used Material (Condition B)

Material in sound and serviceable condition and suitable for reuse without reconditioning:

(1) Material moved to the Joint Property

(a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV.

(2) Material moved from the Joint Property

(a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV, *if Material was originally charged to the Joint Account as new Material, or*

(b) at sixty-five percent (65%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged to the Joint Account as good used Material at seventy-five percent (75%) of current new price.

The cost of reconditioning, if any, shall be absorbed by the transferring property.

C. Other Used Material (Condition C and D)

(1) Condition C

Material which is not in sound and serviceable condition and not suitable for its original function until after reconditioning shall be priced at fifty percent (50%) of current new price as determined by Paragraph 2A of this Section IV. The cost of reconditioning shall be charged to the receiving property, provided Condition C value plus cost of reconditioning does not exceed Condition B value.

(2) Condition D

All other Material, including junk, shall be priced at a value commensurate with its use or at prevailing prices. Material no longer suitable for its original purpose but usable for some other purpose, shall be priced on a basis comparable with that of items normally used for such other purpose. Operator may dispose of Condition D Material under procedures normally utilized by the Operator without prior approval of Non-Operators.

D. Obsolete Material

Material which is serviceable and usable for its original function but condition and/or value of such Material is not equivalent to that which would justify a price as provided above may be specially priced as agreed to by the Parties. Such price should result in the Joint Account being charged with the value of the service rendered by such Material.

E. Pricing Conditions

(1) Loading and unloading costs may be charged to the Joint Account at the rate of fifteen cents (15¢) per hundred weight on all tubular goods movements, in lieu of loading and unloading costs sustained, when actual hauling cost of such tubular goods are equalized under provisions of Paragraph 5 of Section II.

(2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

3. Premium Prices

Whenever Material is not readily obtainable at published or listed prices because of national emergencies, strikes or other unusual causes over which the Operator has no control, the Operator may charge the Joint Account for the required Material at the Operator's actual cost incurred in providing such Material, in making it suitable for use, and in moving it to the Joint Property; provided notice in writing is furnished to Non-Operators of the proposed charge prior to billing Non-Operators for such Material. Each Non-Operator shall have the right, by so electing and notifying Operator within ten days after receiving notice from Operator, to furnish in kind all or part of his share of such Material suitable for use and acceptable to Operator.

4. Warranty of Material Furnished by Operator

Operator does not warrant the Material furnished. In case of defective Material, credit shall not be passed to the Joint Account until adjustment has been received by Operator from the manufacturers or their agents.

V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

At reasonable intervals, Inventories shall be taken by Operator of the Joint Account Controllable Material. Written notice of intention to take inventory shall be given by Operator at least thirty (30) days before any inventory is to begin so that Non-Operators may be represented when any inventory is taken. Failure of Non-Operators to be represented at an inventory shall bind Non-Operators to accept the inventory taken by Operator.

2. Reconciliation and Adjustment of Inventories

Reconciliation of a physical inventory with the Joint Account shall be made, and a list of overages and shortages shall be furnished to the Non-Operators within six months following the taking of the inventory. Inventory adjustments shall be made by Operator with the Joint Account for overages and shortages, but Operator shall be held accountable only for shortages due to lack of reasonable diligence.

3. Special Inventories

Special Inventories may be taken whenever there is any sale or change of interest in the Joint Property. It shall be the duty of the party selling to notify all other Parties as quickly as possible after the transfer of interest takes place. In such cases, both the seller and the purchaser shall be governed by such inventory.

4. Expense of Conducting Periodic Inventories

The expense of conducting periodic Inventories shall not be charged to the Joint Account unless agreed to by the Parties.

EXHIBIT "D"

ATTACHED TO AND MADE A PART THEREOF TO THAT CERTAIN OPERATING AGREEMENT DATED AUGUST 1, 1979 BY AND BETWEEN ESTORIL PRODUCING CORPORATION AS OPERATOR AND FRED M. ALLISON, ET AL AS NON-OPERATORS.

INSURANCE

Operation shall, at the joint expense of the parties hereto at all times while operations are conducted hereunder, provide with responsible insurance companies, insurance as follows:

a. Workmen's Compensation Insurance in accordance with the laws of the state in which the operating area is located, and Employer's Liability Insurance with limits of not less than $100,000.00;

b. Public Liability Insurance with respect to bodily injuries with limits of not less than $100,000.00 as to any one person and $300,000.00 as to any one accident; and Property Damage Liability Insurance with limits of not less than $100,000.00 as to any one accident;

c. Automobile Public Liability Insurance with respect to bodily injuries with limits of not less than $100,000.00 as to any one person and $500,000.00 as to any one accident; also, Automobile Public Liability Insurance with respect to Property Damage with limits of not less than $100,000.00 as to any one accident; and

d. Umbrella Liability with respect to excess over minimum scheduled liability policies of $1,000,000.00.

Operator shall not provide, for the joint account of the parties hereto, insurance against the hazards of fire, windstorm, explosion, blowout, cratering, reservoir damage, pollution damage, or insurance other than that specified above.

It is understood that Operator does not warrant the financial responsibility of its insurance carrier, and except for willful negligence, Operator shall not be liable to Non-Operators for any loss resulting from insufficiency of the insurance carried, or of the insurer with whom carried. Operator shall not be liable to Non-Operators for any loss accruing by reason of the Operator's inability to obtain or maintain the above insurance, but Operator shall notify Non-Operators in writing, if it is unable to obtain or maintain such insurance.

EXHIBIT "E"

ATTACHED TO AND MADE A PART OF THAT CERTAIN OPERATING AGREEMENT DATED AUGUST 1, 1979 BY AND BETWEEN ESTORIL PRODUCING CORPORATION, OPERATOR, AND FRED M. ALLISON, ET AL, NON-OPERATORS.

GAS BALANCING AGREEMENT

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

2. The Unit Operator shall have the duty of controlling gas well production and the responsibility of administering the provisions of this agreement. Unit Operator shall cause deliveries to be made to the gas purchasers at such rates as may be required to give effect to the intent that the gas production accounts of all parties are to be brought into balance under the provisions contained herein.

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

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

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

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

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

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

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

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

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

2) Each overproduced party shall have the rights as in subparagraph (a) (2) above.

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

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

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

6. Each party taking gas shall be responsible for the entire payment to each royalty owner (including owners of overriding royalty and and production payments) entitled to payment for the gas which such party takes, such payment to be based upon the gas produced and the price received.

7. When gas sales from a gas well permanently cease, Unit Operator shall be responsible to determine the final accounting of underproduction and overproduction and each overproduced party shall account to and compensate each underproduced party with a sum of money equal to the amount actually received, less applicable taxes, by any such overproduced party from the sale of that part of the total cumulative volume of gas produced which the underproduced party was entitled to take. The amount of such royalties shall be deducted from such payment.

8. The provisions of this agreement shall be separately applicable to each gas well.

9. All parties hereto shall share in and own the condensate recovered at the surface in accordance with their respective interest.

UWI	Lease Name	Well Num	Spud Date	Comp Date	Operator Name	Current Operator	Location
30025262720002	UNION FEDERAL	1			SNOW OIL & GAS INC	SNOW OIL & GAS INC	20S 34E 9
30025343190000	TRUMAN `5` FEDERAL	1			READ & STEVENS INC	READ & STEVENS INC	20S 34E 5 SE SE
30025343200000	TRUMAN `9` FEDERAL	1			READ & STEVENS INC	READ & STEVENS INC	20S 34E 9 NW NE
300257034790	*MATADOR `5` FEDERAL*	*1*			*TXO PROD CORP*	*TXO PROD CORP*	*20S 34E 5 NW SW*
30025748002001	MESQUITE `8` FEDERAL	1			NEARBURG PROD CO	NEARBURG PROD CO	20S 34E 8 C SW SV
30025127180000	JACKSON	1	1927-06-15	1927-10-06	TEXAS PRODUCTION CO	TEXAS PRODUCTION CO	20S 34E 4
30025024190000	SWEARINGER	1	1934-10-18	1935-05-20	TEXACO INCORPORATED	TEXACO INCORPORATED	20S 34E 8
30025024210000	SWEARINGER	2	1944-07-19	1944-12-12	TEXACO INCORPORATED	TEXACO INCORPORATED	20S 34E 9
30025024120000	FEDERAL	2	1958-01-30	1958-03-06	HUDSON & HUDSON	HUDSON & HUDSON	20S 34E 4
30025024200000	HODGES-FEDERAL	3	1958-11-19	1958-12-27	HUDSON WM A&HUDSON E	HUDSON WM A&HUDSON E	20S 34E 9
30025262720000	UNION FEDERAL	1	1979-03-30	1979-06-26	ESTORIL PROD CORP	ESTORIL PROD CORP	20S 34E 9
30025262720001	UNION FEDERAL	1	1982-06-16	1982-11-27	ESTORIL PROD CORP	ESTORIL PROD CORP	20S 34E 9
30025305190000	POWELL FEDERAL	1	1988-12-04	1989-01-21	FENN BILL INC	SNOW OIL & GAS INC	20S 34E 4 SE SE
30025306330000	POWELL FEDERAL	2	1989-07-08	1989-07-25	FENN BILL INC	FENN BILL INC	20S 34E 4 NW SE
30025310560000	MATADOR `5` FEDERAL	1	1990-12-22	1991-07-27	MARATHON OIL COMPANY	MARATHON OIL COMPANY	20S 34E 5 NW SW
30025317170000	SCJ FEDERAL	1	1992-09-14	1993-01-07	SNOW OIL & GAS INC	SNOW OIL & GAS INC	20S 34E 9 NE NE
30025328210000	UNOCAL FEDERAL `8`	1	1995-05-22	1996-10-18	READ & STEVENS INC	READ & STEVENS INC	20S 34E 8 SW NW
30025330430000	TRUMAN FEDERAL	1	1995-08-29	1995-10-19	READ & STEVENS INC	READ & STEVENS INC	20S 34E 4
30025306330001	TRUMAN FEDERAL	2	1995-12-27	1996-02-11	READ & STEVENS INC	READ & STEVENS INC	20S 34E 4 NW SE
30025333740000	TRUMAN FEDERAL	3	1996-04-11	1996-06-24	READ & STEVENS INC	READ & STEVENS INC	20S 34E 4
30025335160000	TRUMAN FEDERAL	4	1996-07-31	1996-09-11	READ & STEVENS INC	READ & STEVENS INC	20S 34E 4
30025336650000	TRUMAN FEDERAL	5	1996-10-28	1996-12-15	READ & STEVENS INC	READ & STEVENS INC	20S 34E 4
30025338590000	TRUMAN FEDERAL	6	1997-03-06	1997-04-21	READ & STEVENS INC	READ & STEVENS INC	20S 34E 4
30025338720000	TRUMAN FEDERAL	7	1997-05-12	1997-06-19	READ & STEVENS INC	READ & STEVENS INC	20S 34E 4

Exhibit
2

READ & STEVENS, INC.
OIL PRODUCERS

Mailing address
P. O. Box 1518
Roswell, New Mexico 88202

400 Penn Plaza, Suite 1000
Roswell, New Mexico 88201

Phone: 575/622-3770
Fax: 575/622-8643

April 25, 2014

Certified Mail

WORKING INTEREST OWNERS

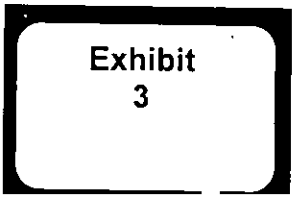
RE: Proposed Horizontal 3rd Bone Spring Test
North Lea 9 Fed #2H
Section 9, T-20-S, R-34-E
Lea County, New Mexico

Ladies and Gentlemen:

Read Operating Company, LLC ("ROC") proposes to drill a horizontal 3rd Bone Spring test in Section 9, T-20-S, R-34-E, Lea County, New Mexico. The well will be called the North Lea 9 Fed #2H with a surface location of 200' FSL and 1670' FEL of Section 4, T-20-S, R-34-E and a bottom hole location of 330' FSL and 1670' FEL of Section 9, T-20-S, R-34-E. We anticipate drilling the well to a total vertical depth of approximately 10,930' and total measured depth of 15,818'. If successful, a 160 acre project area/spacing unit will be assigned to the well comprising of the W/2E/2 of Section 9. We will additionally drill a pilot hole to the middle of the Wolfcamp Zone with sidewall cores and full log suite, and you will be required to make an election at casing point.

Enclosed are duplicate originals of ROC's costs estimate (AFE) for this well. The estimated cost is $8,069,520, as shown on the enclosed AFE. Please indicate in the space provided on page 3 of this letter, your election to participate in this proposal by signing and returning the enclosed AFE along with the same Page 3 within 30 days of receipt of this letter to the attention of: Dianna Dosher, Landman, Read & Stevens, Inc., P.O. Box 1518, Roswell, NM, 88202-1518. We anticipate operations to commence on or about July 1, 2014. ***Those parties electing not to participate or failing to respond within 30 days of receipt of this letter, shall be deemed to have elected to go non-consent in this operation.***

Please note that ROC's AFE provides that by signing the AFE, you agree to be covered by ROC's well control insurance and agree to the limits within and carrier of such insurance, neither of which is guaranteed as sufficient by ROC. In order to decline coverage by ROC's well control insurance, you must sign the second signature line on the AFE and additionally provide ROC a Certificate of Insurance with waiver of subrogation prior to spud date and agree to hold



ROC harmless for any loss to your interest not covered by your insurance or as otherwise set froth in Exhibit D to the Operating Agreement. Also, if you have not already done so, please provide "Well Information Requirements" and contact information in order that ROC can provide daily drilling reports and test results on the proposed well.

Feel free to contact myself or Dianna Dosher if you have any questions or would like to discuss this proposal in greater detail. I can be reached by phone at (575) 622-3770 ext. 307 or via email at rmcminn@read-stevens.com, Dianna can be reached at extension 305 or via e-mail at ddosher@read-stevens.com.

Very truly yours,

READ & STEVENS, INC
READ OPERATING COMPANY, LLC

Rory McMinn,
President

Dianna Dosher,
Landman

Enclosures

READ & STEVENS, INC.

READ OPERATING COMPANY, LLC

Election to Participate in the Read Operating Company, LLC's North Lea 9 Fed #2H, 3rd Bone Spring Formation Test

I/WE hereby:

_____ Elect to Participate

_____ Elect to Participate and acquire percentage of any non-consent

_____ DO NOT Elect to Participate

Name: _____

By: _____

Its: _____

Date: _____

A postage paid envelope is being provided for return of this Election Page; if participating your signed AFE; the signatory and acknowledgement of the JOA and your prepayment.

400 North Pennsylvania, Suite 1000,
Roswell, NM, 88202
(575) 623-2770

AUTHORITY FOR EXPENDITURE
New Drilling, Recompletion & Re-Entry

AFE Number:
AFE Date: 3/21/2014
R&S Well#:

Well Name: North Lea 9 Fed Com #2H
County, State: Lea County, NM
Projected MD: 15818
Projected TVD: 10980

Location: Sec. 9, T20S, R34E
Field: Bonesprings
SHL: 200'FSL & 1670'FEL
BHL: 330'FSL & 1670'FEL

☑ New Drill ☐ Oil
☐ Recompletion ☐ Gas
☐ Re-Entry ☐ Injector
☑ Development ☐ Exploratory

Prognosis:

Description	Code	Drilling Intangibles	Code	Completion Intangibles	Total Cost
Surface Damages	184	3,203		0	3,203
Conductor Setting	201	0	301	0	0
Fuel	202	263,005	302	33,782	296,787
Location, Roads, ROW & Damages	203	146,781	303	21,350	168,131
Mobilization/Demobilization	204	234,850	305	8,540	243,390
Closed Loop Solids Control Equipment	207	59,689	307	5,704	65,394
Drilling Day Work	209	748,113	309	84,510	830,624
Pickup & Laydown	210	0	310	0	0
Geologist/Engineering Consultant	211	86,481	311	23,699	110,180
Bits & Reamers	212	57,111	312	4,270	61,381
Plug Bond	213	0	313	0	0
Closed Loop Haul -off/Disposal	214	120,858		0	120,858
Casing Crew		0	314	0	0
Mud & Chemicals	215	154,788	315	9,608	164,395
Trailer, Septic, Corn	216	51,268	316	3,845	55,113
Mud/Gas Sep & Flare Line	217	0	317	0	0
Water	218	35,757	318	299,664	335,421
Equipment Rental (Sub Surface)	220	3,203	320	0	3,203
Equipment Rental	221	69,570	321	93,865	163,435
Other Special Equipment	222	5,338	323	0	5,338
Wireline Logs	224	241,256	324	0	241,256
Wireline & Coil Tubing	225	0	326	0	0
Drill Stem Test	227	0	326	0	0
Coring & Testing	228	46,671	327	0	46,671
Mud Logging	230	41,511	364	0	41,511
Land Man Service		0	331	0	0
Trucking	233	95,163	333	98,637	193,800
Supervision	236	69,015	336	7,817	76,833
Cement & Float Equipment	239	130,769	339	65,118	195,886
Bond Log, Perforating	242	0	342	0	0
Safety Equipment		0	343	0	0
Acidizing	245	0	345	0	0
Completion Unit	248	0	348	22,044	22,044
Dozer & Forklift	250	0	350	0	0
Contract Services	251	0	351	0	0
Insurance	252	13,603	352	0	13,603
Inspection	254	42,228	354	0	42,228
Legal	255	0	355	0	0
Drilling Title	256	0		0	0
Overhead	257	8,000	357	0	8,000
Engineering Services	260	201,755	360	0	201,755
Professional Fees	265	0		0	0
Misc Connections & Fittings		0	366	26,688	26,688
Fracturing Service	269	0	369	2,346,500	2,346,500
Pipeline Construction		0	370	0	0
Pit Liner	272	0	371	0	0
Step Rate Testing		0	372	0	0
Injection Fall Off Test		0	375	0	0
Roustabout Labor	277	5,338	377	42,700	48,038
Safety & Environment	278	7,481	381	0	7,481
Pump In Test		0	378	0	0
Survey , Permit	281	0	380	0	0
Nipple up BOP	284	21,350	386	5,338	26,688
Turnkey	287	0	387	0	0
Fishing Services	290	0	398	0	0
Other Intangibles		0	390	0	0
Directional Drilling	291	404,171	391	4,226	408,396
Other Services	292	38,430	392	4,270	42,700
Water Disposal	293	0	393	0	0
Other Materials & Supplies	294	0	394	0	0
Welder & Labor	298	18,254	396	4,057	22,311
Other Labor	299	2,135	399	0	2,135
Contingency 3.55%	263	121,100	363	127,020	248,120
TOTAL INTANGIBLES		3,548,224		3,343,230	6,891,454

	Code	Drilling Tangibles	Code	Completion Tangibles	Total Cost
Wellhead	415	46,413		0	46,413
Conductor	401	11,926		0	11,926
Casing 13-3/8": 40#, J-55, STC - 1600ft @34.67/ft	403	59,216		0	59,216
9-5/8": 36#, J-55, STC - 5500ft @33.78/ft	406	198,331		0	198,331
				0	0
5-1/2": 17#, HCP-110, BTC - 15900ft @14.25/ft			503	241,869	241,869
Tubing 2-7/8": 6.5#, L-80, EUE 8RD - 11100ft @8.49/ft	454		509	94,182	94,182
Flowlines, Valves, Fittings			524	69,388	69,388
Storage Facilities			530	69,870	69,870
Separation Equipment			533	42,700	42,700
Electrical Equipment			542	42,700	42,700
Miscellaneous Tangible Equipment	442		540	90,063	90,063
Pumping Equipment			527	98,075	98,075
Compressors/Dehydrators			541	34,190	34,190
Contingency 6%	463	18,953	583	52,421	71,374
TOTAL TANGIBLES		334,840		843,227	1,178,067
TOTAL WELL COST		Drilling (Drytale) 3,881,063		Completion 4,186,457	Total 8,069,520

Prepared By: Steve Morris Date:

Company Approval: _____ Date: 22 April 2014
Rory McMinn, President

Joint Owner Interest: Amount:

Joint Owner: Joint Owner Approval: _____

By execution of this AFE, the above signee is agreeing to be covered by the Operator's well control insurance and agreeing to the limits within and carrier of such insurance, neither of which is guaranteed as sufficient by Operator. In order to decline coverage by Operator's well control insurance, you must sign below and provide a Certificate of Insurance with waiver of subrogation prior to spud date and agree to hold Operator harmless for any loss to your interest not covered by your insurance or as otherwise set forth in Exhibit D of the Joint Operating Agreement.

Agree to decline coverage, provide proof, and hold harmless:

By: _____ Date: _____

A.A.P.L. FORM 610 - 1989

MODEL FORM OPERATING AGREEMENT
HORIZONTAL MODIFICATIONS

OPERATING AGREEMENT

DATED

April 15 , 2014 ,
Year

OPERATOR READ OPERATING COMPANY, LLC (ROC)

CONTRACT AREA TOWNSHIP 20 SOUTH, RANGE 34 EAST

SECTION 9: E/2 AS TO DEPTHS FROM 6,500 FEET SUBSURFACE DOWN TO THE BASE OF THE MORROW FORMATION. *(CONTRACT AREA "A")*

SECTION 9: W/2 AS TO DEPTHS FROM 5,000 FEET SUBSURFACE DOWN TO THE BASE OF THE MORROW FORMATION. *(CONTRACT AREA "B")*

COUNTY ~~OR PARISH~~ OF LEA , **STATE OF** NEW MEXICO

EXHIBIT "A"

Attached to and made a part of for all purposes, that certain Joint Operating Agreement dated effective as of April 15, 2014, by and between READ OPERATING COMPANY, LLC, as Operator, and READ & STEVENS, INC., et al, as Non-Operators.

I. CONTRACT LANDS:

Contract Area A:	**Contract Area B:**
Township 20 South, Range 34 East	Township 20 South, Range 34 East
E/2 of Section 9 *as to depths from 6,500 feet subsurface down to the base of the Morrow formation.*	W/2 of Section 9 *as to depths from 5,000 feet subsurface down to the base of the Morrow formation.*

II. WORKING INTERESTS OF THE PARTIES:

Contract Area A:

E/2 of Sec. 9, as to depths from 6,500 feet subsurface down to the base of the Morrow formation.

Party:	Interest:
Read & Stevens, Inc.	21.008750%
Apache Corporation	23.593750%
Snow Oil & Gas, Inc.	12.812500%
Crump Energy Partners, LLC	10.000000%
Crown Oil Partners IV, LP	10.000000%
Magnum Hunter Production, Inc.	8.750000%
Union Hill Oil & Gas Co., Inc., formerly known as Buchholz Oil & Gas Company, Inc.	2.585000%
HOG Partnership, LP	2.500000%[1]
Francis H. Hudson, Trustee of Lindy's Living Trust	1.906250%
Diane L. Hanley, Successor Trustee of the Delmar Hudson Lewis Living Trust under agreement dated September 9, 2002	1.906250%
Moore & Shelton Company, Ltd.	1.125000%
Edward R. Hudson, Jr. and William A. Hudson, II, as Executors of the Estate of Josephine T. Hudson, deceased	0.953125%
Edward R. Hudson, Jr. and wife, Ann F. Hudson	0.953125%
Ard Oil, Ltd.	0.953125%
Zorro Partners, Ltd.	0.953125%
Contract Area A Working Interest Total:	**100.000000%**

[1] Subject to those certain contractual working interests for the depth interval lying between 6,500' subsurface to the base of the Bone Springs formation held by Javelina Partners (75%) and William A. Hudson, II (25%) by virtue of that certain Correction Assignment of Operating Rights dated October 20, 1992, recorded in Book 564, Page 220, Lea County Records.

II. WORKING INTERESTS OF THE PARTIES (Cont'd.):

Contract Area B:

W/2 of Sec. 9, as to depths from 5,000 feet subsurface down to the base of the Morrow formation.

Party:	Interest:
Read & Stevens, Inc.	18.309964%
Apache Corporation	20.894965%
Magnum Hunter Production, Inc.	17.500000%
Crump Energy Partners, LLC	7.500000%
Crown Oil Partners IV, LP	7.500000%
HOG Partnership, LP	5.000000%[2]
Francis H. Hudson, Trustee of Lindy's Living Trust	3.812500%
Diane L. Hanley, Successor Trustee of the Delmar Hudson Lewis Living Trust under agreement dated September 9, 2002	3.812500%
Union Hill Oil & Gas Co., Inc., formerly known as Buchholz Oil & Gas Company, Inc.	2.585000%
Estoril Producing Corporation	2.272571%
Moore & Shelton Company, Ltd.	2.250000%
Edward R. Hudson, Jr. and William A. Hudson, II, as Executors of the Estate of Josephine T. Hudson, deceased	1.906250%
Edward R. Hudson, Jr. and wife Ann F. Hudson	1.906250%
Ard Oil, Ltd.	1.906250%
Zorro Partners, Ltd.	1.906250%
Farwest Corporation	0.937500%
Contract Area B Working Interest Total:	**100.000000%**

III. ADDRESSES OF THE PARTIES:

Read Operating Company, LLC
P.O. Box 1518
Roswell, NM 88202
Tel.: (575) 622-3770

Apache Corporation
303 Veterans Airpark Lane, Suite 3000
Midland, TX 79705-9909
Tel.:

Read & Stevens, Inc.
P.O. Box 1518
Roswell, NM 88202
Tel.: (575) 622-3770

Crump Energy Partners
P.O. Box 50820
Midland, TX 79710-0820
Tel.:

[2] Subject to those certain contractual working interests for the depth interval lying between 6,500' subsurface to the base of the Bone Springs formation held by Javelina Partners (75%) and William A. Hudson, II (25%) by virtue of that certain Correction Assignment of Operating Rights dated October 20, 1992, recorded in Book 564, Page 220, Lea County Records.

Cimarex Energy Co.
600 N. Marienfeld
Suite 600
Midland, TX 79701
MAIN 432.571.7800

May 9, 2014

Read & Stevens, Inc.
Read Operating Company, LLC
P. O. Box 1518
Roswell, New Mexico
Attn: Dianna Dosher

Re: Proposed Horizontal 3rd Bone Spring Test
North Lea 9 Fed #2H
Section 9, T-20S, R-34-E
Lea County, New Mexico

Dear Ms. Dosher:

Magnum Hunter Production, Inc. received the above captioned well proposal (after it was forwarded from our Tulsa office) on Tuesday, May 6, 2014, along with a proposed Operating Agreement covering all of Section 9. Our research reveals that sections 8, 9, S/2 of 4, and S/2 of 5 are currently under an Operating Agreement dated August 1, 1979 which is in full force and effect. Read & Stevens is a party to the existing Operating Agreement.

Additionally, Read & Stevens has no authority to deem any non-operators non-consent for electing not to participate or for failing to respond within 30 days of its letter unless Read & Stevens proposed the well under the existing 8/1/1979 JOA, and clearly it did not, as a proposed JOA was included with the AFE. "Non-consent" is a term in an executed , governing JOA which defines the time allowed for elections and the associated penalties for failing to do so. The only executed and governing JOA that applies here (being the W/2E/2 of section 9, per your proposal) is the 8/1/1979 JOA.

Should Read & Stevens elect to re-propose the above captioned well under the governing JOA, Article VI.B.1, Magnum Hunter will consider its merits. However, Magnum Hunter is the successor operator in title from Unocal and any well lying within the boundary of the contract area will be drilled by Magnum Hunter.

Therefore, Magnum Hunter concludes that your proposal is not valid.

Please feel free to contact me with any questions or comments.

Sincerely,

Mark Compton
Landman

CC: Apache Corporation
Snow Oil & Gas, Inc.

Exhibit
4

Crump Energy Partners, LLC
Crown Oil Partners IV, LP
Union Hill Oil & Gas Co., Inc.
HOG Partnership, LP
Francis H. Hudson, Trustee of Lindy's Living Trust
Diane L. Hanley, Successor Trustee of the Delmar Hudson Lewis Living Trust
Moore & Shelton Company, Ltd.
Edward R. Hudson, Jr. and William A. Hudson II, as Executors of the Est. of Josephine T. Hudson, dec'd.
Edward R. Hudson. Jr. and wife Ann F. Hudson
Ard Oil, Ltd.
Zorro Partners, Ltd.
Estoril Producing Corporation
Farwest Corporation

Cimarex Energy Co.
600 N. Marienfeld
Suite 600
Midland, TX 79701
MAIN 432.571.7800

May 21, 2014

Apache Corporation
303 Veterans Airpark Lane, Suite 3000
Midland, Texas 79705-9909

Via U.S. Certified Mail Return Receipt Requested No. 91 7108 2133 3939 1609 3123

Dear Working Interest Owner:

On May 1, 2014, we, Magnum Hunter Production, Inc. ("Magnum Hunter", a wholly owned subsidiary of Cimarex Energy Co.) received a letter dated April 25, 2014 in which Read Operating Company, LLC ("ROC") proposed a horizontal 3rd Bone Spring test in the W/2 E/2 Section 9-20S-34E, Lea County, New Mexico, and enclosed with said proposal was an Operating Agreement ("Proposed JOA") to be executed by the Working Interest Owners. ROC states in said letter that "...failing to respond within 30 days of receipt of this letter, will be deemed to have elected to go non-consent in this operation"; however, the Proposed JOA has not been executed by Magnum Hunter, and may not have been executed by other Working Interest Owners, therefore, we fail to see how ROC can deem anyone non-consent under an unexecuted contract.

In fact, Magnum Hunter is the current Operator acting under the Operating Agreement dated August 1, 1979, and the referenced lands are subject thereto, and any operation proposed on the referenced lands should be proposed under said Operating Agreement.

Due to the uncertain intent of ROC's proposal referred to above, if such proposal is deemed to have been properly made pursuant to the Operating Agreement dated August 1, 1979, then Magnum Hunter elects to participate therein and shall be the Operator thereof. We hereby request that ROC transfer any drilling permits, right of way, title opinions or other preparations to drill the proposed well to Magnum Hunter, as Operator.

However, since we believe that ROC failed to propose the operation under the existing Operating Agreement, Magnum Hunter, as Operator, hereby proposes the following operation under Article VI B of the Operating Agreement dated August 1, 1979:

Well:	Union Federal 9 #2H
Operation:	Drill a horizontal test well
Location:	Surface Location 200' FSL & 1670' FEL of Section 4-20S-34E
	Bottom Hole Location 330' FSL & 1670' FEL of Section 9-20S-34E
Objective Formation:	3rd Bone Spring formation
Approximate Depth:	TVD of +/- 10,910' and +/- 4,149' lateral (as further described on attached AFE)

Exhibit 5

Enclosed, in duplicate, is Magnum Hunter's detailed AFE reflecting the estimated costs associated with the proposed operation. Please sign and return one copy of this letter indicating your election to either participate or to not participate, and, if you intend to participate, approve and return one (1) original of the enclosed AFE along with the contact information to receive your well data, to the undersigned within thirty (30) days of receipt of this proposal. If you elect to purchase your own well control insurance, you must provide a certificate of such insurance to Cimarex prior to commencement of drilling operations; otherwise, you will be covered by insurance procured by Cimarex and will be responsible for your share of the cost.

Should you have any questions, please call me at 432-571-7896.

Sincerely,

Mark Compton
Landman

ELECTION TO PARTICIPATE
Union Federal 9 #2H
SHL 200' FSL & 1670' FEL of Section 4 & BHL 330' FSL & 1670' FEL of Section 9; T20S-R34E
Lea County, New Mexico

_____ Elects **TO** participate in the proposed Union Federal 9 #2H.

_____ Elects **TO NOT** participate in the proposed Union Federal 9 #2H.

Dated this _____ day of _____, 2014.

Company/Name:_____

Signature: _____

Title: _____

If your election above is TO participate in the proposed Cimarex Energy Co. Well, then:

_____ Elects TO be covered by well control insurance procured by Cimarex Energy Co.

_____ Elects TO NOT be covered by well control insurance procured by Cimarex Energy Co. and agrees to provide Cimarex Energy Co. with a certificate of insurance prior to commencement of drilling operations or be deemed to have elected to be covered by well control insurance procured by Cimarex Energy Co.

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 8606
Order No. R-8013

APPLICATION OF DOYLE HARTMAN FOR SIMULTANEOUS DEDICATION AND COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8 a.m. on July 2, 1985, at Santa Fe, New Mexico, before Examiner Gilbert P. Quintana.

NOW, on this 20th day of August, 1985, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

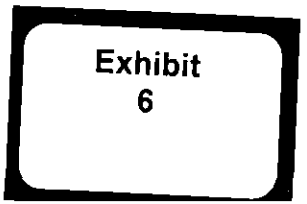
FINDS THAT:

(1) Due public notice having been given as required by law, the Division has jurisdiction of this cause and the subject matter thereof.

(2) The applicant, Doyle Hartman, seeks an order pooling all mineral interests from the surface to the base of the Jalmat Gas Pool underlying the NW/4 of Section 8, Township 24 South, Range 37 East, NMPM, Lea County, New Mexico, forming a previously approved 160-acre non-standard spacing and proration unit in the Jalmat Gas Pool.

(3) The applicant proposes to simultaneously dedicate said gas proration unit to his existing E. E. Jack Well No. 1 located 1980 feet from the North line and 660 feet from the West line (Unit E) of said Section 8 and his proposed E. E. Jack Well No. 5 to be drilled at a standard location within said unit.

(4) Marilyn A. Tarlton, interest owner in the subject proration unit and trustee of the surviving trustor's trust of the Lortscher Family Trust, dated November 26, 1980, has not agreed to the drilling of said E. E. Jack Well No. 5.



(5) Evidence was presented showing that an operating agreement entitled, "Operating Agreement", dated January 16, 1951, covering the subject unit area, was entered into by and between Howard Hogan, operator, and Charles T. Scott, Harold S. Russell, Herbert J. Schmitz, and F. D. Lortscher, non-operators.

(6) Said operating agreement was modified December 15, 1954, by an agreement entitled, "Modification of Operating Agreement" and was entered into by and between R. Olsen, operator, and the same non-operators in Finding No. (5) above.

(7) The applicant, Doyle Hartman, controls 66.667 percent of the subject proration unit, including the titles of Howard Hogan, R. Olsen, Herbert J. Schmitz, and Charles T. Scott, Jr.

(8) Marilyn A. Tarlton controls the title of F. D. Lortscher, which is 20 percent of the subject proration unit.

(9) Ms. Tarlton contends that the applicant, other interest owners, and herself are governed by the operating agreements in Findings Nos. (5) and (6) above, hereafter referred to as the "Agreements."

(10) The "Agreements" have provisions for the drilling of additional wells on the subject proration unit, including provisions for non-consent drilling risk penalties, drilling supervision charges, and production supervision charges.

(11) The applicant failed to provide evidence to refute that the "Agreements" are not binding and do not govern the operation of the subject proration unit.

(12) Because of a lack of evidence to the contrary, it appears that the "Agreements" are current binding operating agreements for the subject proration unit, having provisions governing those issues to be addressed in compulsory pooling cases obviating the need for such a hearing in this case.

(13) The compulsory pooling portion of this application should be denied.

(14) The simultaneous dedication portion of this application should be approved, provided the proposed new well is drilled under the provisions of the "Agreements."

IT IS THEREFORE ORDERED THAT:

(1) The portion of the application of Doyle Hartman seeking an order pooling all mineral interests from the surface to the base of the Jalmat Gas Pool underlying the NW/4 of Section 8, Township 24 South, Range 37 East, NMPM, Lea County, New Mexico, is hereby denied.

(2) The previously approved 160-acre non-standard gas proration unit, comprising the NW/4 of said Section 8, shall be simultaneously dedicated to the proposed E. E. Jack Well No. 5 and the applicant's E. E. Jack Well No. 1 located in Unit E of said Section 8 provided the E. E. Jack Well No. 5 is drilled under the terms of the "Agreements."

(3) Jurisdiction of this cause is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

R. L. STAMETS
Director

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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING
CALLED BY THE OIL CONSERVATION
DIVISION FOR THE PURPOSE OF
CONSIDERING:

CASE NO. 10658
ORDER NO. R-9841

APPLICATION OF MEWBOURNE OIL COMPANY FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on January 21, 1993, at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this 3rd day of February, 1993, the Division Director, having considered the testimony, the record and the recommendations of the Examiner, and being fully advised in the premises,

FINDS THAT:

(1) Due public notice having been given as required by law, the Division has jurisdiction of this cause and the subject matter thereof.

(2) The applicant, Mewbourne Oil Company, seeks an order pooling all mineral interests from the base of the Abo formation to the base of the Morrow formation, underlying the following described acreage in Section 35, Township 17 South, Range 27 East, NMPM, Eddy County, New Mexico, and in the following manner:

> the W/2 forming a standard 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within said vertical extent, which presently includes, but is not necessarily limited to, the Undesignated Scoggin Draw-Atoka Gas Pool, Undesignated North Illinois Camp-Morrow Gas Pool, Undesignated Scoggin-Morrow Gas Pool and Undesignated Logan Draw-Morrow Gas Pool;

the NW/4 forming a standard 160-acre gas spacing and proration unit for any and all formations and/or pools developed on 160-acre spacing within said vertical extent, which presently includes only the Undesignated Logan Draw-Wolfcamp Gas Pool; and,

the E/2 NW/4 forming a standard 80-acre oil spacing and proration unit for any pools developed on 80-acre spacing within said vertical extent, of which there are currently none.

(3) Said units are to be dedicated to the applicant's Chalk Bluff "35" Federal Well No. 2, to be drilled at an orthodox gas well location within the SE/4 NW/4 (Unit F) of said Section 35.

(4) Devon Energy Corporation (Devon), successor owner of Malco Refineries, Inc.'s interest in the NW/4 and NW/4 SW/4 of said Section 35, appeared at the hearing through counsel and opposed the application on the basis that its interest is governed by an operating agreement with Mewbourne Oil Company, who is the successor owner of the Stanolind Oil and Gas Company underlying the same acreage.

(5) Devon claims its interest is bound under the agreements reached by Malco Refineries, Inc. and Stanolind Oil and Gas Company in July, 1953 and April, 1958, being Devon's Exhibit "A" and "B" in this case.

Mewbourne, also represented by counsel, contends that a supplemental agreement is necessary where acreage outside the "contract lands" are included in a spacing unit, being the NE/4 SW/4 and S/2 SW/4 of said Section 35, which is 100% Mewbourne-contracted properties. Since both parties have not agreed to a "supplemental agreement", Mewbourne contends that the original agreement is invalid and seeks to force-pool Devon's interest into the W/2 spacing unit.

FINDING: Since under the "force-pooling" statutes (Chapter 70-2-17 of the NMSA 1978) there exists in this matter an agreement between the two parties owning undivided interests in a proposed 320-acre gas spacing and proration unit, an order from the Division pooling said parties is unnecessary.

(6) This case should therefore be dismissed.

IT IS THEREFORE ORDERED THAT:

(1) Case No. 10658 is hereby **dismissed**.

(2) Jurisdiction of this cause is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

WILLIAM J. LEMAY
Director

S E A L

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING
CALLED BY THE OIL CONSERVATION
DIVISION FOR THE PURPOSE OF
CONSIDERING:

CASE NO. 11434
ORDER NO. R-10545

APPLICATION OF MERIDIAN OIL, INC. FOR COMPULSORY POOLING AND AN UNORTHODOX GAS WELL LOCATION, SAN JUAN COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on January 11, 1996, at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this 22nd day of February, 1996, the Division Director, having considered the record and the recommendations of the Examiner, and being fully advised in the premises,

FINDS THAT:

(1) Due public notice having been given as required by law, the Division has jurisdiction of this cause and the subject matter thereof.

(2) The applicant, Meridian Oil, Inc. ("Meridian"), seeks an order pooling all mineral interests in the Blanco-Mesaverde Pool underlying an existing 313.63-acre gas spacing and proration unit comprising Lots 1, 2, 7, 8, 9, 10, 15, and 16 (the E/2 equivalent) of Section 23, Township 31 North, Range 9 West, NMPM, San Juan County, New Mexico, for the drilling and completion of its proposed Seymour Well No. 7-A to be drilled at an unorthodox infill gas well location 1,615 feet from the South line and 2,200 feet from the East line (Unit J) of said Section 23.

(3) Said unit is currently dedicated to Meridian's Seymour Well No. 7 (**API No. 30-045-10597**), located at a standard gas well location 1,170 feet from the North line and 970 feet from the East line (Lot 1/Unit A) of said Section 23.

(4) By New Mexico Oil Conservation Commission ("Commission") Order No. 799, dated February 25, 1949, the Blanco-Mesaverde Pool was created, defined, and 320-acre spacing was established therefor. By Order No. R-128-C, issued on December 16, 1954 the Commission instituted gas prorationing in the Blanco-Mesaverde Pool to be made effective March 1, 1955. By Order No. R-1670-T, dated November 14, 1974, the rules governing the Blanco-Mesaverde Pool were amended to permit the optional "infill drilling" of an additional well on each 320-acre gas spacing and proration unit within the Blanco-Mesaverde Pool.

(5) Prior to the hearing Doyle Hartman and Margaret Hartman, doing business as Doyle Hartman, Oil Operator ("Hartman"), who own a 12.500% working interest in the subject acreage, filed a motion to dismiss this case. By letter dated January 8, 1996 the Division denied Hartman's request and this matter remained on the Division's docket for the immediate hearing.

(6) At the time of the hearing Hartman and Four Star Oil & Gas Company ("Four Star") again requested that this matter be dismissed on the grounds that the subject acreage is currently subject to an Operating Agreement and a Communitization Agreement that have been in effect since 1953 and that Meridian failed to undertake reasonable efforts to obtain voluntary joinder of their respective interests in drilling the proposed infill well.

(7) Meridian was allowed to present testimony on land and ownership matters in this case, which indicates that:

(a) the E/2 equivalent of said Section 23 consists of two separate Federal oil and gas leases, each dated May 1, 1948, with:

(i) tract 1 comprising the NE/4 equivalent of said Section 23 issued to John C. Dawson; and,

(ii) tract 2 comprising the SE/4 equivalent of said Section 23 issued to Claude A. Teel;

(b) on March 30, 1953 a communitization agreement was made for the E/2 equivalent of said Section 23 between Southern Union Gas Company, Meridian's predecessor in interest and as operator of the Seymour Well No. 7, and Skelly Oil Company, Four Star's predecessor in interest;

(c) on April 10, 1953, the working interest owners in the E/2 equivalent of said Section 23 entered into an operating agreement which:

(i) provided for the drilling of the Seymour Well No. 7 in Unit "A" of said Section 23;

(ii) designated Southern Union Gas Company operator of the unit;

(iii) governs operations in the Mesaverde formation in the E/2 equivalent of said Section 23; and,

(iv) binds the successors and assigns of the original parties; and,

(d) on November 10, 1953 Southern Union Gas Company spudded the Seymour Well No. 7 and completed it as a producing Mesaverde gas well to which the E/2 equivalent of said Section 23 was dedicated.

(8) By letters dated January 27 and April 12, 1993 Meridian advised all working interest owners within this 320-acre unit that the 1953 Operating Agreement did not contain any subsequent well provisions and therefore proposed a new Joint Operating Agreement for the drilling of an "infill" Blanco-Mesaverde well in the SE/4 equivalent of said Section 23.

(9) Meridian by letter dated October 31, 1995 renewed its request for a voluntary agreement of the working interests for the drilling of the proposed infill well. Eight days later by letter dated November 8, 1995 Meridian filed with the Division its application to force pool this acreage for the Seymour Well No. 7-A.

(10) *It is both Four Star's and Hartman's position that pursuant to Section 70-2-17.C of the New Mexico Oil & Gas Act of N.M.S.A. 1978 the owners of Mesaverde rights in the E/2 equivalent of said Section 23 have a voluntary agreement in place and that the Division may not force pool this acreage.*

FINDING: Pursuant to Section 70-2-17.E. of said Act the Division may modify the 1953 Operating Agreement to the extent necessary to prevent waste. The Division therefore has jurisdiction over this matter.

(11) Meridian, however, failed to make reasonable efforts to adequately obtain voluntary joinder of all working interests for further development of this acreage prior to filing its application, see Finding Paragraph (9), above; therefore, this case should be dismissed at this time.

IT IS THEREFORE ORDERED THAT:

Case No. 11434 is hereby dismissed.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

WILLIAM J. LEMAY
Director

SEAL

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 13877
ORDER NO. R-12747-A

APPLICATION OF BOLD ENERGY, LP FOR APPROVAL OF AN APPLICATION FOR PERMIT TO DRILL AND TO ALLOW TWO OPERATORS ON A WELL UNIT, EDDY COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on May 10, 2007, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 7th day of June, 2007, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) Due notice has been given, and the Division has jurisdiction of the parties and of the subject matter.

(2) Bold Energy, LP ("Bold" or "Applicant") filed this application seeking approval of its Application for Permit to Drill ("APD") for its proposed OXY Checker State Well No. 2 ("the proposed well"), to be located in the SW/4 NW/4 (Unit E) of Section 8, Township 19 South, Range 29 East, NMPM, Eddy County, New Mexico.

(3) Bold proposes to drill the proposed well to a depth sufficient to test the Wolfcamp and Canyon formations.

(4) Well spacing in the Wolfcamp and Canyon formations at this location is governed by statewide Rule 104.C(2), which provides that spacing units shall consist of 320 acres. Pursuant to this spacing pattern, the W/2 of Section 8 is dedicated to the OXY Checker State Well No. 1, located in the NW/4 SW/4 (Unit L) of Section 8. OXY USA WTP Limited Partnership ("OXY") is the operator of that well.

(5) Because the proposed well is to be located in a different quarter section from the Checker State No. 1 well, Rule 104.C(2) would permit a Wolfcamp or Canyon well at the location of the proposed well. However, Rule 104.E requires that an operator who proposes to drill a well in a spacing unit that is dedicated to another operator's existing well shall first give notice to the other operator.

(6) Bold notified OXY of its intent to drill the proposed well. OXY objected, and the Artesia District Office of the Division denied Bold's APD. Bold accordingly filed this application.

(7) Both Bold and OXY appeared at the hearing through counsel, and both parties offered testimony from experts in petroleum land matters. Neither party offered any geologic or engineering evidence.

(8) The parties' land witnesses testified to the following matters, which, except as expressly indicated below, were not controverted:

(a) Both Bold and OXY, along with others who did not appear in this case, own interests in the W/2 of Section 8.

(b) The owners of this tract are parties to a Joint Operating Agreement ("the JOA"), which was admitted in evidence. The JOA designates OXY as the operator of this unit.

(c) There previously existed a letter agreement between the parties that also contained provisions with respect to operation of wells on this land. However, the parties have now agreed to terminate that letter agreement, leaving the JOA as the only applicable agreement.

(d) On November 27, 2006, Bold sent OXY a proposal under the JOA for drilling the proposed well as a Wolfcamp/Canyon test. OXY did not elect to participate in the well. Under the terms of the JOA, OXY's failure to elect to participate constituted an election not to participate. However, at the time of this proposal, OXY had not agreed to termination of the letter agreement. OXY's witness testified that OXY did not consent to Bold's proposal under the JOA because OXY regarded the letter agreement as the controlling agreement at that time.

(e) Bold wants to drill the proposed well as a Walfcamp/Canyon test, and does not want to drill to the deeper Morrow formation at this location.

(f) Bold is willing to, and in fact intends to, re-propose the proposed well under the JOA.

(g) OXY's witness testified that OXY preferred, if a well were drilled at the proposed location, that it be drilled to a depth sufficient to test the Morrow. However OXY's witness disclaimed knowledge as to whether OXY would propose a well, or whether it would, or would not, elect to participate in Bold's proposal, and disclaimed knowledge as to whether the proposed well could be subsequently deepened to test the Morrow.

(9) Counsel for OXY argued that the granting of this application would affect the economics of a Morrow well on this unit, and accordingly could cause waste, and impair correlative rights, by practically precluding development of otherwise recoverable gas. However, OXY presented no geologic testimony to indicate that the Morrow at this location would be an economic prospect in any case, nor did OXY's witness testify when, if at all, OXY proposes to pursue that prospect. Furthermore, there was no evidence as to whether the proposed well could be deepened to test the Morrow.

(10) Assuming that drilling a shallow well that would impair the economics of a contemplated deeper prospect might, in some cases, constitute waste or impair correlative rights, there is not sufficient evidence to resolve this case on that basis.

(11) The presentations of the parties focused on the legal rights of the parties to drill and operate the proposed well.

(12) Both parties agreed that their rights to drill and operate are now governed by the JOA. The JOA provides that the operator, and only the operator, may conduct operations on the unit, except in the case where a non-operator proposes an operation, and the operator does not elect to participate in that operation. In that case, the participating non-operators may designate one of them to conduct the operation.

(13) In this case, Bold, a non-operator, proposed the drilling of the proposed well, and OXY, the operator, did not elect to participate. OXY's witness testified that OXY did not elect to participate because it believed that the prior letter agreement precluded Bold from making a proposal that required an election under the JOA. Bold disputes that contention. However, Bold does not dispute that it did not commence drilling the well within ninety days after the expiration of OXY's 30-day election time as provided in the JOA.

(14) If the Operator elects to participate in a proposed operation, the JOA clearly requires that the Operator commence the well within the prescribed 90-day period (or authorized extension), and that if it does not do so, a new proposal is required, regardless of the reason for the delay. Because the final sentence of paragraph VI.B.1 of the JOA, which imposes this requirement where the operator is a consenting party, is not repeated in paragraph VI.B.2 which imposes the same time requirement where the operator is not a consenting party, the JOA may be ambiguous as to the effect of failure

to commence the well within the 90-day period in the latter situation. However, it is difficult to conceive what reason the drafters of this form contract would have had for making consent or non-consent elections binding for only 90 days if the operator consented, but binding indefinitely if the operator did not consent.

(15) Regardless of the possible ambiguity of the JOA in this respect, Bold apparently does not now contend that OXY is bound by its failure to elect to participate in the proposed well pursuant to the November 27 proposal. To the contrary, Bold's witness not only repeatedly testified that Bold was willing to make a new proposal, but definitely stated that Bold would make such a proposal as soon as possible after the hearing. In view of this testimony, the Division need not be concerned with the possible ambiguity in the JOA, but can treat this case as one where the non-operator has declared an intention to propose a well under the JOA, but has not yet done so.

(16) The Division has no power to determine contractual rights. However, its decision to grant or deny an APD may affect the exercise of those rights.

(17) The courts of New Mexico have not decided any case which has involved the granting or withholding of an APD in a case that involved disputed titles or contractual rights.

(18) The Supreme Court of Texas, in *Magnolia Petroleum Co. v. Railroad Com'n,* 141 Tex 96, 170 SW2d 189 (1943), held that the Texas Railroad Commission could grant a drilling permit to an operator whose title was disputed, so long as that operator had a good faith claim to the land in question. That court reasoned that a permit from the Railroad Commission did not grant the operator a legal right to drill a well if it did not have the necessary property right. The Court noted, however, that "the Commission should deny the permit if it does not reasonably appear to it that the applicant has a good-faith claim in the property." 170 SW2d at 191.

(19) In this case, Bold's property right is not disputed. However, its right to exercise that property right by physically conducting operations on the land is subject to a condition precedent that it apparently does not dispute. It must first propose the well to the other parties to the JOA, and then its right to conduct operations arises if, but only if, the operator (OXY) elects not to participate. At the time of hearing, these events had not yet occurred. Accordingly it does not appear that Bold had a good faith basis for asserting, or even that it did assert, that it has a present legal right to enter the property to drill this well.

(20) This case is similar to Case No. 13215, decided by the New Mexico Oil Conservation Commission ("the Commission"). In that case an operator applied for permits to re-enter abandoned geothermal wells located on land the surface of which was controlled by the United States Forest Service. There, as here, the applicant's title to an

undivided mineral interest was undisputed. However, under applicable federal law, the applicant was required to obtain a surface use permit from the Forest Service prior to conducting operations on the land. At the time of the hearing, it had not done so. In Order No. 12093-A, entered on February 12, 2004, the Commission rejected the application, concluding that it was premature because the conditions necessary to the applicant's right to conduct operations had not occurred and might never occur. See Order R-12093-A, Finding Paragraphs 21 and 24. This decision appears to control the present case as it was presented in this record.

(21) Accordingly, Bold's application for APD approval should be denied, without prejudice to its reassertion should the conditions precedent to its right to conduct operations on the property be satisfied.

IT IS THEREFORE ORDERED THAT:

(1) The application of Bold Energy, LP for an APD for approval of its proposed OXY Checker State Well No. 2 is denied, without prejudice.

(2) It is assumed that if Bold can demonstrate that it has proposed this well in accordance with the terms of the JOA and OXY has not elected to participate, the Artesia District Office of the Division will approve an APD for this well without the necessity of a further hearing, unless OXY or some other party files an application requesting denial of the APD. Otherwise, this Order is not intended to suggest what decision the Division would make on any state of facts other than that shown at the hearing of this case.

(3) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

MARK E. FESMIRE, P.E.
Director

SEAL