



**UNIT OPERATING AGREEMENT**

**FOR THE**

**EAST HOBBS (SAN ANDRES) UNIT**

**LEA COUNTY, NEW MEXICO**

**EXHIBIT C**

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**UNIT OPERATING AGREEMENT**

**FOR THE**

**EAST HOBBS (SAN ANDRES) UNIT**

**LEA COUNTY, NEW MEXICO**

THIS AGREEMENT ("this agreement" or "this Operating Agreement"), entered into as of the 14th day of February 2003, by the parties who have signed the original of this instrument, a counterpart thereof or other instrument agreeing to be bound by the provisions hereof;

WITNESSETH:

WHEREAS, the parties hereto as Working Interest Owners have executed, as of the date hereof, an agreement entitled, "Unit Agreement for the Development and Operation of the East Hobbs (San Andres) Unit, Lea County, New Mexico" (the "Unit Agreement"), which among other things, provides for a separate agreement to be entered into by Working Interest Owners to provide for the development and operation of the Unit Area as therein defined;

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

**ARTICLE 1**

**CONFIRMATION OF UNIT AGREEMENT AND DEFINITIONS**

1.1 Confirmation of Unit Agreement. The Unit Agreement is hereby confirmed and by reference made a part of this agreement. If there is any conflict between the Unit Agreement and this agreement, the Unit Agreement shall govern.

1.2 Definitions. The definitions contained in the Unit Agreement are adopted for all purposes of this agreement. The words, terms and phrases used in this Agreement are written to convey the most common industry meaning or understanding, but shall also be construed to mean the plural if written in the singular and vice versa. In addition, the following terms, when used herein, shall have the following meanings:

1.2.1 Person is defined as any individual, corporation, partnership, common law or statutory trust, association of any kind, the State of New Mexico or any subdivision or agency thereof acting in a proprietary capacity, guardian, executor, administrator, fiduciary of any kind, or any entity capable of holding an interest in the Unit Area.

1.2.2 Oil and Gas Rights are the rights to explore, develop and operate lands within the Unit Area for the production of Unitized Substances, or to share in the production so obtained or the proceeds thereof.

1.2.3 Unit Equipment is all personal property, lease and well equipment, plants, and other facilities and equipment taken over or otherwise acquired for the joint account for use in Unit Operations.

1.2.4 Unit Expense is all cost, expense, or indebtedness incurred by Working Interest Owners or Unit Operator pursuant to this Agreement and the Unit Agreement for or on account of Unit Operations.

1.2.5 Unit Operations are all operations conducted pursuant to this Agreement and the Unit Agreement.

1.2.6 Unit Operator is the party designated by Working Interest Owners under this Agreement to conduct Unit Operations.

**ARTICLE 2  
EXHIBITS**

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

2.1.1 Exhibits "A", "B" and "C" of the Unit Agreement.

2.1.2 Exhibit D attached hereto is a schedule showing the percentage of total Unit Participation attributable to each Working Interest Owner in each Tract. Exhibit "D", or revisions thereof, shall not be conclusive as to the information therein, except it may be used as showing the Unit Participation of the Working Interest Owners for purposes of this agreement until shown to be in error or as revised as herein authorized.

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

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

2.1.5 Exhibit "G", attached hereto, contains an inventory of wells, equipment and other personal property to be utilized in Unit Operations and a pricing of such material.

2.2 Revision of Exhibits. Whenever Exhibits "A", "B" and "C" are revised, Exhibit "D" shall be revised accordingly and be effective as of the same date. Unit Operator shall also revise the Exhibit "D" from time to time, as required, to conform to changes in ownership of which Unit Operator has been notified as provided in the Unit Agreement.

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

**ARTICLE 3  
SUPERVISION OF OPERATIONS BY WORKING INTEREST OWNERS**

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

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

3.2.1 Method of Operation. The method of operation, including any type of pressure maintenance, enhanced recovery or other recovery program to be employed.

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

3.2.3 Well Recompletion and Change of Status. The recompletion, abandonment or change of status of any well, or the use of any well for injection or other purposes.

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

3.2.5 Expenditures. The making of any single expenditure in excess of Twenty- Five Thousand Dollars (\$25,000.00); provided that, approval by Working Interest Owners of the drilling, reworking, deepening or plugging back of any well shall include approval of all necessary expenditures required therefore, and for completing, testing and equipping the same including necessary flow lines, separators and lease tankage.

3.2.6 Disposition of Unit Equipment. The selling or otherwise disposing of any major item of surplus Unit Equipment, if the current list price of new equipment similar thereto is in excess of Ten Thousand Dollars (\$10,000.00).

3.2.7 Appearance Before a Court or Regulatory Agency. The designating of a representative to appear before any court or regulatory agency in matters pertaining to Unit Operations; and shall be made in accordance with Article 4, Paragraph 4.3.2; provided that, such designation shall not prevent any Working Interest Owner from appearing in person or from designating another representative in its own behalf, at its expense.

3.2.8 Audits. The auditing of the accounts of Unit Operator pertaining to Unit Operations hereunder, provided that the audits shall:

- (a) Not be conducted more than once each year, except upon the resignation or removal of Unit Operator;
- (b) Be made upon the approval of sixty percent (60%) or more of the Unit Participation interests of the Working Interest Owners, after excluding the Unit Participation interest of the Unit Operator, voting in the affirmative, at the expense of all Working Interest Owners, other than the Working Interest Owner designated as Unit Operator; and
- (c) Be made upon not less than thirty (30) days written notice to Unit Operator and in accordance with guidelines established by the Council of Petroleum Accountants Societies.

3.2.9 Inventories. Taking of periodic inventories under the terms of Exhibit "E".

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

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

3.2.12 Removal of Unit Operator. The removal of Unit Operator and the selection of a successor as provided in the Unit Agreement.

3.2.13 Changes and Amendments. The changing of the Unit Area or the amending of this agreement or the Unit Agreement as provided by the Unit Agreement.

3.2.14 Investment Adjustment. The adjustment and readjustment of investments.

3.2.15 Termination of Unit Agreement. The termination of the Unit Agreement as provided therein.

#### ARTICLE 4 MANNER OF EXERCISING SUPERVISION

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

4.2 Meetings. All meetings of Working Interest Owners shall be called by Unit Operator upon its own motion or at the request of one (1) or more of the Working Interest Owners having a total Unit Participation of not less than ten percent (10%). No meeting shall be called less than fourteen (14) days advance written notice. The Owner requesting the meeting shall prepare an agenda outlining the topics to be discussed at the proposed meeting and attach it to the notice requesting the meeting. Working Interest Owners who attend the meeting shall not be prevented from adding to or amending items on the agenda or from acting upon the amended items or other added items presented at the meeting. The representative of the Unit Operator shall be chairman of each meeting. The Unit Operator will prepare and furnish minutes of all meetings to the Working Interest Owners.

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

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

4.3.2 Vote Required - Generally. Unless otherwise provided herein or in the Unit Agreement, all matters shall be decided by an affirmative vote of two-thirds or more voting interest; provided that, should any one Working Interest Owner have more than two-thirds of the voting interest, its vote must be supported by the vote of one (1) or more Working Interest Owners; provided, further however, that the negative vote of any one Working Interest Owner having more than one-third (1/3) but less than one-half (1/2) of such voting interest shall not defeat a motion or measure, unless such owner is joined by the negative vote of one or more other Working Interest Owners.

4.3.3 Vote at Meeting by Non-Attending Working Interest Owner. Any Working Interest Owner who is not represented at a meeting may vote by letter, fax or telegram addressed to the representative of the Unit Operator, if its vote is received prior to the vote on the item. Such vote will not be counted with respect to any item on the agenda which is amended at the meeting.

4.3.4 Poll Votes. Working Interest Owners may vote by letter, fax or telegram on any matter submitted in writing to all Working Interest Owners. If a meeting is not requested, as provided in Section 4.2, within fourteen (14) days after a written proposal is sent to Working Interest Owners, the vote taken by letter or telegram shall control. Failure to vote within the time prescribed by the Unit Operator, which shall be no less than fourteen (14) days after receipt of such matter, shall be deemed to be a positive vote with respect to the proposal. Unit Operator shall give prompt notice of the results of such voting to each Working Interest Owner.

4.3.5 Binding Effect of Vote. All Working Interest Owners shall be bound for their proportionate share of all costs and expenses of Unit Operations approved by the Working Interest Owners by the vote required herein.

## ARTICLE 5

### INDIVIDUAL RIGHTS OF WORKING INTEREST OWNERS

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

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

5.2.1 Access to Unit Area. Access to the Unit Area at all reasonable times at Working Interest Owner's sole risk and expense to inspect Unit Operations, all wells, and the records and data pertaining thereto.

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

5.3 Taking Unitized Substances in Kind. The Unitized Substances allocated to each Tract shall be taken in kind by the respective parties entitled thereto by virtue of the ownership of Oil and Gas Rights therein or by purchase from such owners. Such parties shall have the right at their sole cost and expense, to construct, maintain and operate within the Unit Area all necessary facilities for that purpose, provided that they are so constructed, maintained and operated as not to interfere with Unit Operations. Any extra expenditures incurred by Unit Operator by reason of the delivery in kind of any portion of the Unitized Substances shall be borne by the receiving party. If a Royalty Owner has the right to take in kind a share of Unitized Substances and fails to do so, the Working Interest Owner whose working interest is subject to such Royalty Interest shall be entitled to take in kind such share of Unitized Substances.

5.4 Failure to Take in Kind. If any party fails to take in kind or separately dispose of such party's share of Unitized Substances, Unit Operator shall have the right, but not the obligation, for the time being and subject to revocation at will by the party owning the share and giving Unit Operator thirty (30) days written notice thereof, to purchase such share for its own account or to sell to others, at the same market value realized by Unit Operator. However, should Unit Operator's purchaser of Unitized Substances be an affiliate, such party's share of Unitized Substances shall be purchased by Unit Operator or sold, unless otherwise agreed to in writing, at an equivalent price to the best price obtainable in the area for such production from an independent purchaser. The intent of the parties is to keep the production and the sale of Unitized Substances balanced at all times. Contracts of sale by Unit Operator of any other party's share of Unitized Substances shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the circumstances, but in no event shall any such contract be for a period in excess of one (1) year. The proceeds of the Unitized Substances so disposed of by Unit Operator shall be paid in accordance with the Unit Agreement and applicable laws and regulations.

5.5 No Sharing of Market. Nothing herein shall be construed to provide directly or indirectly for any cooperative refining, joining sale or marketing of Unit Production.

## ARTICLE 6 UNIT OPERATOR

6.1 Initial Unit Operator. EnerQuest Resources, LLC is hereby designated Unit Operator.

## ARTICLE 7 AUTHORITIES AND DUTIES OF UNIT OPERATOR

7.1 Exclusive Right to Operate Unit. Subject to the provisions of this agreement and to instructions from Working Interest Owners, Unit Operator shall have the exclusive right and be obligated to conduct Unit Operations. Notwithstanding anything contained herein or in the Unit Agreement to the contrary, Unit Operator shall not be deemed to be a fiduciary on behalf of Working Interest Owners or have the duties and responsibilities associated with a fiduciary or agency relationship. In its performance of services hereunder for Working Interest Owners, the Unit Operator shall act in a good and workmanlike manner as would a prudent operator under the same or similar circumstances. The conduct of Unit Operator shall comply with Article 7.2 below but as noted above shall not give rise to any fiduciary relationship or duties.

7.2 Workmanlike Conduct. Unit Operator shall conduct Unit Operations in a good and workmanlike manner as would a prudent operator under the same or similar circumstances. Unit Operator shall freely consult with Working Interest Owners and keep them informed of all matters which Unit Operator, in the exercise of its best judgment, considers important. Unit Operator shall not be liable to Working Interest Owners for damages caused by its operations unless such damages result from its gross negligence or willful misconduct. **EXCEPT FOR UNIT OPERATOR'S INTEREST IN THE UNIT AREA (IF ANY), WORKING INTEREST OWNERS SHALL INDEMNIFY UNIT OPERATOR FOR, FROM, AND AGAINST ANY AND ALL CLAIMS, DAMAGES AND LIABILITY OF EVERY KIND AND CHARACTER (INCLUDING ALL COSTS AND EXPENSES, INCLUDING BUT NOT LIMITED TO ATTORNEYS FEES), RESULTING FROM, ARISING OUT OF, OR INCIDENTAL TO UNIT OPERATOR'S PERFORMANCE OF DUTIES ON THE UNIT AREA EVEN IF SUCH LIABILITIES ARISE FROM OR ARE ATTRIBUTABLE TO UNIT OPERATOR'S NEGLIGENCE. THE ONLY LIABILITIES TO WHICH THIS INDEMNITY OBLIGATION DOES NOT APPLY ARE THOSE RESULTING FROM UNIT OPERATOR'S GROSS NEGLIGENCE OR INTENTIONAL TORTS FOR WHICH UNIT OPERATOR SHALL BE SOLELY RESPONSIBLE.**

7.3 Liens and Encumbrances. Unit Operator shall keep the lands and leases in the Unit Area free from all liens and encumbrances occasioned by Unit Operations except the lien of Unit Operator granted hereunder.

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

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

7.6 Reports to Working Interest Owners. Unit Operator shall furnish to Working Interest Owners periodic reports on Unit Operation.

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

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

7.9 Expenditures. Unit Operator is authorized to make single expenditures not in excess of Twenty-Five Thousand Dollars (\$25,000.00) without prior approval of Working Interest Owners. If an emergency occurs, Unit Operator may immediately make or incur such expenditures as in its reasonable opinion are required to deal with the emergency. Unit Operator shall report to Working Interest Owners, as promptly as possible, the nature of the emergency and the action taken. Upon request, Unit Operator shall furnish Working Interest Owners, for information purposes, copies of its Authorities for Expenditures for any single project costing in excess of Twenty-Five Thousand Dollars (\$25,000.00), and for lesser amounts when prepared for Unit Operator's own use.

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

## ARTICLE 8 TAXES

8.1 Severance, Gross Products and Ad Valorem Taxes. Beginning with the first calendar year after the effective date hereof, Unit Operator shall render and pay on behalf of the Working Interest Owners severance and gross products taxes assessed on oil and gas produced and ad valorem tax on all property subject to this agreement, before they become delinquent. Prior to the rendition date, each Working Interest Owner shall furnish the Unit Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) and taxable and non-taxable interests on leases and oil and gas interests contributed by such Working Interest Owner. If the assessed tax of any leasehold estate or produced Substances is reduced by reason of its being subject to outstanding excess royalties, overriding royalties, reimbursements, or production payments, the reduction in taxes shall inure to the benefit of the owner or owners of such leasehold or Unitized Substances, and Unit Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. Unit Operator shall charge the Working Interest Owners for their proportionate share of severance and gross products tax at the date the tax is assessed based on the value each Working Interest Owner receives for their sales of the unitized substances. Unit Operator shall charge the Working Interest Owners for their proportionate share of all other tax payments in the manner provided in Exhibit "E" and other parties for their share in the manner provided in the Unit Agreement.

If Unit Operator considers any tax assessment improper, Unit Operator may, after notice to Working Interest Owners, 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. All direct expenses incurred by Unit Operator in protesting an assessment will constitute a direct charge to the joint account. During the pendency of administrative or judicial proceedings, Unit 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, Unit Operator shall pay the tax for the joint account and other parties, 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 "E" and the Unit Agreement, respectively.

8.2 Notices. Each Working Interest Owner shall promptly furnish the Unit Operator with copies of notices, assessments, levies or tax statements received by it pertaining to the taxes to be paid by the Unit Operator. Each month, the Working Interest Owners shall furnish the Unit Operator with

the gross value of any production taken in kind or other information necessary in order for the Unit Operator to compute the severance and gross products tax on the unitized substances.

8.3 Other Taxes. Each Working Interest Owner shall pay or cause to be paid all gathering or other taxes or excises due the State of New Mexico, the Federal Government, or otherwise, together with all licenses and excises, which are now imposed or may be imposed upon or with respect to the production or handling of its share of unitized substances.

## ARTICLE 9 INSURANCE

9.1 Insurance. Unit Operator, with respect to Unit Operations, shall do the following:

9.1.1 Comply with the Workmen's Compensation Law of the State of New Mexico.

9.1.2 Carry Employer's Liability and other insurance as required by the laws of the State of New Mexico.

9.1.3 Carry other insurance as set forth in Exhibit "F".

## ARTICLE 10 ADJUSTMENT OF INVESTMENTS

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

10.1.1 Wells. All wells completed or to be completed in the Unitized Formation, as shown in the initial Plan of Operation and Development and all service wells to be utilized for Unit Operations, including water supply and disposal wells, completed within or outside the Unitized Formation.

10.1.2 Well and Lease Equipment. The casing and tubing in each such well, the wellhead connection thereon and all other lease and operating equipment that is used in the operation of such wells, which the Working Interest Owners determine is necessary or desirable for conducting the Unit Operations.

10.1.3 Records. A complete copy of all production and well records that pertain to such wells. In the event a Working Interest Owner fails to provide Unit Operator with said records within sixty (60) days of the Effective Date, then the Unit Operator is hereby authorized to suspend in-kind delivery or payment of proceeds of production to said Working Interest Owner, of its share of Unit Production, until said records are provided to the Unit Operator.

10.2 Inventory and Evaluation of Personal Property. The Working Interest Owners shall at Unit Expense inventory and evaluate, as determined by Working Interest owners, the personal property taken over. Such inventory shall include and be limited to those items of equipment considered controllable under Exhibit "G" except, upon determination of Working Interest Owners, items considered non-controllable may be included in the inventory but shall be excluded from evaluation and investment adjustment. Casing shall be included in the inventory for record purposes, but shall be excluded from pricing and investment adjustment.

10.3 Investment Adjustment. Upon approval by Working Interest Owners of the inventory and evaluation, each Working Interest Owner shall be credited with the value of its interest in all personal property taken over under Section 10.1.2 and evaluated under Section 10.2, and shall be charged with an amount equal to that obtained by multiplying the total value of all personal property taken over under Section 10.1.2 and evaluated under Section 10.2 by the Working Interest Owner's Unit Participation. If the charge against any Working Interest Owner is greater than the amount credited to such Working Interest Owner, the resulting net charge shall be an item of Unit Expense chargeable against such Working Interest Owner. If the credit to any Working Interest Owner is greater than the amount charged against such Working Interest Owner, the resulting net credit shall be paid to such Working Interest Owner by Unit Operator out of funds received by it in settlement of the net charges described above.

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

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

10.6 Adjustment for Non-Usable Wells. All wells delivered to the Unit Operator shall be (a) in usable physical condition, (b) completed in some portion of the Unitized Formation, and (c) physically separated from formations not a part of the Unitized Formation as of the Effective Date. If within three (3) months from the date of takeover, Unit Operator reports to Working Interest Owners, the wells that were not in suitable condition to serve Unit Operator on the date of takeover and the Working Interest Owners approve, Unit Operator shall properly place such well in suitable condition to serve Unit Operator, or drill a substitute well if such well cannot be placed in suitable condition to serve Unit Operator, at the sole cost of the Working Interest Owner who delivered such well and casing to Unit Operator. It is the intent of this Section 10.6 that the cost of normal conversion of wells and casing therein from operating practices utilized immediately prior to the date of takeover to operating practices contemplated hereunder shall be a Unit Expense.

10.7 Surface Leases. Upon the effective date hereof Working Interest Owners shall deliver to Unit Operator assignment(s) of all surface lease agreements pertaining to the Unit Area, but only to the limited extent they relate to production from the Unitized Formation or Unit Operations. Unit Operator shall become responsible for all future rentals on behalf of Working Interest Owners. All said surface unit rental costs shall be apportioned to each Working Interest as set forth in Exhibit "D".

## ARTICLE 11 UNIT EXPENSE

11.1 Basis of Charges to Working Interest Owners. Unit Operator initially shall pay and discharge all Unit Expense. Each Working Interest Owner shall reimburse Unit Operator for its share of Unit Expense. Each Working Interest Owner's share of Unit Expense shall be the same as its Unit Participation.

11.2 Advance Billing. Unit Operator shall have the right to require Working Interest Owners to advance their respective shares of estimated Unit Expense by submitting to Working Interest Owners, on or before the 15th day of any month, an itemized estimate thereof for the succeeding month, with a request for payment in advance. Within thirty (30) days thereafter, each Working Interest Owner shall pay to Unit Operator its share of such estimate. Adjustments between estimated and actual Unit Expense shall be made by Unit Operator at the close of each calendar month and the accounts of Working Interest Owners shall be adjusted accordingly.

11.3 Commingling of Funds. No funds received by Unit Operator under this agreement need be segregated or maintained by it as a separate fund but may be commingled with its own funds.

11.4 Lien and Security Interests. Each Working Interest Owner grants to the other Working Interest Owners and to Unit Operator a lien upon any interest it now owns or hereafter acquires in Oil and Gas Rights and Working Interests in the Unit Area, and a security interest and/or purchase money security interest in all of its interest in all personal property and equipment used or obtained for use in connection therewith, all fixtures now or hereafter located thereon, all Unitized Substances extracted therefrom and all accounts arising from the sale at the wellhead of Unitized Substances produced therefrom, to secure performance of all its obligations under this Agreement including but not limited to payment of Unit Expense, interest, attorney fees, court costs, cost of collection, the proper disbursement of all monies paid hereunder, the assignment or relinquishment of interest in Oil and Gas Rights as required hereunder, and the proper performance of operations hereunder. Such lien and security interest granted by each Working Interest Owner hereto shall cover and include all of such Working Interest Owner's leasehold interest, Working Interests, operating rights, and Royalty Interests and overriding royalty interests in the Unit Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject to this Agreement, the Unitized Substances when extracted therefrom and fixtures and equipment now or hereafter situated thereon or used or obtained for use in connection therewith (including, without limitation, all wells, tools, and tubular goods), and accounts

(including, without limitation, accounts arising from gas imbalances or from the sale of Unitized Substances at the wellhead), contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of the foregoing.

Each Working Interest Owner hereby grants, sells, assigns, sets over and mortgages into Unit Operator and the other Working Interest Owners during the term of this Agreement, all of such Working Interest Owner's rights and interests pursuant to the provisions of Sections 48-9-1, et seq., N.M.S.A. 1978 Comp. (the "New Mexico Act"), hereby vesting in Unit Operator and the other Working Interest Owners all of such Working Interest Owner's rights as an interest owner to the continuing security interest in and lien upon the production of the Unitized Substances. Any other Working Interest Owner or Unit Operator may, at its option, file the verified notice of lien in order to perfect such lien, but shall not be obligated to make such filing and shall not be held liable to such Working Interest Owner for any act or omission pursuant to the New Mexico Act.

To perfect the lien and security agreement provided herein, each Party hereto shall execute and acknowledge this Agreement, and this Agreement is to be filed for record in the real property records. Unit Operator is authorized to file this Agreement as a lien or mortgage in the applicable records and as a financing statement with the proper officer under the Uniform Commercial Code or other applicable laws in the state in which the Unit Area is situated and such other states as Unit Operator shall deem appropriate to perfect the security interest granted hereunder. Any Working Interest Owner may file this Agreement or such other documents as it deems necessary as a lien or mortgage in the applicable records and/or a financing statement with the proper officer under the Uniform Commercial Code.

All Working Interest Owners acquiring an interest in Oil and Gas Rights and Working Interest covered by this Agreement whether by assignment, merger, mortgage, operation of law, or otherwise, shall be deemed to have taken subject to the lien and security interest granted by this Section 11.4 as to all obligations attributable to such interest hereunder.

To the extent that Unit Operator or the Working Interest Owners have a security interest under the Uniform Commercial Code or other applicable laws of the state in which the Unit Area is situated, they shall be entitled to exercise the rights and remedies of a secured party under the Uniform Commercial Code or such other laws. The bringing of a suit and the obtaining of judgment by the Unit Operator or a Working Interest Owner 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 Working Interest Owner in the payment of its share of expenses, interest, or fees, or upon the improper use of funds by the Unit Operator, the other Working Interest Owners shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting Working Interest Owner's share of Unitized Substances until the amount owed by such Working Interest Owner, plus interest as provided in Exhibit "E", has been received, and shall have the right to offset the amount owed against the proceeds from the sale of such defaulting Working Interest Owner's share of Unitized Substances. All purchasers of production may rely on a notification of default from the non-defaulting Working Interest Owner(s) stating the amount due as a result of the default, and all Working Interest Owners waive any recourse available against purchasers for releasing production proceeds as provided in this Section 11.4.

If any Working Interest Owner does not perform all of its obligations hereunder, and the failure to perform subjects such Working Interest Owner to foreclosure or execution proceedings pursuant to the provisions of this Agreement, to the extent allowed by governing law, the defaulting Working Interest Owner waives any available right of redemption from and after the date of judgment, and any required valuation or appraisal of the mortgaged or secured property prior to sale, any available rights to stay execution or to require a marshalling of assets and any required bond in the event a receiver is appointed. Pursuant to Section 39-5-19 of New Mexico Statutes, 1978 Annotated, the redemption period after foreclosure sale for any mortgaged or secured property situated in or otherwise subject to the jurisdiction of the State of New Mexico shall be limited to one (1) month. In addition, to the extent permitted by applicable law, each Working Interest Owner hereby grants to the Unit Operator and the other Working Interest Owners a power of sale as to any property that is subject to the lien and security rights granted hereunder, such power to be exercised in the manner provided by applicable law or otherwise in a commercially reasonable manner and upon reasonable notice.

To the extent permitted by applicable law, each Working Interest Owner agrees that the Unit Operator and the other Working Interest Owners shall be entitled to utilize the provisions of oil and gas lien law or other lien law of the state in which the Unit Area is situated to enforce the obligations of each Working Interest Owner hereunder. Without limiting the generality of the foregoing, to the extent

permitted by applicable law, non-operators agree that Unit Operator may invoke or utilize the mechanics' or materialmen's lien law of the state in which the Unit Area is situated in order to secure the payment to Unit Operator of any sum due hereunder for services performed or materials supplied by Unit Operator.

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

11.6 Unpaid Unit Expenses. If any Working Interest Owner, other than Unit Operator, fails to pay its share of Unit Expense within sixty (60) days after rendition of a statement therefor by Unit Operator, each Working Interest Owner agrees, upon request by Unit Operator, to pay its proportionate part of the unpaid share of Unit Expense of the defaulting Working Interest Owner. Working Interest Owners that pay the share of Unit Expense of a defaulting Working Interest Owner shall be reimbursed by Unit Operator for the amount so paid, plus any interest collected thereon, upon receipt by Unit Operator of any past due amount collected from the defaulting Working Interest Owner. Any Working Interest Owner so paying a defaulting Working Interest Owner's share of Unit Expense shall, to obtain reimbursement thereof, be subrogated to the lien and other rights herein granted Unit Operator.

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

11.8 Pre-Unitization Expense. Prior to the Effective Date, Unit Operator and other Working Interest Owners have incurred certain costs and expenses for and on behalf of the Working Interest Owners in anticipation of the Unit Agreement and this agreement becoming effective, including but not limited to title review, document preparation, mailings and attorneys' fees related to presentation of the unitization proposal to the Division. Such costs approved by the Working Interest Owners shall herein be referred to as "Pre-Unitization Expenses". As soon as practicable after the Effective Date of this agreement, Pre-Unitization Expenses shall be reallocated and billed among all Working Interest Owners in accordance with the Unit Participation interest of each such owner. Credit shall be given for payments made by Working Interest Owners prior to the Effective Date for costs included in the Pre-Unitization Expenses. If the charge against any Working Interest Owner is greater than the amount credited to such Working Interest Owner, the resulting net charge shall be an item of Unit Expense chargeable against such Working Interest Owner. If the credit to any Working Interest Owner is greater than the amount charged against such Working Interest Owner, the resulting net credit shall be paid to such Working Interest Owner by Unit Operator out of funds received by it in settlement of the net charge described above.

## ARTICLE 12 NON-UNITIZED FORMATIONS

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

12.2 Dual Completions. There shall be no dual completions of wells within the Unit Area as to the Unitized Formation and another formation.

**ARTICLE 13  
TITLES**

13.1 Warranty and Indemnity. Each Working Interest Owner represents and warrants that it is the owner of the respective Working Interests set forth opposite its name in Exhibit "D", and hereby agrees to indemnify and hold harmless the other Working Interest Owners from any loss due to failure in whole or in part of its title to any such interest, except failure of title arising out of Unit Operations; provided that, such indemnity shall be limited to an amount equal to the net value that has been received from the sale or receipt of Unitized Substances attributed to the interest as to which title failed. Each failure of title will be deemed to be effective, insofar as this agreement is concerned, as of the first day of the calendar month in which such failure is finally determined, and there shall be no retroactive adjustment of Unit Expense or retroactive allocation of Unitized Substances or the proceeds therefrom, as a result of title failure.

13.2 Failure Because of Unit Operations. The failure of title to any Working Interest in any Tract by reason of Unit Operations, including non-production from such Tract, shall not change the Unit Participation of the Working Interest Owner whose title failed in relation to the Unit Participation of the other Working Interest Owners at the time of the title failure.

13.3 Waiver of Rights to Partition. Each Lessee and Working Interest Owner hereto agrees that, during the existence of this agreement, it will not resort to any action to partition the interval of the formation unitized hereunder or the Unit Equipment, and to that extent waives the benefits of all laws authorizing such partition.

**ARTICLE 14  
UNLEASED INTERESTS**

14.1 Treated as Leased. If a Working Interest Owner owns in fee all or a part of the Oil and Gas Rights in any Tract within the Unit Area which is not subject to any oil and gas lease or other contract in the nature thereof, such Working Interest Owner shall be deemed to own a Working Interest in such Tract to the extent of seven-eighths (7/8ths) of its interest therein and a Royalty Interest with respect to the remaining one-eighth (1/8th) interest therein.

**ARTICLE 15  
LIABILITIES, CLAIMS, SUITS, AND FORCE MAJEURE**

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

15.2 Settlements. Unit Operator may settle any single damage claim or suit involving Unit Operations but not involving an expenditure in excess of Ten Thousand Dollars (\$10,000.00), provided the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above specified amount, Working Interest Owners shall assume and take over the further handling of the claim or suit unless such authority is expressly delegated to Unit Operator.

All costs and expense of handling, settling or otherwise discharging such claim or suit shall be an item of Unit Expense. If a claim is made against any Working Interest Owner or if any Working Interest Owner is sued on account of any matter arising from Unit Operations and over which such Working Interest Owner individually has no control because of the rights given Working Interest Owners and Unit Operator by this agreement and the Unit Agreement, the Working Interest Owner shall immediately notify the Unit Operator, and the claim or suit shall be treated as any other claim or suit involving Unit Operations.

15.3 Notices of Damages, Claims and Suits by Unit Operator to Lessees. Unit Operator shall report to Lessees as soon as practicable after each occurrence, damages or losses to Unit Equipment, and accidents, occurrences, claims or suits involving third party bodily injury or property damage which are not covered by insurance carried for the benefit of Lessees.

15.4 Force Majeure. Any obligation imposed by this agreement on each party, except for the payment of money, shall be suspended while compliance therewith is prevented, in whole or in part, by

a strike, fire, war, civil disturbance, act of God; by Federal, State or municipal laws; by any rule, regulation or order of a governmental agency; by inability to secure materials, services or equipment, or by any other cause beyond the reasonable control of such party. No party shall be required against its will to adjust or settle any labor dispute. Neither this agreement nor any lease or other instrument subject hereto shall be terminated by reason of the suspension of Unit Operations due to any of the causes set forth in this Article.

## ARTICLE 16 INTERNAL REVENUE PROVISION

16.1 Internal Revenue Provision. Each Working Interest Owner hereby elects that it and the operations covered by this agreement are excluded from the application of Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code of 1986, or such portion thereof as the Secretary of the Treasury of the United States or his delegate shall permit by election to be excluded therefrom. Unit Operator is hereby authorized and directed to execute on behalf of each Working Interest Owner such additional or further evidence of the election as may be required by regulations issued under said Subchapter K. Should the regulations require each party to execute such further evidence, each Working Interest Owner agrees to execute or join in the execution thereof. The election hereby made and the other provisions of this paragraph shall apply in like manner to applicable state laws, regulations and rulings now in effect or hereafter enacted that have an effect similar to the Federal provisions referred to herein.

## ARTICLE 17 NOTICES

17.1 Notices. All notices required hereunder shall be in writing and shall be deemed to have been properly served when received by mail, overnight delivery, facsimile transmission (fax), electronic mail (e-mail) or telegram to the address of the representative of each Working Interest Owner as furnished to Unit Operator in accordance with Article 4.

17.2 Notice of Transfer of Title. No change of title shall be binding on the Unit Operator until the first day of the calendar month next succeeding the date of receipt by Unit Operator of evidence, satisfactory to it, of such change of ownership. Each such transfer, assignment or conveyance, whether so stating or not, shall operate to impose upon the party or parties acquiring such interest the obligation of the predecessor in interest with respect to the interest so transferred and shall likewise operate to give and grant to the party or parties acquiring such interest all benefits attributable hereunder to such interest.

## ARTICLE 18 WITHDRAWAL OF WORKING INTEREST OWNERS

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

relieved from all further obligations and subsequently accrued liabilities hereunder and under the Unit Agreement, and the rights of the withdrawing Working Interest Owner hereunder and under the Unit Agreement shall cease insofar as they existed by virtue of the interest transferred.

18.2 Limitation on Withdrawal. Notwithstanding anything set forth in Article 18.1, Working Interest Owners may refuse to permit the withdrawal of a Working Interest Owner if its Working Interest is burdened by any Royalties, overriding royalties, production payments, net proceeds interest, carried interest, or any other interest created out of the Working Interest in excess of a one-eighth (1/8th) lessor's Royalty, unless the other Working Interest Owners are willing to accept the assignment and agree to accept the Working Interest, subject to such burdens.

## ARTICLE 19 ABANDONMENT OF WELLS

19.1 Rights of Former Owners. If Working Interest Owners decide to abandon permanently any well within the Unit Area prior to termination of the Unit Agreement, the Unit Operator shall give written notice thereof to the Working Interest Owners of the Tract on which the well is located, and they shall have the option for a period of thirty (30) days after the sending of such notice to notify Unit Operator in writing of their election to take over and own the well. Within ten (10) days after Working Interest Owners of the Tract have notified Unit Operator of their election take over the well, they shall pay Unit Operator, for credit to the joint account, the amount estimated by Working Interest Owners to be the net salvage value of the equipment in and on the well. The Working Interest Owners of the Tract, by taking over the well, agree to seal off effectively and protect the Unitized Formation, and upon abandonment to plug the well in compliance with applicable laws and regulations.

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

## ARTICLE 20 EFFECTIVE DATE AND TERM

20.1 Effective Date. This agreement shall become effective on the date and at the time that the Unit Agreement becomes effective.

20.2 Term. This agreement shall continue in effect so long as the Unit Agreement remains in effect, and thereafter until (a) all unit wells have been abandoned and plugged or turned over to Working Interest Owners in accordance with Article 21, (b) all Unit Equipment and real property acquired for the joint account have been disposed of by Unit Operator in accordance with instructions of Working Interest Owners, and (c) there has been a final accounting.

## ARTICLE 21 ABANDONMENT OF OPERATIONS

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

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

21.1.2 Right to Operate. Working Interest Owners of any Tract that desire to take over and to continue to operate wells located thereon may do so by paying Unit Operator, for credit to the joint account, the net salvage value of the equipment in and on the wells taken over, as estimated by Working Interest Owners, and by agreeing to properly plug each well at such time as it is abandoned.

21.1.3 Salvaging Wells. Unit Operator shall salvage as much of the casing and equipment in or on wells not taken over by Working Interest Owners of separate Tracts as can economically and reasonably be salvaged, and shall cause the wells to be properly plugged and abandoned and cause the surface of the Unit Area to be restored in compliance with applicable laws, rules, regulations, orders, and contractual obligations.

21.1.4 Cost of Salvaging. The cost of salvaging, liquidation or other distribution of assets and properties used in Unit Operations shall constitute a Unit Expense to be borne by the Working

Interest Owners in proportion to their respective Unit Participation. The cost of abandonment of Unit Operations and surface restoration of the Unit Area shall be Unit Expense except on wells taken over by a Working Interest Owner.

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

## ARTICLE 22 SIGNING, RATIFICATION, OR APPROVAL

22.1 Original, Counterparts, or Ratifications. This agreement may be signed, ratified or approved by signing the original of this instrument, a counterpart or other instrument adopting the provisions hereof, all with the same effect as if all persons had signed the same instrument. Persons signing, ratifying or otherwise approving this agreement thereby agree to all of the provisions hereof.

22.2 Prior Agreements. It is recognized there are certain existing agreements by and between several of the Lessee or Working Interest Owners hereto, covering a portion of the Oil and Gas Rights subject to this Operating Agreement. In case of any inconsistency or conflict between this Operating Agreement and those certain existing agreements, this Operating Agreement shall govern.

## ARTICLE 23 SUCCESSORS AND ASSIGNS

23.1 Successors and Assigns. The provisions hereof shall be covenants running with the lands, leases and interests covered hereby and shall be binding upon and inure to the benefit of the respective heirs, devisees, legal representatives, successors and assigns of the parties hereto.

## ARTICLE 24 OTHER PROVISIONS

24.1 Environmental Warranty and Representation. Each Working Interest Owner that operates a property to be contributed to the Unit, represents and warrants that it has conducted the following environmental review of the contributed property:

- (a) A review of applicable lease and well file information and of any other sources of information that would be relevant to evaluating the environmental status of the contributed property.
- (b) A visual inspection of the contributed property to identify any obvious past or present land uses that dictate further investigation.

Prior to the Effective Date, each Working Interest Owner that operates a property to be contributed to the Unit shall report the results of such review and inspection, in writing, to all other Working Interest Owners, including the Unit Operator.

24.2 Removal of Surplus Equipment. The applicable Working Interest Owner shall be responsible and liable for the removal of (a) any surplus equipment or facilities deemed unnecessary for the operation of the Unit by the Unit Operator, and (2) junk and/or debris from their contributed property, including, but not limited to, chemical drums, paint cans, grease buckets, rags, tires, belts, sucker rods, tubing, paraffin, and oil filters. Should any tank batteries or facilities be deemed surplus equipment due to consolidation or otherwise, in addition to removal of the same, the applicable Working Interest Owner shall be required to conduct environmental remediation to the level required by the agency regulating such remediation, if any, or as required by the applicable oil and gas leases. Within 180 days of the Effective Date, should any well be deemed surplus or unnecessary for the operation of the Unit, all costs associated with said well shall remain the responsibility of the well's operator and the applicable Working Interest Owner, said costs shall include, but not limited to, (i) the cost of well plugging and abandonment, and (ii) all costs of environmental remediation of the area around said well which is associated with the operation, plugging and abandonment of said well to the level required by the agency regulating such remediation, if any, or as required by the applicable oil and gas leases. Any surplus equipment, facilities, junk and/or debris that is not removed by the applicable Working Interest Owners within 180 days from the Effective Date will then be removed by the Unit Operator, but associated expenses will be charged directly back to said Working Interest Owner.

24.3 Environmental Indemnification. Notwithstanding any others provisions set forth herein, the Working Interest Owners of lands contributed to the Unit shall retain all environmental liability of any nature, whatsoever, caused by or resulting from its operations, or the operations of others, prior to the Effective Date hereof, and shall indemnify and hold harmless all other Working Interest Owners in the Unit against all claims, demands, damages, losses, liabilities, penalties, fines, liens, judgements, costs or expenses, including attorney's fees, whatsoever, foreseen or unforeseen, that may arise on account of or in any way be connected with the physical condition of the lands prior to inclusion of said equipment, facilities and/or lands into this Unit. This includes, but is not limited to, environmental liability claims brought under any state, federal, or local law, order or regulation, whether known or unknown at this time.

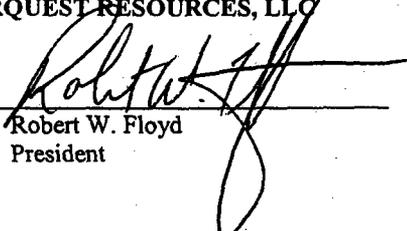
24.4 Governing Law. This Agreement and all matters pertaining hereto, including, but not limited to matters of performance, non-performance, breach, remedies, procedures, rights, duties, and interpretation or construction, shall be governed and determined by the law of the State of Texas (excluding any conflict of laws provision that would require the application of the laws of any other jurisdiction). In the event of any litigation or other proceeding in connection with this Agreement, the venue for any such proceeding shall be in a court of competent jurisdiction located in Midland County, Texas.

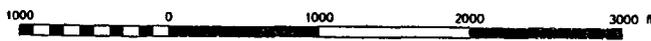
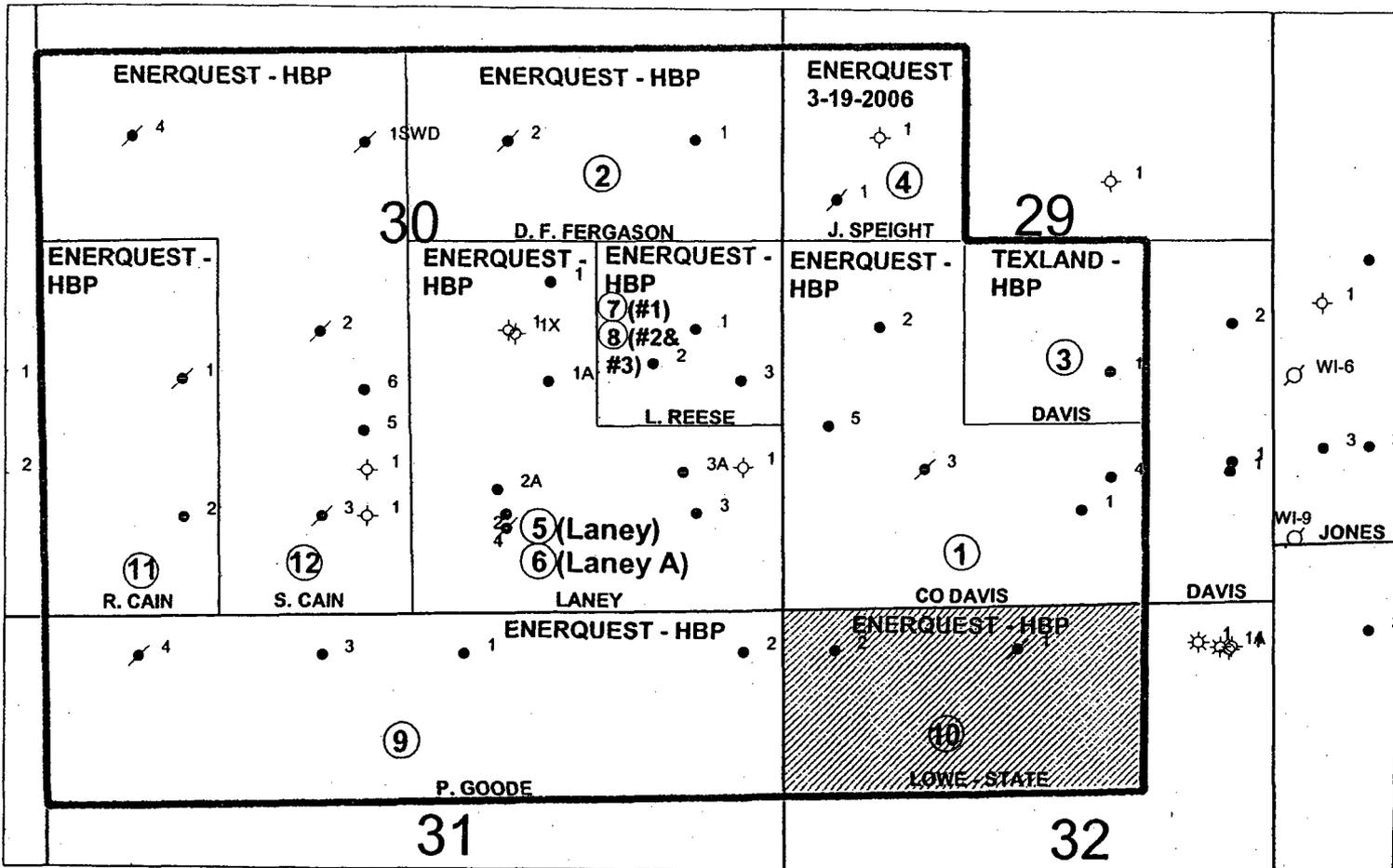
IN WITNESS WHEREOF, the parties hereto have caused this Operating Agreement to be executed and have set opposite their respective names the date of execution.

UNIT OPERATOR

ENERQUEST RESOURCES, LLO

By: \_\_\_\_\_

  
Robert W. Floyd  
President



	State Lands 80 acres (8.7%)
	Patented Lands 840 acres (91.3%)

③ Tract Number      — Unit Outline

**EXHIBIT A**

<b>ENERQUEST RESOURCES, LLC</b>		
<b>EAST HOBBS (SAN ANDRES) UNIT</b>		
920 ACRES		
Lea County, New Mexico		
T18S - R39E		
Project:	Date: February 14, 2003	Geologist:
Area:	Scale: 1"=1000'	Geophysicist:
Prospect:	C.I.:	Engineer:

**Exhibit "B"**  
**Schedule of Ownership of Oil and Gas Interests East Hobbs (San Andres) Unit**

**Lea County, New Mexico**

Tract #	Description of Land	Number of Acres	Serial #, Lease Status	Royalty Ownership	Interest	Working Interest	Interest	Overriding Royalty	Interest	
1	Sec. 29: S/2 SW/4, NW/4 SW/4	120	HBP	Eram Ali	0.00010821	Eram Ali	0.00987500	Charter Royalty 94-1 Acq Fund	0.05250000	
				Douglas H. Christensen	0.00005411	Douglas H. Christensen	0.00493750	James R. Small	0.02250000	
				<b>CARRIE O. DAVIS</b>	Crump Family Partnership Ltd.	0.00114705	Crump Family Partnership Ltd.	0.10467500	Marshall R. Young Oil Company	0.00666667
				Carleton Davis	0.00208400	Dingus Investments, Inc.	0.07241669	George M. Young, Sr.	0.00333333	
				Dingus Investments, Inc.	0.00079298	EnerQuest Oil & Gas, Ltd.	0.45659531			
				Donna E. Dyer	0.00312500	Lone Star Oil & Gas	0.00493750			
				Sandra J. Eaton	0.00295150	Parsley Resources, Inc.	0.05069162			
				EnerQuest Oil & Gas, Ltd.	0.00307324	Christopher P. Renaud	0.03517969			
				Gods House of Prayer	0.05833400	Armand Smith, Jr.	0.05069169			
				Virginia Ann Jackson	0.00196800					
				Theodore Johnson Estate	0.00625000					
				Judson Properties, Ltd.	0.00065567					
				LAJ Corporation	0.00065567					
				Dorothy Locastro	0.00062500					
				Lone Star Oil & Gas	0.00005411					
				Elizabeth Love	0.00680500					
				The Martin Living Trust	0.00065566					
				New Mexico Boys and Girls Ranch	0.00208300					
				Mary J. Parker	0.00393400					
				Matthew J. Parsley	0.00068563					
Sal Ribera	0.01180600									
Rowley Bros	0.00833400									
Armand Smith, Jr.	0.00068563									
Sugarberry Land Company	0.00205604									
David A. Williams	0.00312500									
Virginia M. Wingard	0.00295150									
2	Sec. 30: S/2 NE/4	80	HBP	Eram Ali	0.00017414	Eram Ali	0.00973947	Charter Royalty 94-1 Acq Fund	0.04790625	
				BKKA	0.01171880	FAO Florence Branaman	0.00625000	James R. Small	0.02053125	
				<b>D.F. FERGASON</b>	Roy G. Barton, Jr.	0.01171880	Douglas H. Christensen	0.00486974	Marshall R. Young Oil Company	0.00177084
				Roy G. Barton, Sr & Opal Barton	0.00468750	Crump Family Partnership Ltd.	0.10323821	George M. Young, Sr.	0.00088541	
				Clare C. Beall	0.00156250	Dingus Investments, Inc.	0.07142266			
				Mildred M. Day Bernard	0.00234370	EnerQuest Oil & Gas, Ltd.	0.45032823			

**Exhibit "B"**  
**Schedule of Ownership of Oil and Gas Interests East Hobbs (San Andres) Unit**  
**Lea County, New Mexico**

<u>Tract #</u>	<u>Description of Land</u>	<u>Number of Acres</u>	<u>Serial #, Lease Status</u>	<u>Royalty Ownership</u>	<u>Interest</u>	<u>Working Interest</u>	<u>Interest</u>	<u>Overriding Royalty</u>	<u>Interest</u>
				Mary Payne Brisbane	0.00911460	Lone Star Oil & Gas	0.00486974		
				Douglas H. Christensen	0.00007243	Parsley Resources, Inc.	0.04999571		
				Dr. Ben M. Colletti	0.00468750	Christopher P. Renaud	0.03469679		
				Genevieve Fergason Colletti	0.01997228	Armand Smith, Jr.	0.04999570		
				Crump Family Partnership Ltd.	0.00153549	FAO Andrew A. Stoudt	0.00625000		
				Helen A. Dean	0.00152990	FAO Mary E. Wrynn	0.00625000		
				Ivan C. Dean	0.00611980				
				Dingus Investments, Inc.	0.00115430				
				Kenneth L. & Jane E. Edwards	0.00260420				
				Ervin Elsea	0.00130200				
				EnerQuest Oil & Gas, Ltd.	0.00496030				
				Nellie L. Fleming	0.00026041				
				Headington Oil Company, LP	0.00390620				
				Charles Fred Jennings	0.00009766				
				James Roger Jennings	0.00009766				
				Jo Johnson	0.00390630				
				M.H. Lang	0.00039060				
				Jewel Lansing & Annette Lansing J/T	0.00065104				
				Eva Mae Lewis	0.00234370				
				Lone Star Oil & Gas	0.00007243				
				Michelle Martinez	0.00130210				
				Virginia H. Jennings Matthews	0.00006510				
				Margaret Fergason Mauk	0.00998609				
				Elizabeth Jennings McCormick	0.00026041				
				Margaret Peabody Newkorn	0.00065105				
				Kendall B. Niceley	0.00078130				
				Matthew J. Parsley	0.00101060				
				Pecos Bend Royalties, Inc.	0.00039060				
				Christine Riley	0.00130210				
				Russell T. Rudy	0.00781250				
				Armand Smith, Jr.	0.00101060				
				Sugarberry Land Company	0.00303060				
				Mrs. Harry Titzkowski	0.00156250				
				Wanda K. Vandenberg	0.00026041				

**Exhibit "B"**

**Schedule of Ownership of Oil and Gas Interests East Hobbs (San Andres) Unit**

**Lea County, New Mexico**

Tract #	Description of Land	Number of Acres	Serial #, Lease Status	Royalty Ownership	Interest	Working Interest	Interest	Overriding Royalty	Interest
				Carolyn Wardwell	0.00458980				
3	Sec.29:NW/4 SW/4	40	HBP	Eram Ali	0.00024590	Eram Ali	0.00621448	Peggy Pratt Chartier Estate	0.05468750
				EnerQuest Oil & Gas, Ltd.	0.00491890	David H. Arrington	0.28586660		
	<b>DAVIS</b>			Carleton Davis	0.00208330	Bruce D. Brockman	0.00142933		
				Dingus Investments, Inc.	0.00077880	Michael E. Chapman	0.00142933		
				Donna E. Dyer	0.00312500	Keith W. Davis	0.00571733		
				Sandra J. Eaton	0.00295150	Dingus Investments, Inc.	0.03937497		
				Gods House of Prayer	0.05833330	EnerQuest Oil & Gas, Ltd.	0.16366462		
				Virginia Ann Jackson	0.00196760	JMA Oil Properties, Ltd.	0.01429333		
				Theodore R. Johnson Estate	0.00625000	Sydney E. Niblo	0.00571733		
				Judson Properties, Ltd.	0.00065580	Parsley Resources, Inc.	0.01966262		
				LAJ Corporation	0.00065580	W.F. Pendleton	0.00571733		
				Dorothy L. Locastro	0.00062500	Gary Phillips	0.00142933		
				Elizabeth N. Love	0.00562500	Armand Smith, Jr.	0.01966262		
				The Martin Living Trust	0.00065590	Gordon E. Sommers	0.00571733		
				New Mexico Boys and Girls Ranch	0.00208340	Texland Limited Partnership, I	0.24155728		
				Mary Parker	0.00393520	H.C. Zachry	0.00285867		
				Matthew J. Parsley	0.00077890				
				Salvatore Ribera	0.01180560				
				Rowley Bros.	0.00833340				
				Armand Smith, Jr.	0.00077890				
				Sugarberry Land Company	0.00233650				
				David A. Williams	0.00312500				
				Virginia M. Wingard	0.00295130				
4	Sec.29:SW/4 NW/4	40	Expires 3/19/06	June D. Speight	0.10156250	Eram Ali	0.01199010		
				Ellis Carl Browning & Evelyn Browning	0.00954861	Douglas H. Christensen	0.00364775		
	<b>JUNE SPEIGHT</b>			Vera Browning Stephens	0.00954861	Crump Family Partnership Ltd.	0.03575078		
				Nelda Charlene Browning	0.00954861	Dingus Investments, Inc.	0.08048336		
				Nancy L. Willman, Trustee	0.00954861	EnerQuest Oil & Gas, Ltd.	0.42030482		
				Grady Hicks	0.00954861	Lone Star Oil & Gas	0.00364775		
				Deborah A. Smith	0.00318287	Parsley Resources, Inc.	0.04748330		

**Exhibit "B"**

**Schedule of Ownership of Oil and Gas Interests East Hobbs (San Andres) Unit**

**Lea County, New Mexico**

<u>Tract #</u>	<u>Description of Land</u>	<u>Number of Acres</u>	<u>Serial #, Lease Status</u>	<u>Royalty Ownership</u>	<u>Interest</u>	<u>Working Interest</u>	<u>Interest</u>	<u>Overriding Royalty</u>	<u>Interest</u>
				Linda Browning Kinman	0.00318287	Christopher P. Renaud	0.02650802		
				Rex Taylor Browning	0.00318287	Armand Smith, Jr.	0.05228800		
				William John Nolan	0.02343750	Anne Key Davis	0.02019990		
				Jane Harris	0.02083334	Hugh B. Key, II	0.01552172		
						Julie Ann Hopkins Trust	0.00776089		
						Kite Royalty, LLC	0.01381118		
						Mark Colver Hopkins Trust	0.01009999		
						White Star Royalty Co., LLC	0.00638872		
						Murray E. Helmers	0.04098872		
5	Sec. 30: NW/4 SE/4, S/2 SE/4	60	HBP	Crump Family Partnership Ltd.	0.00196761	Crump Family Partnership Ltd.	0.07842910		
				Jana Sue Barry, ssp	0.00023872	Lois Sherrerd Clements Trust	0.00607639		
	LANEY			Ro Jean Booth	0.00525174	Nancy Hershberger	0.00151910		
				Claudine Bradley, ssp	0.00023872	Julie Ann Hopkins Trust	0.02221680		
				Ruth Fosberg, ssp	0.00095486	Mark Colver Hopkins Trust	0.02221680		
				Mary Virginia Gibbs	0.00477431	Hugh B. Key, II, ssp	0.04443360		
				Velma E. Gilmer	0.02005208	Carolyn V. Larson	0.00151910		
				Julie Ann Hopkins Trust	0.00055416	Virginia G. Olincy Oil Trust	0.01822917		
				Mark Colver Hopkins Trust	0.00055416	Marie Urfer Stinnett	0.00303820		
				Hugh B. Key, II, ssp	0.00110832	Anne Key Davis	0.04443360		
				N. Duane & Dorthea L.J. Laney Revocable Trust	0.00023872	Urfer Family Trust Dated 4/28/99	0.00303820		
				Vera N. Laney, ssp	0.02864583	Robert Gordon Van Vranken, Jr.	0.00151910		
				A. Jeanette Laney Trust	0.00572917	James F. Van Vranken	0.00151910		
				Anna Lois Lynch	0.00477431	Dingus Investments, Inc.	0.05570290		
				Loyce M. Matthews Trust	0.00477430	Douglas H. Christensen	0.00375645		
				P.T. Matthews Trust	0.00477430	Eram Ali	0.00751289		
				Rev. Ray D. Pinson	0.00525174	Armand Smith, Jr.	0.03853191		
				Reta Joyce Stone	0.00023872	Christopher P. Renaud	0.02756735		
				Anne Key Davis	0.00110832	Kite Royalty Co., LLC	0.04443360		
				Dingus Investments, Inc.	0.00136124	EnerQuest Oil & Gas, Ltd.	0.34724354		
				Douglas H. Christensen	0.00009281	Parsley Resources, Inc.	0.03853191		
				Eram Ali	0.00018563	Artamyse Watts Oil, Ltd.	0.05977475		

**Exhibit "B"**

**Schedule of Ownership of Oil and Gas Interests East Hobbs (San Andres) Unit**

Lea County, New Mexico

Tract #	Description of Land	Number of Acres	Serial #, Lease Status	Royalty Ownership	Interest	Working Interest	Interest	Overriding Royalty	Interest
				Armand Smith, Jr.	0.00097538	Lone Star Oil & Gas	0.00375645		
				Matthew J. Parsley	0.00097538				
				Evelyn M. Laney	0.00954861				
				Sugarberry Land Company	0.00352686				
				Kite Royalty Co., LLC	0.00110832				
				Viersen Oil & Gas Co.	0.00886657				
				EnerQuest Oil & Gas, Ltd.	0.00567221				
				Artamyse Watts Oil, Ltd.	0.00136409				
				Lone Star Oil & Gas	0.00009280				
6	Sec. 30: NW/4 SE/4, S/2 SE/4	60	HBP	Eram Ali	0.00018563	Eram Ali	0.01396442	Artamyse Watts Oil, Ltd.	0.00853925
				Jana Sue Barry, ssp	0.00023872	Douglas H. Christensen	0.00698220		
	LANEY A			Ro Jean Booth	0.00525174	Lois Sherrerd Clements Trust	0.00958602		
				Claudine Bradley, ssp	0.00023872	Anne Key Davis, ssp	0.04443360		
				Douglas H. Christensen	0.00009281	Anne Key Davis	0.02566502		
				Crump Family Partnership Ltd.	0.00196761	Dingus Investments, Inc.	0.08978358		
				Anne Key Davis, ssp	0.00110832	EnerQuest Oil & Gas, Ltd.	0.25485461		
				Dingus Investments, Inc.	0.00136124	Nancy Hershberger	0.00239653		
				EnerQuest Oil & Gas, Ltd.	0.00567221	Julie Ann Hopkins Trust	0.02221680		
				Ruth Fosberg, ssp	0.00095486	Mark Collver Hopkins Trust	0.03504936		
				Mary Virginia Gibbs	0.00477431	Hugh B. Key, II, ssp	0.04443360		
				Velma E. Gilmer Trust	0.02005208	Kite Royalty Co., LLC	0.03504933		
				Julie Ann Hopkins Trust	0.00055416	Carolyn V. Larson	0.00239653		
				Mark Collver Hopkins Trust	0.00055416	Lone Star Oil & Gas	0.00698221		
				Hugh B. Key, II, ssp	0.00110832	Virginia G. Olincy Oil Trust	0.02875825		
				Kite Royalty Co., LLC	0.00055416	Parsley Resources, Inc.	0.07161998		
				A. Jeanette Laney Trust	0.00572917	Christopher P. Renaud	0.05124011		
				N. Duane & Dorthea L.J. Laney Revocable Trust	0.00023872	Armand Smith, Jr.	0.07162009		
				Evelyn M. Laney	0.00954861	Marie Urfer Stinnett	0.00479306		
				Vera N. Laney, ssp	0.02864583	Urfer Family Trust dated 4/28/99	0.00479306		
				Lone Star Oil & Gas	0.00009281	James F. Van Vranken	0.00239653		
				Anna Lois Lynch Revocable Trust	0.00477431	Robert Gordon Van Vranken, Jr.	0.00239653		

**Exhibit "B"**  
**Schedule of Ownership of Oil and Gas Interests East Hobbs (San Andres) Unit**

Lea County, New Mexico

Tract #	Description of Land	Number of Acres	Serial #, Lease Status	Royalty Ownership	Interest	Working Interest	Interest	Overriding Royalty	Interest
				Loyce M. Matthews Trust	0.00477430	White Star Royalty Co., LLC	0.03504933		
				P.T. Matthews Trust	0.00477430				
				Matthew J. Parsley	0.00097538				
				Rev. Ray D. Pinson	0.00525174				
				Armand Smith, Jr.	0.00097538				
				Rita Joyce Stone, ssp	0.00023872				
				Sugarberry Land Company	0.00352686				
				Viersen Oil & Gas Co.	0.00886657				
				Artamyse Watts Oil, Ltd.	0.00136409				
				White Star Royalty Co., LLC	0.00055416				
7	Sec. 30: NE/4 SE/4	13.33	HBP	Texas Land & Royalty Company, Ltd.	0.06007948	Eram Ali	0.01187943	Fisher Family Partnership	0.00585938
				Armand Smith, Jr.	0.00417020	Dingus Investments, Inc.	0.07717991	Ring Investments Corp.	0.00703125
	LANEY REESE 1			Christopher P. Renaud	0.00208753	EnerQuest Oil & Gas, Ltd.	0.36483499	Sophie Gimbel Estate	0.00156250
				Reese Minerals Limited Partnership	0.03125000	Christopher P. Renaud	0.01166544	Jill A. Roberts Rev. Trust dated 10/27/83	0.00268555
				Caprock Minerals, LLC	0.00173611	Parsley Resources, Inc.	0.03224288	Susan A. Unterberg	0.00268555
				Laurie Juanita Scott	0.00347222	Armand Smith, Jr.	0.04389475	Jill A. Roberts Trust U/A IX A. Appleman Trust	0.00268555
				Angela Marie Reese	0.00173611	Douglas H. Christensen	0.00160060	Susan A. Unterberg Trust U/A IX A. Appleman Trust	0.00268555
				Irene Investments, Inc.	0.00260417	Murray E. Helmers	0.11374800	Peter J. Gould	0.00195313
				Ann Hooper Taylor	0.00520833	George R. Kravis II Trust	0.08271484	Texas Land & Royalty Company, Ltd.	0.02638374
				Colleen G.M. Wallace	0.00260417	The Raymond and Bessie Kravis Foundation	0.06767578	Armand Smith, Jr.	0.00317841
				Dingus Investments, Inc.	0.00643249	Lone Star Oil & Gas	0.00160060	Christopher P. Renaud	0.00159105
				Douglas H. Christensen	0.00028643			Dingus Investments, Inc.	0.00490267
				Eram Ali	0.00096123			Douglas H. Christensen	0.00021831
				Lone Star Oil & Gas	0.00028643			Eram Ali	0.00073263
				Parsley Resources, Inc.	0.00208510			Lone Star Oil & Gas	0.00021831
								Parsley Resources, Inc.	0.00158920
8	Sec. 30: NE/4 SE/4	26.67	HBP	Texas Land & Royalty Company, Ltd.	0.06007948	Eram Ali	0.01537064	Fisher Family Partnership	0.00585938

**Exhibit "B"**  
**Schedule of Ownership of Oil and Gas Interests East Hobbs (San Andres) Unit**  
**Lea County, New Mexico**

Tract #	Description of Land	Number of Acres	Serial #, Lease Status	Royalty Ownership	Interest	Working Interest	Interest	Overriding Royalty	Interest
	<b>LANEY REESE 2&amp;3</b>			Armand Smith, Jr.	0.00417020	Dingus Investments, Inc.	0.09930025	Ring Investments Corp.	0.00703125
				Christopher P. Renaud	0.00208753	EnerQuest Oil & Gas, Ltd.	0.45677948	Sophie Gimbel Estate	0.00156250
				Reese Minerals Limited Partnership	0.03125000	Christopher P. Renaud	0.01166544	Jill A. Roberts Rev. Trust dated 10/27/83	0.00268555
				Caprock Minerals, LLC	0.00173611	Parsley Resources, Inc.	0.04328908	Susan A. Unterberg	0.00268555
				Laurie Juanita Scott	0.00347222	Armand Smith, Jr.	0.05494095	Jill A. Roberts Trust U/A IX A. Appleman Trust	0.00268555
				Angela Marie Reese	0.00173611	Douglas H. Christensen	0.00160060	Susan A. Unterberg Trust U/A IX A. Appleman Trust	0.00268555
				Irene Investments, Inc.	0.00260417	Lone Star Oil & Gas	0.00160060	George R. Kravis II Trust	0.00590820
				Ann Hooper Taylor	0.00520833	Murray E. Helmers	0.11374800	The Raymond and Bessie Kravis Foundation	0.00483398
				Colleen G.M. Wallace	0.00260417			Peter J. Gould	0.00195313
				Dingus Investments, Inc.	0.00643249			Texas Land & Royalty Company, Ltd.	0.02638374
				Douglas H. Christensen	0.00028643			Armand Smith, Jr.	0.00317841
				Eram Ali	0.00096123			Christopher P. Renaud	0.00159105
				Lone Star Oil & Gas	0.00028643			Dingus Investments, Inc.	0.00490267
				Parsley Resources, Inc.	0.00208510			Douglas H. Christensen	0.00021831
								Eram Ali	0.00073263
							Lone Star Oil & Gas	0.00021831	
							Parsley Resources, Inc.	0.00158920	
9	Sec. 31: N/2 N/2	160	HBP	Elmer R. Beebe	0.01093750	Eram Ali	0.01053575	Sapphire Royalties, Inc.	0.00250000
	<b>PEARL GOODE</b>			Norma L. Beebe	0.01093750	Douglas H. Christensen	0.00526787	Andrews Royalty, Inc.	0.00112500
				Kathrine Bingham	0.01093750	Crump Family Partnership Ltd.	0.11167886	Bandera Minerals, III LLC	0.00250000
				Culroy P/A	0.00130215	Dingus Investments, Inc.	0.07726212	Lowell Deckert Estate	0.01000000
				Keith Pratt Daniels	0.00585937	EnerQuest Oil & Gas, Ltd.	0.48714058	Llano Production Company	0.00071094
				Arnold Dunn	0.01093750	Lone Star Oil & Gas	0.00526787	Magnolia Royalty Company, Inc.	0.00250000
				Pearline R. Elrod	0.01093750	Parsley Resources, Inc.	0.05408638	Morgan Capital Group, Inc.	0.00250000
				Sherri Faye Halliburton & David Vincent Halliburton J/T	0.02734375	Christopher P. Renaud	0.03753357	Daniel M. Alexander & Padgett Alexander Revocable Trust	0.01000000
				Carl & Cybil Lee	0.00195313	Armand Smith, Jr.	0.05408637	James R. Small	0.00030469
				McCaig Family Partnership	0.00065098				

**Exhibit "B"**

**Schedule of Ownership of Oil and Gas Interests East Hobbs (San Andres) Unit**

**Lea County, New Mexico**

Tract #	Description of Land	Number of Acres	Serial #, Lease Status	Royalty Ownership	Interest	Working Interest	Interest	Overriding Royalty	Interest
				Lajuan Miles	0.02734375				
				Lynda Pratt Rast	0.00585937				
10	Sec. 32: N/2 NW/4	80	HBP	State of New Mexico	0.12500000	Eram Ali	0.00987500	Jim A. Dawson	0.00005000
	<b>LOWE STATE</b>					Douglas H. Christensen	0.00493750	Llano Production Company	0.02620000
						Crump Family Partnership Ltd.	0.10467500	Lowe Partners, LP	0.04250000
						Dingus Investments, Inc.	0.07241669	James R. Small	0.01125000
						EnerQuest Oil & Gas, Ltd.	0.45659531	Marshall R. Young Oil Company	0.00333333
						Lone Star Oil & Gas	0.00493750	George M. Young, Sr.	0.00166667
						Parsley Resources, Inc.	0.05069162		
						Christopher P. Renaud	0.03517969		
						Armand Smith, Jr.	0.05069169		
11	Sec. 30: W/2 SW/4	80	HBP	Fleischaker Mineral Company LLC	0.02083374	Eram Ali	0.00987500	Charter Royalty 94-1 Acq Fund	0.03062500
	<b>ROCKET CAIN</b>			Rocket Oil & Gas Co Ltd Partnership	0.10046820	Douglas H. Christensen	0.00493750	James R. Small	0.01312500
				Stanley H. Singer Revocable Trust	0.00890620	Crump Family Partnership Ltd.	0.10467500	Marshall R. Young Oil Company	0.00666667
				Teton Properties, LLC	0.01041686	Dingus Investments, Inc.	0.07241669	George M. Young, Sr.	0.00333333
				Three M Oil Company	0.01562500	EnerQuest Oil & Gas, Ltd.	0.45659531		
						Lone Star Oil & Gas	0.00493750		
						Parsley Resources, Inc.	0.05069162		
						Christopher P. Renaud	0.03517969		
						Armand Smith, Jr.	0.05069169		
12	Sec. 30: E/2 SW/4, S/2 NW/4	160	HBP	Marjorie H. Augustine	0.00979170	Eram Ali	0.01029284		
	<b>SAMUEL CAIN</b>			Jeannine H. Byron	0.00694440	Douglas H. Christensen	0.00514643		
				Roy Lee Wright Cain Trust u/v/d 10/6/90	0.02937500	Crump Family Partnership Ltd.	0.10910434		
				Beverly V. Cox	0.00833330	Dingus Investments, Inc.	0.07548096		
				Nancy Iola Henry	0.05875000	EnerQuest Oil & Gas, Ltd.	0.47591338		
				Jerry & Margaret Hooper	0.00694440	Lone Star Oil & Gas	0.00514643		
				Jimmy Joe & Lynne Hooper	0.00694440	Parsley Resources, Inc.	0.05283810		
				William C. Humble	0.00979170	Christopher P. Renaud	0.03666832		
				Lora Mae Rawlings	0.01101560	Armand Smith, Jr.	0.05283810		

**Exhibit "B"**  
**Schedule of Ownership of Oil and Gas Interests East Hobbs (San Andres) Unit**  
**Lea County, New Mexico**

<b>Tract #</b>	<b>Description of Land</b>	<b>Number of Acres</b>	<b>Serial #, Lease Status</b>	<b>Royalty Ownership</b>	<b>Interest</b>	<b>Working Interest</b>	<b>Interest</b>	<b>Overriding Royalty</b>	<b>Interest</b>
				Jill A. Roberts Revocable Trust	0.00781250				
				Lavita Joy Sullivan	0.01305560				
				Susan Unterberg	0.00781250				

**EXHIBIT "C"**  
**Schedule of Tract Participation East Hobbs (San Andres) Unit**  
**Lea County, New Mexico**

<u>Tract #</u>	<u>Description</u>	<u>Lease Name</u>	<u>Acreage</u>	<u>Tract Participation Factor</u>
1	S/2 SW/4, NW/4 SW/4 Section 29, T-18-S, R-39-E	Carrie O. Davis	120	15.204311
2	S/2 NE/4 Section 30, T-18-S, R-39-E	D.F. Ferguson	80	0.857979
3	NE/4 SW/4 Section 29, T-18-S, R-39-E	Zachary Davis	40	1.473563
4	SW/4 NW/4 Section 29, T-18-S, R-39-E	June Speight	40	0.108696
5	NW/4 SE/4, S/2 SE/4 Section 30, T-18-S, R-39-E	Laney	60	18.322423
6	NW/4 SE/4, S/2 SE/4 Section 30, T-18-S, R-39-E	Laney A	60	19.993114
7	NE/4 SE/4 Section 30, T-18-S, R-39-E	Laney Reese #1	13.33	1.822673
8	NE/4 SE/4 Section 30, T-18-S, R-39-E	Laney Reese #2 & #3	26.67	36.944219
9	N/2 N/2 Section 31, T-18-S, R-39-E	Pearl Goode	160	2.473871
10	N/2 NW/4 Section 32, T-18-S, R-39-E	Ralph Lowe State	80	0.415278
11	W/2 SW/4 Section 30, T-18-S, R-39-E	Rocket Cain	80	0.330804
12	E/2 SW/4, S/2 NW/4 Section 30, T-18-S, R-39-E	Samuel Cain	160	2.053069
		<b>TOTALS</b>	<b>920</b>	<b>100.000000</b>

EAST HOBBS (GRAYBURG SAN ANDRES) UNIT - UNIT PARTICIPATION					
Tr. #	Lease	Working Int. Owner	Wl, %	Tract Participation Factor %	Unit Participation %
2	FERGASON	Andrew Stoudt	0.625000%	0.857979%	0.005362%
5	LANEY	Anne Key Davis	5.078120%	18.322423%	0.930435%
6	LANEY A	Anne Key Davis	8.011270%	19.993114%	1.601702%
4	J SPEIGHT	Anne Key Davis	2.534889%	0.108696%	0.002755%
		<b>Anne Key Davis Subtotal</b>			<b>2.534892%</b>
1	C O DAVIS	Armand Smith, Jr.	6.416665%	15.204311%	0.975610%
3	DAVIS	Armand Smith, Jr.	2.397000%	1.473563%	0.035321%
2	FERGASON	Armand Smith, Jr.	6.296330%	0.857979%	0.054021%
4	J SPEIGHT	Armand Smith, Jr.	6.561631%	0.108696%	0.007132%
7	L REESE 1	Armand Smith, Jr.	5.607862%	1.822673%	0.102213%
8	L REESE 2,3	Armand Smith, Jr.	6.967392%	36.944219%	2.574049%
5	LANEY	Armand Smith, Jr.	4.403644%	18.322423%	0.806854%
6	LANEY A	Armand Smith, Jr.	8.308419%	19.993114%	1.661112%
9	PEARL GOODE	Armand Smith, Jr.	6.416665%	2.473871%	0.158740%
10	RALPH LOWE ST	Armand Smith, Jr.	6.416665%	0.415278%	0.026647%
11	ROCKET CAIN	Armand Smith, Jr.	6.416665%	0.330804%	0.021227%
12	SAMUEL CAIN	Armand Smith, Jr.	6.416665%	2.053069%	0.131739%
		<b>Armand Smith, Jr. Subtotal</b>			<b>6.554664%</b>
5	LANEY	Carolyn Larson	0.173610%	18.322423%	0.031810%
6	LANEY A	Carolyn Larson	0.273888%	19.993114%	0.054759%
		<b>Carolyn Larson Subtotal</b>			<b>0.086568%</b>
1	C O DAVIS	Christopher P. Renaud	4.453125%	15.204311%	0.677067%
2	FERGASON	Christopher P. Renaud	4.369627%	0.857979%	0.037490%
4	J SPEIGHT	Christopher P. Renaud	3.326496%	0.108696%	0.003616%
5	LANEY	Christopher P. Renaud	3.150571%	18.322423%	0.577261%
6	LANEY A	Christopher P. Renaud	5.944215%	19.993114%	1.188434%
7	L REESE 1	Christopher P. Renaud	1.555394%	1.822673%	0.028350%
8	L REESE 2,3	Christopher P. Renaud	1.555394%	36.944219%	0.574628%
9	PEARL GOODE	Christopher P. Renaud	4.453125%	2.473871%	0.110165%
10	RALPH LOWE ST	Christopher P. Renaud	4.453125%	0.415278%	0.018493%
11	ROCKET CAIN	Christopher P. Renaud	4.453125%	0.330804%	0.014731%
12	SAMUEL CAIN	Christopher P. Renaud	4.453125%	2.053069%	0.091426%
		<b>Christopher P. Renaud Subtotal</b>			<b>3.321660%</b>
1	C O DAVIS	Crump Family Part., Ltd.	13.250000%	15.204311%	2.014571%
2	FERGASON	Crump Family Part., Ltd.	13.001563%	0.857979%	0.111551%
4	J SPEIGHT	Crump Family Part., Ltd.	4.486372%	0.108696%	0.004877%
5	LANEY	Crump Family Part., Ltd.	8.963342%	18.322423%	1.642301%
9	PEARL GOODE	Crump Family Part., Ltd.	13.250000%	2.473871%	0.327788%
10	RALPH LOWE ST	Crump Family Part., Ltd.	13.250000%	0.415278%	0.055024%
11	ROCKET CAIN	Crump Family Part., Ltd.	13.250000%	0.330804%	0.043832%
12	SAMUEL CAIN	Crump Family Part., Ltd.	13.250000%	2.053069%	0.272032%
		<b>Crump Family Subtotal</b>			<b>4.471975%</b>
1	C O DAVIS	Dingus Investments, Inc.	9.166670%	15.204311%	1.393729%
3	DAVIS	Dingus Investments, Inc.	4.800000%	1.473563%	0.070731%
2	FERGASON	Dingus Investments, Inc.	8.994792%	0.857979%	0.077173%
4	J SPEIGHT	Dingus Investments, Inc.	10.099873%	0.108696%	0.010978%
7	L REESE 1	Dingus Investments, Inc.	9.800488%	1.822673%	0.178631%
8	L REESE 2,3	Dingus Investments, Inc.	12.522988%	36.944219%	4.626520%
5	LANEY	Dingus Investments, Inc.	6.366045%	18.322423%	1.166414%
6	LANEY A	Dingus Investments, Inc.	10.415507%	19.993114%	2.082384%
9	PEARL GOODE	Dingus Investments, Inc.	9.166670%	2.473871%	0.226772%
10	RALPH LOWE ST	Dingus Investments, Inc.	9.166670%	0.415278%	0.038067%
11	ROCKET CAIN	Dingus Investments, Inc.	9.166670%	0.330804%	0.030324%
12	SAMUEL CAIN	Dingus Investments, Inc.	9.166670%	2.053069%	0.188198%
		<b>Dingus Investments, Inc. Subtotal</b>			<b>10.089921%</b>
1	C O DAVIS	Douglas H. Christensen	0.625000%	15.204311%	0.065027%
2	FERGASON	Douglas H. Christensen	0.613282%	0.857979%	0.005262%
4	J SPEIGHT	Douglas H. Christensen	0.457757%	0.108696%	0.000498%
5	LANEY	Douglas H. Christensen	0.429310%	18.322423%	0.078660%
6	LANEY A	Douglas H. Christensen	0.809986%	19.993114%	0.161941%
7	L REESE 1	Douglas H. Christensen	0.213414%	1.822673%	0.003890%
8	L REESE 2,3	Douglas H. Christensen	0.213414%	36.944219%	0.078844%
9	PEARL GOODE	Douglas H. Christensen	0.625000%	2.473871%	0.015462%
10	RALPH LOWE ST	Douglas H. Christensen	0.625000%	0.415278%	0.002595%
11	ROCKET CAIN	Douglas H. Christensen	0.625000%	0.330804%	0.002068%
12	SAMUEL CAIN	Douglas H. Christensen	0.625000%	2.053069%	0.012832%
		<b>Douglas H. Christensen Subtotal</b>			<b>0.457078%</b>

EAST HOBBS (GRAYBURG SAN ANDRES) UNIT - UNIT PARTICIPATION					
Tr. #	Lease	Working Int. Owner	WI, %	Tract Participation Factor %	Unit Participation %
1	C O DAVIS	Enerquest Oil & Gas, Ltd.	57.796875%	15.204311%	8.787617%
3	DAVIS	Enerquest Oil & Gas, Ltd.	19.951400%	1.473563%	0.293996%
2	FERGASON	Enerquest Oil & Gas, Ltd.	56.713228%	0.857979%	0.486588%
4	J SPEIGHT	Enerquest Oil & Gas, Ltd.	52.744134%	0.108696%	0.057331%
7	L REESE 1	Enerquest Oil & Gas, Ltd.	46.607260%	1.822673%	0.849498%
8	L REESE 2,3	Enerquest Oil & Gas, Ltd.	57.923513%	36.944219%	21.399389%
5	LANEY	Enerquest Oil & Gas, Ltd.	39.685032%	18.322423%	7.271259%
6	LANEY A	Enerquest Oil & Gas, Ltd.	29.564903%	19.993114%	5.910945%
9	PEARL GOODE	Enerquest Oil & Gas, Ltd.	57.796875%	2.473871%	1.429820%
10	RALPH LOWE ST	Enerquest Oil & Gas, Ltd.	57.796875%	0.415278%	0.240018%
11	ROCKET CAIN	Enerquest Oil & Gas, Ltd.	57.796875%	0.330804%	0.191194%
12	SAMUEL CAIN	Enerquest Oil & Gas, Ltd.	57.796875%	2.053069%	1.186610%
		<b>Enerquest Oil &amp; Gas, Ltd. Subtotal</b>			<b>48.104265%</b>
1	C O DAVIS	Eram All	1.250000%	15.204311%	0.190054%
3	DAVIS	Eram All	0.757500%	1.473563%	0.011162%
2	FERGASON	Eram All	1.226566%	0.857979%	0.010524%
4	J SPEIGHT	Eram All	1.504640%	0.108696%	0.001635%
7	L REESE 1	Eram All	1.506563%	1.822673%	0.027460%
8	L REESE 2,3	Eram All	1.936250%	36.944219%	0.715332%
5	LANEY	Eram All	0.858621%	18.322423%	0.157320%
6	LANEY A	Eram All	1.619973%	19.993114%	0.323883%
9	PEARL GOODE	Eram All	1.250000%	2.473871%	0.030923%
10	RALPH LOWE ST	Eram All	1.250000%	0.415278%	0.005191%
11	ROCKET CAIN	Eram All	1.250000%	0.330804%	0.004135%
12	SAMUEL CAIN	Eram All	1.250000%	2.053069%	0.025663%
		<b>Eram All Subtotal</b>			<b>1.503283%</b>
2	FERGASON	Florence Branaman	0.625000%	0.857979%	0.005362%
5	LANEY	Hugh B. Key II	5.078120%	18.322423%	0.930435%
4	J SPEIGHT	Hugh B. Key II	1.947824%	0.108696%	0.002117%
6	LANEY A	Hugh B. Key II	5.078120%	19.993114%	1.015274%
		<b>Hugh B. Key II Subtotal</b>			<b>1.947826%</b>
5	LANEY	Urfer Family Trust dtd. 4/28/99	0.347220%	18.322423%	0.063619%
6	LANEY A	Urfer Family Trust dtd. 4/28/99	0.547776%	19.993114%	0.109517%
		<b>James F. Urfer Subtotal</b>			<b>0.173137%</b>
5	LANEY	James F. Van Vranken	0.173610%	18.322423%	0.031810%
6	LANEY A	James F. Van Vranken	0.273888%	19.993114%	0.054759%
		<b>James F. Van Vranken Subtotal</b>			<b>0.086568%</b>
5	LANEY	Julie Ann Hopkins Trust	2.539070%	18.322423%	0.465219%
4	J SPEIGHT	Julie Ann Hopkins Trust	0.973916%	0.108696%	0.001059%
6	LANEY A	Julie Ann Hopkins Trust	2.539070%	19.993114%	0.507639%
		<b>Julie Ann Hopkins Trust Subtotal</b>			<b>0.973917%</b>
5	LANEY	Kite Royalty Co., LLC	5.078120%	18.322423%	0.930435%
4	J SPEIGHT	Kite Royalty Co., LLC	1.733168%	0.108696%	0.001884%
6	LANEY A	Kite Royalty Co., LLC	4.005635%	19.993114%	0.800851%
		<b>Kite Royalty Co., LLC Subtotal</b>			<b>1.733170%</b>
5	LANEY	Lois S. Clements Trust	0.694420%	18.322423%	0.127235%
6	LANEY A	Lois S. Clements Trust	1.095520%	19.993114%	0.219029%
		<b>Lois S. Clements Trust Subtotal</b>			<b>0.346263%</b>
1	C O DAVIS	Lone Star Oil & Gas	0.625000%	15.204311%	0.095027%
2	FERGASON	Lone Star Oil & Gas	0.613282%	0.857979%	0.005262%
4	J SPEIGHT	Lone Star Oil & Gas	0.457757%	0.108660%	0.000497%
5	LANEY	Lone Star Oil & Gas	0.429310%	18.322423%	0.078660%
6	LANEY A	Lone Star Oil & Gas	0.809986%	19.993114%	0.161941%
7	L REESE 1	Lone Star Oil & Gas	0.213414%	1.822673%	0.003890%
8	L REESE 2,3	Lone Star Oil & Gas	0.213414%	36.944219%	0.078844%
9	PEARL GOODE	Lone Star Oil & Gas	0.625000%	2.473871%	0.015462%
10	RALPH LOWE ST	Lone Star Oil & Gas	0.625000%	0.415278%	0.002595%
11	ROCKET CAIN	Lone Star Oil & Gas	0.625000%	0.330804%	0.002068%
12	SAMUEL CAIN	Lone Star Oil & Gas	0.625000%	2.053069%	0.012832%
		<b>Lone Star Oil &amp; Gas Subtotal</b>			<b>0.457078%</b>
7	L REESE 1	Murray E. Helmers	13.253828%	1.822673%	0.241574%
4	J SPEIGHT	Murray E. Helmers	5.143682%	0.108696%	0.005591%
8	L REESE 2,3	Murray E. Helmers	13.253828%	36.944219%	4.896523%
		<b>Murray E. Helmers Subtotal</b>			<b>5.143688%</b>

EAST HOBBS (GRAYBURG SAN ANDRES) UNIT - UNIT PARTICIPATION					
Tr. #	Lease	Working Int. Owner	WI, %	Tract Participation Factor %	Unit Participation %
7	L REESE 1	George Kravis II, Trust	9.453125%	1.822673%	0.172300%
7	L REESE 1	Ray & Bessie Kravis Foundatio	7.734375%	1.822673%	0.140972%
5	LANEY	Marie Urfer Stinnett	0.347220%	18.322423%	0.063619%
6	LANEY A	Marie Urfer Stinnett	0.547776%	19.993114%	0.109517%
		Marie Urfer Stinnett			0.173137%
5	LANEY	Mark Collver Hopkins Trust	2.539070%	18.322423%	0.465219%
4	J SPEIGHT	Mark Collver Hopkins Trust	1.267450%	0.108696%	0.001378%
6	LANEY A	Mark Collver Hopkins Trust	4.005650%	19.993114%	0.800854%
		<b>Mark C Hopkins Trust Subtotal</b>			<b>1.267451%</b>
2	FERGASON	Mary E. Wrynn	0.625000%	0.857979%	0.005362%
1	C O DAVIS	Parsley Resources, Inc.	6.416665%	15.204311%	0.975610%
3	DAVIS	Parsley Resources, Inc.	2.397000%	1.473563%	0.035321%
2	FERGASON	Parsley Resources, Inc.	6.296330%	0.857979%	0.054021%
4	J SPEIGHT	Parsley Resources, Inc.	5.958689%	0.108696%	0.006477%
7	L REESE 1	Parsley Resources, Inc.	4.054277%	1.822673%	0.073896%
8	L REESE 2,3	Parsley Resources, Inc.	5.413807%	36.944219%	2.000089%
5	LANEY	Parsley Resources, Inc.	4.403625%	18.322423%	0.806851%
6	LANEY A	Parsley Resources, Inc.	8.308382%	19.993114%	1.661104%
9	PEARL GOODE	Parsley Resources, Inc.	6.416665%	2.473871%	0.158740%
10	RALPH LOWE ST	Parsley Resources, Inc.	6.416665%	0.415278%	0.026647%
11	ROCKET CAIN	Parsley Resources, Inc.	6.416665%	0.330804%	0.021227%
12	SAMUEL CAIN	Parsley Resources, Inc.	6.416665%	2.053069%	0.131739%
		<b>Parsley Resources, Inc. Subtotal</b>			<b>5.951721%</b>
5	LANEY	Nancy Hershberger	0.173610%	18.322423%	0.031810%
6	LANEY A	Nancy Hershberger	0.273888%	19.993114%	0.054759%
		<b>Nancy Hershberger Subtotal</b>			<b>0.086568%</b>
5	LANEY	Robert G. Van Vranken, Jr.	0.173610%	18.322423%	0.031810%
6	LANEY A	Robert G. Van Vranken, Jr.	0.273888%	19.993114%	0.054759%
		<b>Robert G. Van Vranken, Jr. Subtotal</b>			<b>0.086568%</b>
5	LANEY	Artamyse Watts Oil, Ltd.	6.831400%	18.322423%	1.251678%
5	LANEY	Virginia G. Olincy Trust	2.083300%	18.322423%	0.381711%
6	LANEY A	Virginia G. Olincy Trust	3.286625%	19.993114%	0.657099%
		<b>Virginia G. Olincy Trust Subtotal</b>			<b>1.038810%</b>
6	LANEY A	White Star Royalty Co., LLC	4.005635%	19.993114%	0.800851%
4	J SPEIGHT	White Star Royalty Co., LLC	0.801722%	0.108696%	0.000871%
		<b>White Star Royalty Co., LLC Subtotal</b>			<b>0.801723%</b>
3	DAVIS	Texland LP	29.447025%	1.473563%	0.433920%
3	DAVIS	David H. Arrington	34.848550%	1.473563%	0.513515%
3	DAVIS	Bruce D. Brockman	0.174243%	1.473563%	0.002568%
3	DAVIS	Michael E Chapman	0.174243%	1.473563%	0.002568%
3	DAVIS	Keith W. Davis	0.696971%	1.473563%	0.010270%
3	DAVIS	JMA Oil Properties Ltd.	1.742428%	1.473563%	0.025676%
3	DAVIS	Sydney E. Niblo	0.696971%	1.473563%	0.010270%
3	DAVIS	William F. Pendleton	0.696971%	1.473563%	0.010270%
3	DAVIS	Gary Phillips	0.174243%	1.473563%	0.002568%
3	DAVIS	Gordon E. Sommers	0.696971%	1.473563%	0.010270%
3	DAVIS	H. C. Zachry	0.348486%	1.473563%	0.005135%
		<b>Grand Total East Hobbs Unit</b>			<b>100.000000%</b>

EXHIBIT "E"

1 Attached to and made a part of that Certain Unit Operating Agreement for the East Hobbs (San Andres) Unit by and between  
2 EnerQuest Resources, LLC as Unit Operator and EnerQuest Oil & Gas, Ltd., et al as Working Interest Owners  
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ACCOUNTING PROCEDURE  
JOINT OPERATIONS

I. GENERAL PROVISIONS

1. **Definitions** (The added terms below in quotes are defined in the Unit Agreement and the Unit Operating Agreement and shall have the same meaning and effect in this Exhibit "E".

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

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

"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 as set out in Article 11 and elsewhere in the Unit Operating Agreement.

"Operator" shall mean the party designated to conduct the Joint Operations and mean the same as "Unit Operator".

"Non-Operators" shall mean the Parties to this agreement other than the Operator and mean the same as "Working Interest Owner".

"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.~~ <sup>the same as "Unit Equipment"</sup>

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

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**

A. 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 within fifteen (15) days after receipt of the billing or by the first day of the month for which the advance is required, whichever is later. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

B. 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 prime rate in effect at Bank of Texas on the first day of the month in which delinquency occurs plus 1% 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.

1 5. Audits

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3 A. A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit  
4 Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four  
5 (24) month period following the end of such calendar year, provided, however, the making of an audit shall not  
6 extend the time for the taking of written exception to and the adjustments of accounts as provided for in  
7 Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make  
8 every reasonable effort to conduct a joint audit in a manner which will result in a minimum of inconvenience  
9 to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this  
10 paragraph unless agreed to by the Operator. The audits shall not be conducted more than once each year  
11 without prior approval of Operator, except upon the resignation or removal of the Operator, and shall be made  
12 at the expense of those Non-Operators approving such audit.

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14 B. The Operator shall reply in writing to an audit report within 180 days after receipt of such report.

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16 6. Approval By Non-Operators

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

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24 **II. DIRECT CHARGES**

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

27  
28 1. Ecological and Environmental

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30 Costs incurred for the benefit of the Joint Property as a result of governmental or regulatory requirements to satisfy  
31 environmental considerations applicable to the Joint Operations. Such costs may include surveys of an ecological or  
32 archaeological nature and pollution control procedures as required by applicable laws and regulations.

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34 2. Rentals and Royalties

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

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38 3. Labor

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

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43 (2) Salaries of First level Supervisors in the field.

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

47  
48 (4) Salaries and wages of Technical Employees either temporarily or permanently assigned to and directly  
49 employed in the operation or the Joint Property if such charges are excluded from the overhead rates.

50  
51 B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to  
52 employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II.  
53 Such costs under this Paragraph 3B may be charged on a "when and as paid basis" or by "percentage assessment"  
54 on the amount of salaries and wages chargeable to the Joint Account under Paragraph 3A of this Section II. If  
55 percentage assessment is used, the rate shall be based on the Operator's cost experience.

56  
57 C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are  
58 applicable to Operator's costs chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II.

59  
60 D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under  
61 Paragraphs 3A and 3B of this Section II.

62  
63 4. Employee Benefits

64  
65 Operator's current costs or established plans for employees' group life insurance, hospitalization, pension, retirement,  
66 stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the  
67 Joint Account under Paragraphs 3A and 3B of this Section II shall be Operator's actual cost not to exceed the percent  
68 most recently recommended by the Council of Petroleum Accountants Societies.

69  
70

1 5. Material

2  
3 Material purchased or furnished by Operator for use on the Joint Property as provided under Section IV. Only such  
4 Material shall be purchased for or transferred to the Joint Property as may be required for immediate use and is  
5 reasonably practical and consistent with efficient and economical operations. The accumulation of surplus stocks shall be  
6 avoided.

7  
8 6. Transportation

9  
10 Transportation of employees and Material necessary for the Joint Operations but subject to the following limitations:

11  
12 A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be  
13 made to the Joint Account for a distance greater than the distance from the nearest reliable supply store where like  
14 material is normally available or railway receiving point nearest the Joint Property unless agreed to by the Parties.

15  
16 B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint  
17 Account for a distance greater than the distance to the nearest reliable supply store where like material is normally  
18 available, or railway receiving point nearest the Joint Property unless agreed to by the Parties. No charge shall be  
19 made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the  
20 Parties.

21  
22 C. In the application of subparagraphs A and B above, the option to equalize or charge actual trucking cost is  
23 available when the actual charge is \$400 or less excluding accessorial charges. The \$400 will be adjusted to the  
24 amount most recently recommended by the Council of Petroleum Accountants Societies.

25  
26 7. Services

27  
28 The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph  
29 10 of Section II and Paragraph i, ii, and iii, of Section III. The cost of professional consultant services and contract  
30 services of technical personnel directly engaged on / the Joint Property if such charges are excluded from the overhead  
31 rates. The cost of professional consultant services or contract services of technical personnel not directly engaged on / the  
32 Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.  
33

34 8. Equipment and Facilities Furnished By Operator

35  
36 A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate  
37 with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating  
38 expense, insurance, taxes, depreciation, and interest on gross investment less accumulated depreciation not to  
39 exceed twelve percent (12.0%) per annum. Such rates shall not exceed average commercial  
40 rates currently prevailing in the immediate area of the Joint Property.

41  
42 B. In lieu of charges in Paragraph 8A above, Operator may elect to use average commercial rates prevailing in the  
43 immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates  
44 published by the Petroleum Motor Transport Association.

45  
46 9. Damages and Losses to Joint Property

47  
48 All costs or expenses necessary for the repair or replacement of Joint Property made necessary because of damages or  
49 losses incurred by fire, flood, storm, theft, accident, or other cause, except those resulting from Operator's gross  
50 negligence or willful misconduct. Operator shall furnish Non-Operator written notice of damages or losses incurred as  
51 soon as practicable after a report thereof has been received by Operator.

52  
53 10. Legal Expense

54  
55 Expense of handling, investigating and settling litigation or claims, discharging of liens, payment of judgments and  
56 amounts paid for settlement of claims incurred in or resulting from operations under the agreement or necessary to  
57 protect or recover the Joint Property, except that no charge for services of Operator's legal staff or fees or expense of  
58 outside attorneys shall be made unless previously agreed to by the Parties. All other legal expense is considered to be  
59 covered by the overhead provisions of Section III unless otherwise agreed to by the Parties, except as provided in Section  
60 I, Paragraph 3.

61  
62 11. Taxes

63  
64 All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof,  
65 or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties. If the ad  
66 valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then  
67 notwithstanding anything to the contrary herein, charges to the Joint Account shall be made and paid by the Parties  
68 hereto in accordance with the tax value generated by each party's working interest and Article 11.1 of the Unit Operating Agreement.

69  
70

1 12. Insurance

2  
3 Net premiums paid for insurance required to be carried for the Joint Operations for the protection of the Parties. In the  
4 event Joint Operations are conducted in a state in which Operator may act as self-insurer for Worker's Compensation  
5 and/or Employers Liability under the respective state's laws, Operator may, at its election, include the risk under its self-  
6 insurance program and in that event, Operator shall include a charge at Operator's cost not to exceed manual rates.  
7

8 13. Abandonment and Reclamation

9  
10 Costs incurred for abandonment of the Joint Property, including costs required by governmental or other regulatory  
11 authority.  
12

13 14. Communications

14  
15 Cost of acquiring, leasing, installing, operating, repairing and maintaining communication systems, including radio and  
16 microwave facilities directly serving the Joint Property. In the event communication facilities/systems serving the Joint  
17 Property are Operator owned, charges to the Joint Account shall be made as provided in Paragraph 8 of this Section II.  
18

19 15. Other Expenditures

20  
21 Any other expenditure not covered or dealt with in the foregoing provisions of this Section II, or in Section III and which  
22 is of direct benefit to the Joint Property and is incurred by the Operator in the necessary and proper conduct of the Joint  
23 Operations.  
24

25  
26  
27 III. OVERHEAD

28 1. Overhead - Drilling and Producing Operations

29  
30 i. As compensation for administrative, supervision, office services and warehousing costs, Operator shall charge  
31 drilling and producing operations on either:

- 32  
33 ( X ) Fixed Rate Basis, Paragraph 1A, or  
34 ( ) Percentage Basis, Paragraph 1B

35  
36 Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and  
37 salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under  
38 Paragraph 3A, Section II. The cost and expense of services from outside sources in connection with matters of  
39 taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in  
40 the overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are  
41 agreed to by the Parties as a direct charge to the Joint Account.  
42

43 ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant  
44 services and contract services of technical personnel directly employed on the Joint Property:

- 45  
46 ( ) shall be covered by the overhead rates, or  
47 ( X ) shall not be covered by the overhead rates.  
48

49 iii. The salaries, wages and Personal Expenses of Technical Employees and/or costs of professional consultant services  
50 and contract services of technical personnel either temporarily or permanently assigned to and directly employed in  
51 the operation of the Joint Property:

- 52  
53 ( ) shall be covered by the overhead rates, or  
54 ( X ) shall not be covered by the overhead rates.  
55

56 A. Overhead - Fixed Rate Basis

57  
58 (1) Operator shall charge the Joint Account at the following rates per well per month:

59 Drilling Well Rate \$ 3,500.00

60 (Prorated for less than a full month)

61  
62 Producing Well Rate \$ 350.00

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

64  
65 (a) Drilling Well Rate

66  
67  
68 (1) Charges for drilling wells shall begin on the date the well is spudded and terminate on the date  
69 the drilling rig, completion rig, or other units used in completion of the well is released, whichever  
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is later, except that no charge shall be made during suspension of drilling or completion operations for fifteen (15) or more consecutive calendar days.

- (2) Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive work 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 or other units used in workover, commence through date of rig or other unit release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive calendar 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 shall be made for the month in which plugging and abandonment operations are completed on any well. This one-well charge shall be made whether or not the well has produced except when drilling well rate applies.
- (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 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 10 of Section II and all salvage credits.~~

~~(b) Operating~~

~~Percent ( ) of the cost of operating the Joint Property exclusive of costs provided under Paragraphs 2 and 10 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, re-drilling, deepening, or any remedial operations on any or all wells involving the use of drilling rig and crew capable of drilling to the producing interval on the Joint Property, 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

1 Account for overhead based on the following rates for any Major Construction project in excess of \$ 25,000.00

- 2  
3 A. 5 % of first \$100,000 or total cost if less, plus  
4  
5 B. 3 % of costs in excess of \$100,000 but less than \$1,000,000, plus  
6  
7 C. 2 % of costs in excess of \$1,000,000.  
8

9 Total cost shall mean the gross cost of any one project. For the purpose of this paragraph, the component parts of a single  
10 project shall not be treated separately and the cost of drilling and workover wells and artificial lift equipment shall be  
11 excluded.  
12

13 3. **Catastrophe Overhead**

14 To compensate Operator for overhead costs incurred in the event of expenditures resulting from a single occurrence due  
15 to oil spill, blowout, explosion, fire, storm, hurricane, or other catastrophes as agreed to by the Parties, which are  
16 necessary to restore the Joint Property to the equivalent condition that existed prior to the event causing the  
17 expenditures, Operator shall either negotiate a rate prior to charging the Joint Account or shall charge the Joint Account  
18 for overhead based on the following rates:  
19

- 20  
21 A. 5 % of total costs through \$100,000; plus  
22  
23 B. 3 % of total costs in excess of \$100,000 but less than \$1,000,000; plus  
24  
25 C. 2 % of total costs in excess of \$1,000,000.  
26

27 Expenditures subject to the overheads above will not be reduced by insurance recoveries, and no other overhead  
28 provisions of this Section III shall apply.  
29

30 4. **Amendment of Rates**

31 The overhead rates provided for in this Section III may be amended from time to time only by mutual agreement  
32 between the Parties hereto if, in practice, the rates are found to be insufficient or excessive.  
33  
34  
35

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

37 Operator is responsible for Joint Account Material and shall make proper and timely charges and credits for all Material  
38 movements affecting the Joint Property. Operator shall provide all Material for use on the Joint Property; however, at  
39 Operator's option, such Material may be supplied by the Non-Operator. Operator shall make timely disposition of idle and/or  
40 surplus Material, such disposal being made either through sale to Operator or Non-Operator, division in kind, or sale to  
41 outsiders. Operator may purchase, but shall be under no obligation to purchase, interest of Non-Operators in surplus condition  
42 A or B Material. The disposal of surplus Controllable Material not purchased by the Operator shall be agreed to by the Parties.  
43  
44

45 1. **Purchases**

46 Material purchased shall be charged at the price paid by Operator after deduction of all discounts received. In case of  
47 Material found to be defective or returned to vendor for any other reasons, credit shall be passed to the Joint Account  
48 when adjustment has been received by the Operator.  
49  
50

51 2. **Transfers and Dispositions**

52 Material furnished to the Joint Property and Material transferred from the Joint Property or disposed of by the Operator,  
53 unless otherwise agreed to by the Parties, shall be priced on the following basis exclusive of cash discounts:  
54  
55

56 A. **New Material (Condition A)**

57 (1) **Tubular Goods Other than Line Pipe**

58 (a) Tubular goods, sized 2 3/8 inches OD and larger, except line pipe, shall be priced at Eastern mill  
59 published carload base prices effective as of date of movement plus transportation cost using the 80,000  
60 pound carload weight basis to the railway receiving point nearest the Joint Property for which  
61 published rail rates for tubular goods exist. If the 80,000 pound rail rate is not offered, the 70,000 pound  
62 or 90,000 pound rail rate may be used. Freight charges for tubing will be calculated from Lorain, Ohio  
63 and casing from Youngstown, Ohio.  
64  
65

66 (b) For grades which are special to one mill only, prices shall be computed at the mill base of that mill plus  
67 transportation cost from that mill to the railway receiving point nearest the Joint Property as provided  
68 above in Paragraph 2.A.(1)(a). For transportation cost from points other than Eastern mills, the 30,000  
69  
70

1 pound Oil Field Haulers Association interstate truck rate shall be used.

2  
3 ~~(c) Special end finish tubular goods shall be priced at the lowest published out of stock price, f.o.b. Houston,~~  
4 ~~Texas, plus transportation cost, using Oil Field Haulers Association interstate 30,000 pound truck rate,~~  
5 ~~to the railway receiving point nearest the Joint Property.~~

6  
7 ~~(d) Macaroni tubing (size less than 2 3/8 inch OD) shall be priced at the lowest published out of stock prices~~  
8 ~~f.o.b. the supplier plus transportation costs, using the Oil Field Haulers Association interstate truck rate~~  
9 ~~per weight of tubing transferred, to the railway receiving point nearest the Joint Property.~~

10  
11 (2) Line Pipe

12  
13 ~~(a) Line pipe movements (except size 24 inch OD and larger with walls 1/4 inch and over) 30,000 pounds or~~  
14 ~~more shall be priced under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above.~~  
15 ~~Freight charges shall be calculated from Lorain, Ohio.~~

16  
17 ~~(b) Line Pipe movements (except size 24 inch OD) and larger with walls 1/4 inch and over less than 30,000~~  
18 ~~pounds shall be priced at Eastern mill published carload base prices effective as of date of shipment,~~  
19 ~~plus 20 percent, plus transportation costs based on freight rates as set forth under provisions of tubular~~  
20 ~~goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain,~~  
21 ~~Ohio.~~

22  
23 ~~(c) Line pipe 24 inch OD and over and 1/4 inch wall and larger shall be priced f.o.b. the point of~~  
24 ~~manufacture at current new published prices plus transportation cost to the railway receiving point~~  
25 ~~nearest the Joint Property.~~

26  
27 ~~(d) Line pipe, including fabricated line pipe, drive pipe and conduit not listed on published price lists shall~~  
28 ~~be priced at quoted prices plus freight to the railway receiving point nearest the Joint Property or at~~  
29 ~~prices agreed to by the Parties.~~

30  
31 (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable  
32 supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the  
33 railway receiving point nearest the Joint Property.

34  
35 (4) Unused new Material, except tubular goods, moved from the Joint Property shall be priced at the current  
36 new price, in effect on date of movement, as listed by a reliable supply store nearest the Joint Property, or  
37 point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint  
38 Property. ~~Unused new tubular will be priced as provided above in Paragraph 2-A.(1) and (2).~~

39  
40 B. Good Used Material (Condition B)

41  
42 Material in sound and serviceable condition and suitable for reuse without reconditioning:

43  
44 (1) Material moved to the Joint Property

45  
46 At seventy-five percent (75%) of current new price, as determined by Paragraph A.

47  
48 (2) Material used on and moved from the Joint Property

49  
50 (a) At seventy-five percent (75%) of current new price, as determined by Paragraph A, if Material was  
51 originally charged to the Joint Account as new Material or

52  
53 (b) At sixty-five percent (65%) of current new price, as determined by Paragraph A, if Material was  
54 originally charged to the Joint Account as used Material

55  
56 (3) Material not used on and moved from the Joint Property

57  
58 At seventy-five percent (75%) of current new price as determined by Paragraph A.

59  
60 The cost of reconditioning, if any, shall <sup>not</sup> be absorbed by the transferring property and shall be charged to the Joint Account.

61  
62 C. Other Used Material

63  
64 (1) Condition C

65  
66 Material which is not in sound and serviceable condition and not suitable for its original function until  
67 after reconditioning shall be priced at fifty percent (50%) of current new price as determined by  
68 Paragraph A. The cost of reconditioning shall be charged to the receiving property, provided Condition  
69 C value plus cost of reconditioning does not exceed Condition B value.  
70

1 (2) Condition D

2  
3 Material, excluding junk, no longer suitable for its original purpose, but usable for some other purpose  
4 shall be priced on a basis commensurate with its use. Operator may dispose of Condition D Material  
5 under procedures normally used by Operator without prior approval of Non-Operators.  
6

7 (a) Casing, tubing, or drill pipe used as line pipe shall be priced as Grade A and B seamless line pipe  
8 of comparable size and weight. Used casing, tubing or drill pipe utilized as line pipe shall be  
9 priced at used line pipe prices.  
10

11 (b) Casing, tubing or drill pipe used as higher pressure service lines than standard line pipe, e.g.  
12 power oil lines, shall be priced under normal pricing procedures for casing, tubing, or drill pipe.  
13 Upset tubular goods shall be priced on a non upset basis.  
14

15 (3) Condition E

16  
17 Junk shall be priced at prevailing prices. Operator may dispose of Condition E Material under  
18 procedures normally utilized by Operator without prior approval of Non-Operators.  
19

20 D. Obsolete Material

21  
22 Material which is serviceable and usable for its original function but condition and/or value of such Material  
23 is not equivalent to that which would justify a price as provided above may be specially priced as agreed to by  
24 the Parties. Such price should result in the Joint Account being charged with the value of the service  
25 rendered by such Material.  
26

27 E. Pricing Conditions

28  
29 (1) Loading or unloading costs may be charged to the Joint Account at the rate of twenty-five cents (25¢)  
30 per hundred weight on all tubular goods movements, in lieu of actual loading or unloading costs  
31 sustained at the stocking point. The above rate shall be adjusted as of the first day of April each year  
32 following January 1, 1985 by the same percentage increase or decrease used to adjust overhead rates in  
33 Section III, Paragraph 1.A.(3). Each year, the rate calculated shall be rounded to the nearest cent and  
34 shall be the rate in effect until the first day of April next year. Such rate shall be published each year  
35 by the Council of Petroleum Accountants Societies.  
36

37 (2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down  
38 price of new Material.  
39

40 3. Premium Prices

41  
42 Whenever Material is not readily obtainable at published or listed prices because of national emergencies, strikes or other  
43 unusual causes over which the Operator has no control, the Operator may charge the Joint Account for the required  
44 Material at the Operator's actual cost incurred in providing such Material, in making it suitable for use, and in moving it  
45 to the Joint Property; provided notice in writing is furnished to Non-Operators of the proposed charge prior to billing  
46 Non-Operators for such Material. Each Non-Operator shall have the right, by so electing and notifying Operator within  
47 ten days after receiving notice from Operator, to furnish in kind all or part of his share of such Material suitable for use  
48 and acceptable to Operator.  
49

50 4. Warranty of Material Furnished By Operator

51  
52 Operator does not warrant the Material furnished. In case of defective Material, credit shall not be passed to the Joint  
53 Account until adjustment has been received by Operator from the manufacturers or their agents.  
54  
55

56 V. INVENTORIES

57  
58 The Operator shall maintain detailed records of Controllable Material.  
59

60 1. Periodic Inventories, Notice and Representation

61  
62 At reasonable intervals, inventories shall be taken by Operator of the Joint Account Controllable Material. Written notice  
63 of intention to take inventory shall be given by Operator at least thirty (30) days before any inventory is to begin so that  
64 Non-Operators may be represented when any inventory is taken. Failure of Non-Operators to be represented at an  
65 inventory shall bind Non-Operators to accept the inventory taken by Operator.  
66

67 2. Reconciliation and Adjustment of Inventories

68  
69 Adjustments to the Joint Account resulting from the reconciliation of a physical inventory shall be made within six  
70 months following the taking of the inventory. Inventory adjustments shall be made by Operator to the Joint Account for

1 overages and shortages, but, Operator shall be held accountable only for shortages due to lack of reasonable diligence.

2  
3 **3. Special Inventories**

4  
5 Special inventories may be taken whenever there is any sale, change of interest, or change of Operator in the Joint  
6 Property. It shall be the duty of the party selling to notify all other Parties as quickly as possible after the transfer of  
7 interest takes place. In such cases, both the seller and the purchaser shall be governed by such inventory. In cases  
8 involving a change of Operator, all Parties shall be governed by such inventory.

9  
10 **4. Expense of Conducting Inventories**

11  
12 A. The expense of conducting periodic inventories shall not be charged to the Joint Account unless agreed to by the  
13 Parties.

14  
15 B. The expense of conducting special inventories shall be charged to the Parties requesting such inventories, except  
16 inventories required due to change of Operator shall be charged to the Joint Account.

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EXHIBIT "F"

Attached to and made a part of that Certain Unit Operating Agreement for the East Hobbs (San Andres) Unit by and between EnerQuest Resources, LLC as Unit Operator and EnerQuest Oil & Gas, Ltd., et al as Working Interest Owners

INSURANCE AND INDEMNITY

Without in any way limiting the Operator's and Non-Operator's liability pursuant to this Agreement, Operator shall, at all times while operations are conducted under this Agreement, maintain for the benefit of all parties hereto, insurance at the types and in the maximum amounts as follows. Premiums for such charges shall be charged to the joint account.

All such insurance shall be maintained in full force and effect during the terms of this Agreement; however, such insurance may be canceled, altered or amended as deemed necessary by Operator. If so required, Operator agrees to have its insurance carrier furnish certificates of insurance evidencing such insurance coverages.

Operator and non-operating working interest owners agree to mutually waive subrogation in favor of each other on all insurance carried by each party and/or to obtain such waiver from the insurance carrier if so required by the insurance contract.

Non-operating working interest owners agree that the limits and coverage carried by the Operator are adequate and shall hold Operator harmless if any claim exceed such limits or is not covered by such policy.

<u>KIND</u>	<u>POLICY FORM</u>	<u>MINIMUM LIMITS OF LIABILITY</u>
Workmen's Compensation	Statutory	Statutory \$ 500,000
Comp. General Liability	Comprehensive	\$1,000,000 General Aggregate
Motor Vehicle	Comprehensive (including non-ownership liability & hired automobile coverage)	\$1,000,000 Combined Single Limit
Excess Liability	Umbrella	\$5,000,000 Aggregate

Operator shall require all third party contractors performing work in or on the premises covered hereby to carry insurance and in such amounts as Operator shall deem necessary.

**EXHIBIT "G"**  
**Equipment Inventory East Hobbs (San Andres) Unit**  
**Lea County, New Mexico**

<u>Tract #</u>	<u>Lease Name</u>	<u>Equipment</u>	<u>Value</u>	<u>Tract Participation Factor</u>
1	Carrie O. Davis	American D-228 Lufkin 228-D EMSCO SN 551 Jenson Bros. 320-235 Tank Battery TOTAL	\$10,000.00 \$12,500.00 \$5,000.00 \$15,000.00 \$18,000.00 \$60,500.00	15.204311
2	D.F. Ferguson	Lufkin 228 Tank Battery TOTAL	\$7,500.00 \$1,500.00 \$9,000.00	0.857979
3	Zachary Davis	API 228 Tank Battery TOTAL	\$10,000.00 \$4,000.00 \$14,000.00	1.473563
4	June Speight	Non producing TOTAL	\$0.00 \$0.00	0.108696
5	Laney	Cabot 114 Cabot 114 Cabot 114 Tank Battery TOTAL	\$2,000.00 \$2,000.00 \$2,000.00 \$6,000.00 \$12,000.00	18.322423
6	Laney A	Lufkin 228-D Bethlehem 228 American 160 Tank Battery TOTAL	\$12,500.00 \$12,500.00 \$10,000.00 \$20,000.00 \$55,000.00	19.993114
7	Laney Reese #1	Lufkin 114 Tank Battery TOTAL	\$6,000.00 \$2,833.33 \$8,833.33	1.822673
8	Laney Reese #2 & #3	American 228 American 160D Tank Battery TOTAL	\$12,500.00 \$6,000.00 \$5,666.67 \$24,166.67	36.944219
9	Pearl Goode	Sentry 114 Sentry 114 Lufkin 1400 Tank Battery TOTAL	\$1,500.00 \$1,500.00 \$3,500.00 \$4,000.00 \$10,500.00	2.473871
10	Ralph Lowe State	National 228 Tank Battery TOTAL	\$1,500.00 \$2,000.00 \$3,500.00	0.415278
11	Rocket Cain	American 114 Tank Battery TOTAL	\$1,500.00 \$1,000.00 \$2,500.00	0.330804
12	Samuel Cain	CMI 160 Churchill 228 Tank Battery TOTAL	\$8,500.00 \$12,000.00 \$5,500.00 \$26,000.00	2.053069
<b><u>TOTAL EQUIPMENT</u></b>			<b><u>\$226,000.00</u></b>	<b><u>100.000000</u></b>