

UNIT OPERATING AGREEMENT
ROCK QUEEN UNIT
LEA AND CHAVES COUNTIES, NEW MEXICO

NO. _____

THIS AGREEMENT, entered into as of the _____ day of _____ 1959, by and between the parties who execute or ratify this Agreement.

WITNESSETH: that,

WHEREAS, the parties hereto as Working Interest Owners have executed as of the date hereof, that certain Unit Agreement For The Development and Operation of the ROCK QUEEN UNIT, Lea and Chaves Counties, New Mexico, hereinafter referred to as "Unit Agreement", and which, among other things, provides for a separate agreement to be made and entered into by and between Working Interest Owners pertaining to the development and operation of the Unit Area therein defined;

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

ARTICLE 1

CONFIRMATION OF UNIT AGREEMENT

1.1 Confirmation of Unit Agreement. The Unit Agreement is hereby confirmed and incorporated herein by reference and made a part of this Agreement. The definitions in the Unit Agreement are adopted for all purposes of this Agreement. In the event of any conflict between the Unit Agreement and this Agreement, the Unit Agreement shall prevail.

ARTICLE 2

EXHIBITS

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

2.1.1 Exhibits A and B of the Unit Agreement.

2.1.2 Exhibit C, attached hereto, is a schedule showing the total Unit Participation of each Working Interest Owner.

2.1.3 Exhibit D, attached hereto, is the Accounting Procedure applicable to development and operation of the Unit Area. In the

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event, shall be subject to the same and limited by the same Agreement shall prevail.

2.1 Exhibits Attached hereto contain insurance provisions applicable to the development and operation of the Unit Area.

2.2 Revision of Exhibits Whenever Exhibits A and B are revised, Exhibit C shall be revised according to such revision to be effective as of the effective date of revised Exhibits A and B.

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 the development and operation of the Unit Area pursuant to this Agreement and the Unit Agreement. In the exercise of such power 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 Particular Powers and Duties The matters to be passed upon and decided by Working Interest Owners shall include, but not be limited to, the following:

3.2.1 Method of Operation The kind, character and method of operation, including any type of pressure maintenance or secondary recovery program to be employed.

3.2.2 Drilling of Wells The drilling of any well within the Unit Area either for production of Unitized Substances, for use as an injection well, or for other purposes.

3.2.3 Well Workovers and Change of Status The workover, re-completion, repair, abandonment, or change of status of any well in the Unit Area or use of any such well for injection or other purposes. In this connection, Working Interest Owners, shall within eighteen months from the effective date hereof, determine whether or not each of the wells to be used for Unit operations, either as an injection well or a producing well, is in a satisfactory state of repair for such use. If they should determine that a well requires the use of a liner to contain casing formations, or other

repairs, the Working Interest Owner of such well shall promptly, and within a reasonable time commensurate with the needs of unit operations, cause such work to be done, and the Working Interest Owner of such well shall have the option of doing such work itself, or requesting the Unit Operator to do such work and be billed for such expenses entailed in the rework or repair. If Unit Operator is requested to do such work, the Working Interest Owner of the well shall indemnify Unit Operator from any damages which might result from such rework or repair. If it should be determined that any such well be logged, such logging will be at Unit expense.

3.2.4 Expenditures. Making of any single expenditure in excess of Five Thousand and No/100 (\$5,000.00) Dollars, provided that approval by Working Interest Owners of the drilling, reworking, drilling deeper, or plugging back of any well shall include approval of all necessary expenditures required therefor and for completing, testing and equipping the same, including necessary flow lines, separators and lease tankage.

3.2.5 Disposition of Surplus Facilities. Selling or otherwise disposing of any major item of surplus material or equipment, the current list price of new equipment similar thereto being One Thousand Five Hundred and No/100 (\$1,500.00) Dollars or more.

3.2.6 Appearance Before a Court or Regulatory Body. The designation of a representative to appear before any court or regulatory body in all matters pertaining to Unit operations; provided, however, such designation by Working Interest Owners shall not prevent any Working Interest Owner from appearing in person or from designating another representative in its own behalf.

3.2.7 Audits. The making of proper audits of the accounts of Unit Operator pertaining to operations hereunder, provided that such audits shall:

- (a) not be conducted more than once each year except upon the resignation or removal of Unit Operator, and shall:

be made at the expense of all Working Interest Owners
... within the Working Interest Owner designated as Unit
Operator, unless such activities conducted at the specific
instance and request of Unit Operator, in which latter
event the same shall be made at the expense of all work-
ing Interest Owners including the Working Interest Owner
designated as Unit Operator, and

(c) upon not less than thirty (30) days written notice
to Unit Operator.

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

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

3.2.10. Appointment of Committees. The appointment or desig-
nation of committees or subcommittees necessary for the study of
any problem in connection with Unit operations.

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

3.2.12. The enlargement of the Unit Area.

3.2.13. The readjustment of investments as required.

3.2.14. The termination of the Unit Agreement.

ARTICLE 4

MANNER OF EXERCISING SUPERVISION

4.1. Designation of Representatives. Each Working Interest Owner
shall advise Unit Operator in writing the names and addresses of its
representative and alternate representative authorized to represent and
bind it in respect to any matter pertaining to the development and oper-
ation of the Unit Area. Such representative or alternate representative
may be changed from time to time by written notice to Unit Operator.

4.2. Meetings. All meetings of Working Interest Owners for the
purpose of considering and acting upon any matter pertaining to the de-

(b) be made at the expense of all Working Interest Owners other than the Working Interest Owner designated as Unit Operator unless such audit is conducted at the specific instance and request of Unit Operator in which latter event the same shall be made at the expense of all Working Interest Owners including the Working Interest Owner designated as Unit Operator; and

(c) be upon not less than thirty (30) days' written notice to Unit Operator.

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

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

3.2.10 Appointment of Committees. The appointment or designation of committees or subcommittees necessary for the study of any problem in connection with Unit operations.

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

3.2.12 The enlargement of the Unit Area.

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ARTICLE 4

MANNER OF EXERCISING SUPERVISION

4.1 Designation of Representatives. Each Working Interest Owner shall advise Unit Operator in writing the names and addresses of its representative and alternate representative authorized to represent and bind it in respect to any matter pertaining to the development and operation of the Unit Area. Such representative or alternate representative may be changed from time to time by written notice to Unit Operator.

4.2 Meetings. All meetings of Working Interest Owners for the purpose of considering and acting upon any matter pertaining to the de-

Any meeting for operation of the Unit Area shall be called by Unit Operator upon its own motion or at the request of two (2) or more Working Interest Owners. No meeting shall be called unless ten (10) days advance written notice with agenda for the meeting attached. In the absence of protest by any qualified member of the meeting, the Working Interest Owners attending such meeting shall not be prevented from amending items included in the agenda or from deciding on such amended item or from deciding other items presented at such meeting. The representative of Unit Operator shall be chairman of each meeting.

4.3 Voting Procedure. Working Interest Owners shall act upon and determine all matters coming before them as follows:

4.3.1 Voting Interest. In voting on any matter each Working Interest Owner shall have a voting interest equal to its then percentage in Unit Participation, as shown in Exhibit "C", and such revisions thereof as may hereafter be made in accordance with the terms of this Agreement.

4.3.2 Vote Required. Except as may otherwise be provided herein or in the Unit Agreement, Working Interest Owners shall act upon and determine all matters coming before them including but not limited to:

(a) an expenditure of more than Five Thousand and No/100 (\$5,000.00) Dollars; or

(b) drilling of any wells and method of reconditioning for injection and/or producing wells

by the affirmative vote of a majority of the voting interest; provided, that should any one Working Interest Owner own more than fifty (50%) percent voting interest, its vote must be supported by the vote of two or more Working Interest Owners having a combined voting interest of at least ten (10%) percent.

4.3.3 Vote at Meeting by Nonattending Working Interest Owner. Any Working Interest Owner not represented at a meeting may vote on any item included in the agenda of the meeting by letter or telegram addressed to the chairman of the meeting, provided such vote

is received prior to the submission of such item to vote. Such vote shall not be counted with respect to any item on the agenda which is amended at the meeting.

4.3.0 Poll Votes. Working Interest Owners may decide any matter by vote taken by letter or telegram provided the matter is first submitted in writing to each Working Interest Owner and no meeting on the matter is called as provided in Article 4.2. within seven (7) days after such proposal is served on Working Interest Owners. Unit Operator will give prompt notice of the results of such voting to all Working Interest Owners.

ARTICLE 5

INDIVIDUAL RIGHTS AND PRIVILEGES OF WORKING INTEREST OWNERS

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

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

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

5.2.2 Reports by Request. 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 data not ordinarily furnished by Unit Operator to all Working Interest Owners; the cost of preparing copies of said reports shall be charged solely to the Working Interest Owners requesting the same.

5.3 Undrilled Locations. The individual Working Interest Owners who have undrilled locations on tracts committed to the Unit Area shall have the option of drilling and completing a well in the Unitized Formation on such undrilled location at any time prior to final approval of the Unit Agreement and receive credit for the percentage allocation for

a well on such tract from the effective date of such Unit Agreement. The actual commencement of operations for drilling of such well prior to the final approval of the Unit Agreement shall be deemed compliance with this requirement, provided the same is thereafter drilled and completed in the Unitized Formation with due diligence. In the alternative, the owner of undrilled locations may leave such location undrilled and forego participation in the percentage allocation for a well on such location. If the Working Interest Owners under their powers derived from Article 3 hereof should subsequently determine that an undrilled location be drilled, then such drilling shall be at Unit expense; but the owner of such location shall not receive additional participation for such well under the participation formula when so drilled at Unit expense.

ARTICLE 6

UNIT OPERATOR

6.1 Initial Unit Operator. Great Western Drilling Company, a Texas corporation, is hereby designated as Unit Operator.

6.2 Resignation or Removal - Selection of Successor. The resignation or removal of Unit Operator, and the selection of a successor shall be governed by the provisions of the Unit Agreement.

ARTICLE 7

POWERS AND DUTIES OF UNIT OPERATOR

7.1 Exclusive Right to Operate Unit. Subject to the provisions of this Agreement and to the orders, directions and limitations rightfully given or imposed by Working Interest Owners, Unit Operator shall have the exclusive right and duty to develop and operate the Unit Area for the production of Unitized Substances.

7.2 Workmanlike Conduct. Unit Operator shall conduct all operations hereunder in a good and workmanlike manner, and, in the absence of specific instructions from Working Interest Owners, shall have the right and duty to conduct such operations in the same manner as would a prudent operator under the same or similar circumstances. Unit

Operator shall freely consult with Working Interest Owners and keep them advised of all matters arising in connection with such operations which Unit Operator, in the exercise of its best judgment, considers important. Unit Operator shall not be liable for damages unless such damages result from the gross negligence or willful misconduct of Unit Operator.

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 its operations hereunder, except the lien of Unit Operator granted hereunder.

7.4 Employees. The number of employees used by Unit Operator in conducting operations hereunder, the selection of such employees, the hours of labor, and the compensation for services to be paid any and all such employees shall be determined by Unit Operator. Such employees shall be the employees of Unit Operator.

7.5 Records. Unit Operator shall keep true and correct books, accounts and records of its operations hereunder.

7.6 Reports to Working Interest Owners. Unit Operator shall furnish to each Working Interest Owner monthly, injection and production reports for each well in the Unit, as well as periodic reports of the development and operation of the Unit Area.

7.7 Reports to Governmental Authorities. Unit Operator shall make all necessary reports to governmental authorities.

7.8 Engineering and Geological Information. Unit Operator shall furnish to each Working Interest Owner, upon written request, a copy of the log of, and copies of engineering and geological data pertaining to, wells drilled by Unit Operator.

7.9 Expenditures. Unit Operator is authorized to make single expenditures not in excess of Five Thousand and No/100 (\$5,000.00) Dollars without prior approval of Working Interest Owners; provided, however, that nothing in this Article (nor in Article 3.2.4) shall be deemed to prevent Unit Operator from making an expenditure in excess of said amount if such expenditure becomes necessary because of a sudden emergency which may otherwise cause loss of life or extensive damage to

property.

7.10. Settlements. Unit Operator may settle any single damage claim not involving an expenditure in excess of One Thousand and No/100 (\$1,000.00) Dollars, provided such payment is a complete settlement of such claim. All claims in excess of \$1,000.00 must be approved by the Working Interest Owners.

7.11. Fair Employment. In connection with the performance of work under this Agreement, the Unit Operator agrees not to discriminate against any employee or applicant for employment because of race, religion, color or national origin. The aforesaid provision shall include, but not be limited to, the following: employment, upgrading, demotion or transfer; recruitment or recruitment advertising; layoff or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. The Unit Operator agrees to post hereafter in conspicuous places, available for employees and applicants for employment, notices to be provided by the contracting officer setting forth the provisions of this nondiscrimination clause. The Unit Operator agrees to insert the foregoing provision in all subcontracts hereunder, except subcontracts for standard commercial supplies or raw materials.

7.12. Mathematical Errors. It is hereby agreed by all parties to this Agreement that Unit Operator is empowered to correct any mathematical errors which might exist in the pertinent exhibits to this Agreement upon approval of the Commissioner and the Director.

ARTICLE 8

TAXES

8.1. Ad Valorem Taxes. Unit Operator, after consulting with Working Interest Owners, shall make and file for ad valorem tax purposes all necessary renditions and returns with the proper taxing authorities or governmental subdivisions covering all real and personal property of each Working Interest Owner within the Unit Area and used in connection with the development and operation of the Unit Area. Any Working Interest Owner dissatisfied with any proposed rendition or assessment of its interest in real or personal property shall have the right, at its own expense, to protest and resist the same. All such ad valorem taxes due and payable

on a count of real and personal property of each Working Interest Owner located within the Unit Area and used in connection with Unit operations shall be paid by Unit Operator for the joint account in the same manner as other costs and expenses of Unit operations.

8.2 Direct Taxes and Assessments. Each Working Interest Owner shall pay or cause to be paid all production, severance, gathering and other direct taxes and assessments imposed upon or on account of the production or handling of its share of Unitized Substances.

ARTICLE 9

INSURANCE

9.1 Insurance. Unit Operator shall carry, with respect to Unit operation subject to this Agreement:

9.1.1 Insurance as set forth in Exhibit "E".

ARTICLE 10

ADJUSTMENT OF INVESTMENTS

10.1 Personal Property Taken Over. Upon the effective date hereof, Working Interest Owners shall deliver to Unit Operator possession of:

10.1.1 Wells and Casing. All wells completed in the Unitized Formation together with the casing therein;

10.1.2 Well and Lease Equipment. The tubing and rods in each such well, together with the wellhead connections thereon, and all other lease and operating equipment used in the operation of such wells which Working Interest Owners determine is necessary or desirable for conducting Unit operations; and

10.1.3 Records. A copy of all production and well records pertaining to such wells.

10.2 Inventory and Evaluation of Personal Property. Working Interest Owners shall (at Unit expense) inventory and evaluate (i) all controllable material in accordance with provisions of Exhibit "D" and (ii) all personal property so taken over under Article 10.1.2 above, and Working Interest Owners shall appoint a committee for such purpose. Such inventory and evaluation shall, with the exception of sucker rods, be limited to items considered controllable, as recommended in the Material

Classic Oil & Gas, published by the Petroleum Accountants Society of Oklahoma in 1953. In this connection, Working Interest Owners agree to furnish such committee a list of their underground equipment prior to the effective date of this Agreement. The inventory as taken by the committee shall be as of the effective date of the Unit Agreement.

10.3 Investment Adjustment. Upon approval by Working Interest Owners of such inventory and evaluation, each Working Interest Owner shall be credited with the value of its interest in all personal property so taken over by Unit Operator under Article 10.1.2, and charged with an amount equal to that obtained by multiplying the total value of all such personal property so taken over by Unit Operator under Article 10.1.2 by such Working Interest Owner's Unit Participation as shown on Exhibit "C". 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 paid and in all other respects be treated as any other 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. Pricing of inventory will be in accordance with Article V of Exhibit "D" hereof.

10.4 General Facilities. The acquisition of warehouses, warehouse stocks, lease houses, camps, facility systems, and office buildings necessary for operations hereunder shall be by negotiation by and between 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 in all personal property and facilities taken over or otherwise acquired by Unit Operator pursuant to this Agreement in an amount equal to its Unit Participation, shown on Exhibit "C".

ARTICLE IIIDEVELOPMENT AND OPERATING COSTS

11.1 Basis of Charges to Working Interest Owners. Unit Operator initially shall pay and discharge all costs and expenses incurred in the development and operation of the Unit Area. Working Interest Owners shall reimburse Unit Operator for all such costs and expenses in proportion to their respective Unit Participation shown on Exhibit C. All charges, credits and accounting for costs and expenses shall be in accordance with Exhibit D.

11.2 Budgets. Before or as soon as practical after the effective date hereof, Unit Operator shall prepare a budget of estimated costs and expenses for the remainder of the calendar year, and on or before the first day of each October thereafter shall prepare a budget of estimated costs and expenses for the ensuing calendar year. Such budgets shall set forth the estimated costs and expenses by quarterly periods. Unless otherwise specified in the budget, it shall be presumed for the purpose of advance billings that the estimated costs and expenses for each month of a quarterly period shall be one-third (1/3) of the estimate for the quarterly period. Budgets so prepared shall be estimates only and shall be subject to adjustment and correction by Working Interest Owners and Unit Operator from time to time whenever it shall appear that an adjustment or correction is proper. A copy of each such budget and adjusted budget shall be promptly furnished each Working Interest Owner.

11.3 Advance Billing. Unit Operator shall have the right at its option to require Working Interest Owners to advance their respective proportion of such costs and expenses by submitting to Working Interest Owners, on or before the 15th day of any month, an itemized estimate of such costs and expenses for the succeeding month with a request for payment in advance. Within fifteen (15) days thereafter, each Working Interest Owner shall pay to Unit Operator its proportionate part of such estimate. Adjustment between estimates and the actual costs shall be made by Unit Operator at the close of each calendar month, and the accounts of the Working Interest Owners shall be adjusted accordingly.

where such services and materials are to be acquired. Working Interest Owners may have the option of furnishing such material in kind, subject to acceptance of such material by Unit Operator.

11.4 Commingling of Funds: No funds received by Unit Operator under this Agreement need be segregated by Unit Operator or maintained by it as a joint fund, but may be commingled with its own funds.

11.5 Lien of Unit Operator: Each Working Interest Owner grants to Unit Operator a lien upon such Working Interest Owner's (i) leasehold and other mineral interests in each tract, (ii) its interest in all jointly-owned materials, equipment and other property, and (iii) its interest in all Unitized Substances, as security for payment of the costs and expenses chargeable to it, together with interest thereon at the rate of six (6%) percent per annum. Unit Operator shall have the right to bring any action at law or in equity to enforce collection of such costs and expenses, with or without foreclosure of such lien. In addition, upon default by any Working Interest Owner in the payment of costs and expenses chargeable to it, Unit Operator shall have the right to collect and receive from the purchaser or purchasers all proceeds of such Working Interest Owner's share of Unitized Substances up to the amount owing by such Working Interest Owner plus interest, as aforesaid, until paid. Each such purchaser shall be entitled to rely upon Unit Operator's statement concerning the existence and amount of any such default.

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

11.7 Burden of Unsigned One-eighth (1/8) Royalty Interest: Should the owner of a Royalty Interest fail or refuse to execute or become

bound by the Unit Agreement and as a result thereof the Royalty payments with respect to such tract are more than a basic one-eighth (1/8) royalty computed on the basis of the Unitized Substances allocated to such tract under the Unit Agreement said differences shall be borne by and inure to the benefit of Working Interest Owners in proportion to their respective Unit Participations, as shown in Exhibit "C".

11.8 Burden of Excess Royalty and Other Interests. If any interest contributed by a Working Interest Owner is burdened with a Royalty in excess of one-eighth (1/8), such excess burden shall be borne solely by the Working Interest Owner contributing such interest.

ARTICLE 12

OIL IN LEASE TANKAGE ON EFFECTIVE DATE

12.1 Gauge of Merchantable Oil. Unit Operator shall make a proper and timely gauge of all lease and other tanks within the Unit Area in order to ascertain the amount of merchantable oil above the pipe line connection in such tanks as of 7:00 A.M. on the effective date hereof. All such oil which has then been produced legally shall be and remain the property of the Working Interest Owner entitled thereto the same as if the Unit had not been formed; and such Working Interest Owner shall promptly remove said oil from the Unit Area. Any such oil not so removed shall be sold by Unit Operator for the account of such Working Interest Owner, subject to the payment of all Royalty to Royalty Owners under the terms and provisions of the Unit Agreement and any applicable lease or leases and other contracts.

ARTICLE 13

OPERATION OF NON-UNITIZED FORMATIONS

13.1 Right to Operate in Non-Unitized Formations. Any Working Interest Owner now having, or hereafter acquiring, the right to drill for and produce oil, gas or other minerals, other than Unitized Substances, within the Unit Area shall have the full right to do so notwithstanding this Agreement. In exercising said right, however, such Working Interest Owner shall exercise every reasonable precaution to

prevent unreasonable interference with operations hereunder. No Working Interest Owner other than Unit Operators shall produce Unitized Substances through any well drilled or operated by it. If any such other Working Interest Owner drills any well into or through the Unitized Formation, the Unitized Formation shall be cased or otherwise protected in such a manner that the Unitized Formation and the production of Unitized Substances will not be adversely affected. No dual completions in the Unitized Formation and some other formation shall be permitted.

13.2 Appropriated Water Rights. Any Working Interest Owner who has appropriated water rights in the Lea County Underground Water Basin within the Unit Area agrees to the allocation of such amount of water as is required for the operation of the Unit up to limit appropriated to such owner by Lea County Underground Water Basin. This Agreement shall not be deemed as an assignment of the appropriated water rights to the Unit, but is a covenant to allow the Unit so much of the appropriated water as is required for efficient operations of the secondary recovery operations contemplated by the Unit Agreement, subject to the limitations and requirements of the State Engineer's Office of the State of New Mexico.

ARTICLE 14

TITLES

14.1 Warranty and Indemnity. Each Working Interest Owner represents and warrants that it is the owner of the respective Working Interest set forth opposite its name in Exhibit "B" of the Unit Agreement and hereby indemnifies and agrees to hold the other Working Interest Owners harmless from any loss and liability for damages due to failure (in whole or in part) of its title to any such interest, except failure of title arising out of operations hereunder. Each failure of title shall 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 development and operating expenses, Unitized Substances or the proceeds therefrom, as a result of title failure.

15.1. Failure Because of Unit Operations. The failure of title to any Working Interest in any tract by reason of Unit operations, including nonproduction from such tract, shall not operate to reduce or otherwise affect the percentage of said Unit Participation of the Working Interest Owner whose title has so failed.

ARTICLE 15

LIABILITY, CLAIMS AND SUITS

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

15.2. Settlements. In the event claim is made against a Working Interest Owner, or any Working Interest Owner is sued on account of any matter or thing arising from the development and operation of the Unit Area and over which such Working Interest Owner individually has no control because of the rights, powers and duties granted by this Agreement and the Unit Agreement, said Working Interest Owner shall immediately notify the Unit Operator of such claim or suit. Unit Operator shall assume and take over the further handling of such claim or suit and all costs and expenses of handling, settling or otherwise discharging such claim or suit shall be borne by Working Interest Owners as any other cost or expense of operating the Unit Area.

ARTICLE 16

INTERNAL REVENUE PROVISION

16.1. Internal Revenue Provision. Each party hereto hereby irrevocably elects that it and the operations covered by this Agreement be excluded from the application of Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code of 1954 as permitted and authorized by Section 761 of said Code and the regulations promulgated thereunder. Unit Operator is hereby irrevocably authorized and directed to execute on behalf of each party hereto such additional or further evidence of

said election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service and regulations issued under said Subchapter K, including all of the returns, statements and data required, and Unit Operator shall furnish each party hereto with a copy thereof. Should said regulations require each party to execute such further evidence, each party hereto irrevocably agrees to execute or join in the execution thereof. Each party hereto irrevocably agrees not to give any notices or take any action inconsistent with the elections hereby made and each hereby states that the income derived by it from the operations under this Agreement can be adequately determined without the computation of partnership taxable income.

ARTICLE 17

NOTICES

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

ARTICLE 18

WITHDRAWAL OF WORKING INTEREST OWNER

18.1 Withdrawal. If any Working Interest Owner so desires, it may withdraw from this Agreement by conveying, assigning and transferring, without warranty of title (either expressed or implied) to the other Working Interest Owners who do not desire to withdraw herefrom, all of the former's rights, title and interest in and to its lease or leases, or other operating rights in the Unit Area, insofar as said lease, leases or rights pertain to the Unitized Formation, together with the withdrawing Working Interest Owner's interest in all wells, pipe lines, casing, injection equipment facilities and other personal property used in conjunction with the development and operation of the Unit Area; provided, that such transfer, assignment or conveyance shall not relieve said Working Interest Owner from any obligation or liability incurred prior to the date of the execution and delivery thereof. The interest

to be transferred, assigned and conveyed shall be taken and owned by the other Working Interest Owners in proportion to their respective Unit Participations, and the Unit Operator shall recompute the percentage of participation to include this change and furnish the remaining Working Interest Owners with a corrected interest sheet. After the execution and delivery of such transfer, assignment or conveyance, the withdrawing Working Interest Owner shall be relieved from all further obligations and liability hereunder and under said Unit Agreement, and the right of such Working Interest Owner to any benefits subsequently accruing hereunder and under said Unit Agreement shall cease; provided, that upon delivery of said transfer, assignment or conveyance, the assignees, in the ratio of the respective interests so acquired, shall pay to the assignor for its interest in all jointly-owned equipment, casing and other personal property, the fair salvage value thereof, as estimated and fixed by the remaining Working Interest Owners.

ARTICLE 19

ABANDONMENT OF WELLS

19.1 Rights of Former Owners. If Working Interest Owners decide to permanently abandon any well within the Unit Area prior to termination of the Unit Agreement, Unit Operator shall give written notice of such fact to the former Working Interest Owner of the tract on which such well is located, together with the amount (as estimated and fixed by the Working Interest Owners) to be the net salvage value of the casing and equipment in and on said well; said former Working Interest Owner shall have the right and option for a period of ninety (90) days after receipt of such notice to notify Unit Operator of its election to take over and own said well and to deepen or plug back said well to a formation other than the Unitized Formation. Within ten (10) days after said former Working Interest Owner of the tract has so notified Unit Operator of its desire to take over such well, it shall pay to Unit Operator, for credit to the joint account of the Working Interest Owners, the amount of the net salvage value above described. At the same time the former Working Interest Owner taking over the well shall agree, by

...addressed to Unit Operator to be received, stored and protected in the United States and as such time as the well is ready for abandonment) to plug and abandon the well in a workmanlike manner in accordance with applicable laws and regulations.

19.2 Plugging. In the event the formation is an Interest Owner of a tract does not elect to take over a well located thereon which is proposed for abandonment, Unit Operator shall plug and abandon the well in accordance 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 the Unit Agreement becomes effective.

20.2 Term. This Agreement shall continue in full force and effect so long as the Unit Agreement remains in force and effect and thereafter until all Unit wells have been plugged and abandoned or turned over to Working Interest Owners in accordance with Article 21 hereof, and all personal and real property acquired for the joint account of Working Interest Owners has been disposed of by Unit Operator in accordance with instructions of Working Interest Owners.

ARTICLE 21

TERMINATION OF UNIT AGREEMENT

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

21.1.1 Oil and Gas Rights. Possession of all oil and gas rights in and to the several separate tracts shall revert to the Working Interest Owners thereof.

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

21.1.3 Salvaging Wells. With respect to all wells not taken over by Working Interest Owners, Unit Operator shall at its joint expense or Working Interest Owners salvage as much of the casing and equipment in or on such wells as can economically and reasonably be salvaged and shall cause such wells to be properly plugged and abandoned.

21.1.4 Cost of Salvaging. Working Interest Owners shall share the cost of salvaging, liquidation or other distribution of assets and properties used in the development and operation of the Unit Area in proportion to their respective Unit Participation, as shown on Exhibit "C".

ARTICLE 22

COUNTERPART EXECUTION

22.1 Execution by Separate Counterparts or Ratifications. This Agreement may be executed in any number of counterparts and each counterpart so executed shall have the same force and effect as an original instrument and as if all of the parties to the aggregate counterparts had signed the same instrument; or may be ratified by a separate instrument in writing referring to this Agreement. Each such ratification shall have the force and effect of an executed counterpart and of adopting by reference all of the provisions hereof.

ARTICLE 23

SUCCESSORS AND ASSIGNS

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

IN WITNESS WHEREOF, the parties hereto have executed this Agreement upon the respective dates indicated opposite their respective signatures.

ATTEST:
R.W. Pasman
Assistant Secretary

GREAT WESTERN DRILLING COMPANY

By: *R.L. [Signature]*
President

UNIT OPERATOR & WORKING INTEREST OWNER

Date: OCT 1 1959



STATE OF TEXAS
COUNTY OF MIDLAND

The foregoing instrument was acknowledged before me this 1st day
of October 1959 by R. C. Tucker, President of GREAT
WESTERN DRILLING COMPANY, a Texas corporation, on behalf of said corpora-
tion.

Audrey Key
Notary Public

My Commission Expires 6-1-61

Audrey Key
Notary Public, Midland County, Texas
My Commission Expires 6-1-61

EXHIBIT "C"
ROCK QUEEN UNIT
UNIT PARTICIPATION

| <u>WORKING INTEREST OWNERS</u> | <u>TOTAL UNIT PARTICIPATION</u> |
|--|---------------------------------|
| Nathan Adams | .0135021 |
| Ambassador Oil Corporation | 2.7417427 |
| Amerada Petroleum Corporation | 1.3926451 |
| Morris R. Antweil | 1.9142337 |
| J. Weldon Bateson | .0144025 |
| S. H. Bazell | .0044003 |
| S. R. Bazell | .0044003 |
| J. Russell Bond | .0067511 |
| Edward W. Bradley | .0135021 |
| Henry A. Brawn | .0135021 |
| Carper Drilling Company | 5.6507356 |
| Cities Service Oil Company | .2614120 |
| City National Bank & Trust Company, Trustee for Estate of F. Raymond Shaw, Deceased | .0684110 |
| David J. Cooper | .0088005 |
| Leonard E. Cooper | .0352020 |
| Dalfern Oil Company | 1.1599481 |
| H. L. Dillon, Jr | .3880667 |
| Geror Oil Corporation | 12.4774751 |
| Jos. B. Gould | .0484027 |
| Great Western Drilling Company | 18.2693387 |
| Gulf Oil Corporation | 22.2313970 |
| B. Felix Harris | .0135021 |
| Mrs. C. M. Harris | .0067511 |
| Howspin Corporation | .0115224 |
| Interlaken Corporation | .0057612 |

Exhibit "C"
 Rock Queen Unit
 Unit Participation
 Page # 2

| <u>WORKING INTEREST OWNERS</u> | <u>TOTAL UNIT PARTICIPATION</u> |
|--|---------------------------------|
| Jennings Drilling Company | 119142337 |
| D. C. Johnson | .0044003 |
| Landa Oil Company | .0827730 |
| Milton E. Lehtman | .0044003 |
| Lithoprint Company of New York, Inc. | .0034583 |
| Lynch, Lynch & Watson | .0221435 |
| R. Searle McGrath | .8864841 |
| George T. Marchmont, Trustee | .0135021 |
| Monsanto Chemical Company | 5.2945087 |
| Arris Owen | .0270042 |
| Andrew & Elizabeth Reid | .0144025 |
| O. M. Radin | .0057612 |
| Roberta Wright Reeves | .0270042 |
| Julius M. Rosenfield & Harriet B. Rosenfield | .0044003 |
| Edward Rothbart | .0044003 |
| Neil E. Salsich | 1.4940434 |
| George Sarraffian | .0135021 |
| Tom Schneider | .0258711 |
| Ross Sears Estate | .4284288 |
| Arthur J. Shield | .0044003 |
| Skelly Oil Company | .6354908 |
| Carl X. Smith Construction Company | .0088005 |
| Pomeroy Smith | .8864841 |
| South Permian Oil | .1350132 |
| Stryker & Brown | .0144025 |
| Superior Oil Company | 18.1158118 |
| Raymond Tate | .0135021 |
| Texas-Pacific Coal & Oil Company | .2601171 |

Exhibit "C"
Rock Queen Unit
Unit Participation
Page # 3

| <u>WORKING INTEREST OWNERS</u> | <u>TOTAL UNIT PARTICIPATION</u> |
|--------------------------------|---------------------------------|
| Transquip Company | .0088005 |
| John R. Trett | .0270042 |
| George Williams | 1.0885773 |
| Wolverine Oil Company | <u>1.7750653</u> |
| TOTAL | 100.0000000 |

EXHIBIT "D"

PASO-T-1955-2

Attached to and made a part of Unit Operating Agreement
ROCK QUEEN UNIT
Lea and Chaves Counties, New Mexico

ACCOUNTING PROCEDURE (UNIT AND JOINT LEASE OPERATIONS)

I. GENERAL PROVISIONS

1. Definitions

"Joint property" as herein used shall be construed to mean the subject area covered by the agreement to which this "Accounting Procedure" is attached.

"Operator" as herein used shall be construed to mean the party designated to conduct the development and operation of the subject area for the joint account of the parties hereto.

"Non-Operator" as herein used shall be construed to mean any one or more of the non-operating parties.

2. Statements and Billings

Operator shall bill Non-Operator on or before the last day of each month for its proportionate share of costs and expenditures during the preceding month. Such bills will be accompanied by statements, reflecting the total costs and charges as set forth under Subparagraph C, below:

A. Statement in detail of all charges and credits to the joint account.

B. Statement of all charges and credits to the joint account, summarized by appropriate classifications indicative of the nature thereof.

C. Statements as follows:

(1) Detailed statement of material ordinarily considered controllable by operators of oil and gas properties/ **(See Sec. 10.2 Operating Agreement)**

(2) Statement of ordinary charges and credits to the joint account summarized by appropriate classifications indicative of the nature thereof; and

(3) Detailed statement of any other charges and credits.

3. Payments by Non-Operator

thirty (30)

Each party shall pay its proportion of all such bills within ~~thirty (30)~~ days after receipt thereof. If payment is not made within such time, the unpaid balance shall bear interest at the rate of six per cent (6%) per annum until paid.

4. Adjustments

Payment of any such bills shall not prejudice the right of Non-Operator to protest or question the correctness thereof. Subject to the exception noted in Paragraph 5 of this Section I, all statements rendered to Non-Operator 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 Non-Operator takes written exception thereto and makes claim on Operator for adjustment. Failure on the part of Non-Operator to make claim on Operator for adjustment within such period shall establish the correctness thereof and preclude the filing of exceptions thereto or making of claims for adjustment thereon. The provisions of this paragraph shall not prevent adjustments resulting from physical inventory of property as provided for in Section VI, Inventories, hereof.

5. Audits

A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the accounting hereunder for any calendar year within the twenty-four (24) month period following the end of such calendar year, provided, however, that Non-Operator must take written exception to and make claim upon the Operator for all discrepancies disclosed by said audit within said twenty-four (24) month period. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct joint or simultaneous audits in a manner which will result in a minimum of inconvenience to the Operator.

II. DEVELOPMENT AND OPERATING CHARGES

Subject to limitations hereinafter prescribed, Operator shall charge the joint account with the following items:

1. Rentals and Royalties

Delay or other rentals, when such rentals are paid by Operator for the joint account; royalties, when not paid directly to royalty owners by the purchaser of the oil, gas, casinghead gas, or other products.

2. Labor

A. Salaries and wages of Operator's employees directly engaged on the joint property in the development, maintenance, and operation thereof, including salaries or wages paid to geologists and other employees who are temporarily assigned to and directly employed on a drilling well.

B. Operator's cost of holiday, vacation, sickness and disability benefits, and other customary allowances applicable to the salaries and wages chargeable under Subparagraph 2 A and Paragraph 11 of this Section II. Costs under this Subparagraph 2 B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable under Subparagraph 2 A and Paragraph 11 of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.

C. Costs of expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's labor cost of salaries and wages as provided under Subparagraphs 2 A, 2 B, and Paragraph 11 of this Section II.

3. Employee Benefits

Operator's current cost of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost, provided that the total of such charges shall not exceed ten per cent (10%) of Operator's labor costs as provided in Subparagraphs A and B of Paragraph 2 of this Section II and in Paragraph 11 of this Section II.

4. Material

Material, equipment, and supplies purchased or furnished by Operator for use of the joint property. So far as it is reasonably practical and consistent with efficient and economical operation, only such material shall be purchased for or transferred to the joint property as may be required for immediate use; and the accumulation of surplus stocks shall be avoided.

5. Transportation

Transportation of employees, equipment, material, and supplies necessary for the development, maintenance, and operation of the joint property subject to the following limitations:

A. If material is moved to the joint property from vendor's or from the Operator's warehouse or other properties, no charge shall be made to the joint account for a distance greater than the distance from the nearest reliable supply store or railway receiving point where such material is available, except by special agreement with Non-Operator.

B. If surplus material is moved to Operator's warehouse or other storage point, no charge shall be made to the joint account for a distance greater than the distance from the nearest reliable supply source or readily receiving point, except by special agreement with Non-Operator. No charge shall be made to the joint account for moving material to other properties belonging to Operator, except by special agreement with Non-Operator.

6. Service

- A. Outside Services
The cost of contract services and utilities procured from outside sources.
- B. Use of Operator's Equipment and Facilities
Use of and service by Operator's exclusively owned equipment and facilities as provided in Paragraph 1 of Section III entitled "Operator's Exclusively Owned Facilities."

7. Damages and Losses to Joint Property and Equipment

All costs or expenses necessary to replace or repair damages or losses incurred by fire, flood, storm, theft, accident or any other cause not controllable by Operator through the exercise of reasonable diligence. Operator shall furnish Non-Operator written notice of damages or losses incurred as soon as practicable after report of the same has been received by Operator.

8. Litigation Expense

- A. All costs and expenses of litigation, or legal services otherwise necessary or expedient for the protection of the joint interests, including attorneys' fees and expenses as hereinafter provided, together with all judgments obtained against the parties or any of them on account of the joint operations under this agreement, and actual expenses incurred by any party or parties hereto in securing evidence for the purpose of defending against any action or claim prosecuted or urged against the joint account or the subject matter of this agreement.
- B. If a majority of the interests hereunder shall so agree, actions or claims affecting the joint interests hereunder may be handled by the legal staff of one or more of the parties hereto; and a charge commensurate with cost of providing and furnishing such services rendered may be made against the joint account; but no such charge shall be made until approved by the legal departments of or attorneys for the respective parties hereto.
- C. Fees and expenses of outside attorneys shall not be charged to the joint account unless authorized by the majority of the interests hereunder.

9. TAXES

All taxes of every kind and nature assessed or levied upon or in connection with the properties which are the subject of this agreement, the production therefrom or the operation thereof, and which taxes have been paid by the Operator for the benefit of the parties hereto. As to ad valorem taxes for the year in which this agreement becomes effective, only the pro-ratio part thereof shall be chargeable hereunder.

All taxes of every kind and nature assessed or levied upon or in connection with the properties which are the subject of this agreement, the production therefrom or the operation thereof, and which taxes have been paid by the Operator for the benefit of the parties hereto.

10. Insurance and Claims

- A. Premiums paid for insurance required to be carried for the benefit of the joint account, together with all expenditures incurred and paid in settlement of any and all losses, claims, damages, judgments, and other expenses, including legal services, not recovered from insurance carriers.
- B. If no insurance is required to be carried, all actual expenditures incurred and paid by Operator in settlement of any and all losses, claims, damages, judgments, and any other expenses, including legal services, shall be charged to the joint account.

11. District and Camp Expense (Field Supervision and Camp Expense)

A pro rata portion of the salaries and expenses of Operator's production superintendent and other employees serving the joint property and other properties of the Operator in the same operating area, whose time is not allocated directly to the properties, and a pro rata portion of the cost of maintaining and operating a production office known as Operator's Caprock District office located at or near Caprock, New Mexico (or a comparable office if location changed), and necessary substices (if any), maintained for the convenience of the above-described office, and all necessary camps, including housing facilities for employees if required, used in the conduct of the operation on the joint property and other properties operated in the same locality. The expense of, less any revenue from, these facilities should be inclusive of depreciation or a fair monthly rental in lieu of depreciation on the investment. Such charges shall be apportioned to all properties served on some equitable basis consistent with Operator's accounting practice.

Distribution of charges to be made on a per well basis. Drilling well to be considered as equivalent of five producing wells.

12. Administrative Overhead

Operator shall have the right to assess against the joint property covered hereby the following management and administrative overhead charges, which shall be in lieu of all expenses of all offices of the Operator not covered by Section II, Paragraph 11, above, inclusive salaries and expenses of personnel assigned to such offices, except that salaries of geologists and other employees of Operator who are temporarily assigned to and directly serving on the joint property will be charged as provided in Section II, Paragraph 2, above. Salaries and expenses of other technical employees assigned to such offices will be considered as covered by overhead charges in this paragraph unless charges for such salaries and expenses are agreed upon between Operator and Non-Operator as a direct charge to the joint property.

WELL BASIS (Rate Per Well Per Month)

| Well Depth | DRILLING WELL RATE | PRODUCING WELL RATE (Use Completion Depth) |
|------------|--------------------|--|
| | Each Well | |
| | \$175.00 | \$35.00 |

- A. Overhead charges for drilling wells shall begin on the date each well is spudded and terminate when it is on production or it plugged, as the case may be, except that no charge shall be made during the suspension of drilling operations for fifteen (15) or more consecutive days.
- B. In connection with overhead charges, the status of wells shall be as follows:
 - (1) Injection wells for recovery operations, such as for repressure or water flood, shall be included in the overhead schedule the same as producing oil wells.
 - (2) Water supply wells utilized for water flooding operations, shall be included in the overhead schedule the same as producing oil wells.
 - (3) Producing gas wells shall be included in the overhead schedule the same as producing oil wells.

- (4) Wells permanently shut down but on which plugging operations are deferred shall be dropped from the overhead schedule at the time the shutdown is effected. When such wells are plugged, overhead shall be charged at the producing well rate during the time required for the plugging operation.
- (5) Wells being plugged back, drilled deeper, or converted to a source or input well shall be included in the overhead schedule the same as drilling wells.
- (6) Temporarily shut-down wells (other than by governmental regulatory body) which are not produced or worked upon for a period of a full calendar month shall not be included in the overhead schedule; however, wells shut in by governmental regulatory body shall be included in the overhead schedule only in the event the allowable production is transferred to other wells on the same property. In the event of a unit allowable, all wells capable of producing will be counted in determining the overhead charge.
- (7) Wells completed in dual or multiple horizons shall be considered as two wells in the producing overhead schedule.
- (8) Little salt water disposal wells shall not be included in the overhead schedule unless such wells are used in a secondary recovery program on the joint property.

(9) Each water injection plant shall be included in the overhead schedule the same as two (2) producing wells.

- C. The above schedule for producing wells shall be applied to the total number of wells operated under the Operating Agreement to which this accounting procedure is attached, irrespective of individual leases.
- D. It is specifically understood that the above overhead rates apply only to drilling and producing operations and are not intended to cover the construction or operation of additional facilities such as, but not limited to, gasoline plants, compressor plants, repressuring projects, salt water disposal facilities, and similar installations. If at any time any or all of these become necessary to the operation, a separate agreement will be reached relative to an overhead charge and allocation of district expense.
- E. The above specific overhead rates may be amended from time to time by agreement between Operator and Non-Operator if, in practice, they are found to be insufficient or excessive.

~~The above schedule for producing wells shall be applied to the total number of wells operated under the Operating Agreement to which this accounting procedure is attached, irrespective of individual leases.~~

- D. It is specifically understood that the above overhead rates apply only to drilling and producing operations and are not intended to cover the construction or operation of additional facilities such as, but not limited to, gasoline plants, compressor plants, repressuring projects, salt water disposal facilities, and similar installations. If at any time any or all of these become necessary to the operation, a separate agreement will be reached relative to an overhead charge and allocation of district expense.
- E. The above specific overhead rates may be amended from time to time by agreement between Operator and Non-Operator if, in practice, they are found to be insufficient or excessive.

13. Operator's Fully Owned Warehouse Operating and Maintenance Expense

(Describe fully the agreed procedure to be followed by the Operator.)

14. Other Expenditures

Any expenditure, other than expenditures which are covered and dealt with by the foregoing provisions of this Section II, incurred by the Operator for the necessary and proper development, maintenance, and operation of the joint property.

III. BASIS OF CHARGES TO JOINT ACCOUNT

1. Purchases

Material and equipment purchased and service procured shall be charged at price paid by Operator after deduction of all discounts actually received.

2. Material Furnished by Operator

Material required for operations shall be purchased for direct charge to joint account whenever practicable, except that Operator may furnish such material from Operator's stocks under the following conditions:

A. New Material (Condition "A")

- (1) New material transferred from Operator's warehouse or other properties shall be priced f.o.b. the nearest reputable supply store or railway receiving point, where such material is available, at current replacement cost of the same kind of material. This will include material such as tanks, pumping units, sucker rods, engines, and other major equipment. Tubular goods, two-inch (2") and over, shall be priced on car-load basis effective at date of transfer and f.o.b. railway receiving point nearest the joint account operation, regardless of quantity transferred.
- (2) Other material shall be priced on basis of a reputable supply company's preferential price list effective at date of transfer and f.o.b. the store or railway receiving point nearest the joint account operation where such material is available.

B. Used Material (Condition "B" and "C")

- (1) Material which is in sound and serviceable condition and is suitable for reuse without reconditioning shall be classed as Condition "B" and priced at seventy-five per cent (75%) of new price.
- (2) Material which cannot be classified as Condition "B" but which:
- After reconditioning will be further serviceable for original function as good secondhand material (Condition "B"), or
 - Is serviceable for original function but substantially not suitable for reconditioning, shall be classed as Condition "C" and priced at fifty per cent (50%) of new price.
- (3) Material which cannot be classified as Condition "B" or Condition "C" shall be priced at a value commensurate with its use.
- (4) Tanks, buildings, and other equipment involving erection costs shall be charged at applicable percentage of knocked-down new price.

3. Premium Prices

Whenever materials and equipment are not readily obtainable at the customary supply point and at prices specified in Paragraphs 1 and 2 of this Section III because of national emergencies, strikes or other unusual causes over which the Operator has no control, the Operator may charge the joint account for the required materials on the basis of the Operator's direct cost and expense incurred in procuring such materials, in making it suitable for use, and in moving it to the location, provided, however, that notice in writing is furnished to Non-Operator of the proposed charge prior to billing the Non-Operator for the material and/or equipment acquired pursuant to this provision; whereupon Non-Operator shall have the right, by so electing and notifying Operator within 10 days after receiving notice from the Operator, to furnish in kind; or in tonnage as the parties may agree, at the location, nearest railway receiving point, or Operator's storage point within a comparable distance, all or part of his share of material and/or equipment suitable for use and acceptable to the Operator. Transportation costs on any such material furnished by Non-Operator, at any point other than at the location, shall be borne by such Non-Operator. If, pursuant to the provisions of this paragraph, any Non-Operator furnishes material and/or equipment in kind, the Operator shall make appropriate credits therefor to the account of said Non-Operator.

4. Warranty of Material Furnished by Operator

Operator does not warrant the material furnished beyond or back of the dealer's or manufacturer's guaranty; and in case of defective material, credit shall not be passed until adjustment has been received by Operator from the manufacturers or their agents.

5. Operator's Exclusively Owned Facilities

The following rates shall apply to service rendered to the joint account by facilities owned exclusively by Operator:

- A. Water, fuel, power, compressor and other auxiliary services at rates commensurate with cost of providing and furnishing such service to the

- B. Automotive equipment at rates commensurate with cost of ownership and operation. Such rates should generally be in line with the schedule of rates adopted by the Petroleum Motor Transport Association, or some other recognized organization, as recommended, uniform charges against joint account operations and revised from time to time. Automotive rates shall include cost of oil, gas, repairs, insurance, and other operating expense and depreciation, and charges shall be based on use in actual service on, or in connection with, the joint account operations. Truck and tractor rates only include wages and expenses of driver.
- C. A fair rate shall be charged for the use of drilling and cleaning-out tools and any other items of Operator's fully owned machinery or equipment which shall be ample to cover maintenance, repairs, depreciation, and the service furnished the joint property, provided that such charges shall not exceed those currently prevailing in the field where the joint property is located. Pulling units shall be charged at hourly rates commensurate with the cost of ownership and operation, which shall include repairs and maintenance, operating supplies, insurance, depreciation, and taxes. Pulling unit rates may include wages and expenses of the operator.
- D. A fair rate shall be charged for laboratory services performed by Operator for the benefit of the joint account, such as gas, water, carts, and any other analyses and tests; provided such charges shall not exceed those currently prevailing if performed by outside service laboratories.
- E. Whenever requested, Operator shall inform Non-Operator in advance of the rates it proposes to charge.
- F. Rates shall be revised and adjusted from time to time when found to be either excessive or insufficient.

IV. DISPOSAL OF LEASE EQUIPMENT AND MATERIAL

The Operator shall be under no obligation to purchase interest of Non-Operator in surplus new or secondhand material. The disposition of major items of surplus material, such as derricks, tanks, engines, pumping units, and tubular goods, shall be subject to mutual determination by the parties hereto; provided Operator shall have the right to dispose of normal accumulations of junk and scrap material either by transfer or sale from the joint property.

1. Material Purchased by the Operator or Non-Operator

Material purchased by either the Operator or Non-Operator shall be credited by the Operator to the joint account for the month in which the material is removed by the purchaser.

2. Division in Kind

Division of material in kind, if made between Operator and Non-Operator, shall be in proportion to their respective interests in such material. Each party will thereupon be charged individually with the value of the material received or receivable by each party, and corresponding credits will be made by the Operator to the joint account. Such credits shall appear in the monthly statement of operations.

3. Sales to Outsiders

Sales to outsiders of material from the joint property shall be credited by Operator to the joint account at the net amount collected by Operator from vendor. Any claims by vendor for defective material or otherwise shall be charged back to the joint account if and when paid by Operator.

V. BASIS OF PRICING MATERIAL TRANSFERRED FROM JOINT ACCOUNT

Material purchased by either Operator or Non-Operator or divided in kind, unless otherwise agreed, shall be valued on the following basis:

1. New Price Defined

New price as used in the following paragraphs shall have the same meaning and application as that used above in Section III, "Basis of Charges to Joint Account."

2. New Material

New material (Condition "A"), being new material procured for the joint account but never used thereon, at one hundred per cent (100%) of current new price (plus sales tax if any).

3. Good Used Material

Good used material (Condition "B"), being used material in sound and serviceable condition, suitable for reuse without reconditioning:

- At seventy-five per cent (75%) of current new price if material was charged to joint account as new, or
- At sixty-five per cent (65%) of current new price if material was originally charged to the joint property as secondhand at seventy-five per cent (75%) of new price.

4. Other Used Material

Used material (Condition "C"), at fifty per cent (50%) of current new price, being used material which:

- After reconditioning will be further serviceable for original function as good secondhand material (Condition "B"), or
- Is serviceable for original function but substantially not suitable for reconditioning.

5. Bad-Order Material

Material and equipment (Condition "D"), which is no longer usable for its original purpose without excessive repair cost but is further usable for some other purpose, shall be priced on a basis comparable with that of items normally used for that purpose.

6. Junk

Junk (Condition "E"), being obsolete and scrap material, at prevailing prices.

7. TEMPORARILY USED MATERIAL (In service 60 days or less)

When the use of material is temporary and its service to the joint account does not justify the reduction in price as provided in Paragraph 3 above, such material shall be priced on a basis that will leave a net charge to the joint account of 10% of price charged if material charged out as new and 5% if material charged out as second-hand.

VI. Inventories

1. PERIODIC INVENTORIES, NOTICE AND REPRESENTATION

At reasonable intervals, inventories shall be taken by Operator of the joint account material, which shall include all such material as is ordinarily considered controllable. (See Sec. 10.2, Operating Agreement).

~~7. Temporarily Used Material~~

~~When the use of material is temporary and its service to the joint account does not justify the reduction in price as provided in Paragraph 3 B above, such material shall be priced on a basis that will leave a net charge to the joint account consistent with the value of the service rendered.~~

~~VI. INVENTORIES~~

~~1. Periodic Inventories, Notice and Representation~~

~~At reasonable intervals, inventories shall be taken by Operator of the joint account material, which shall include all such material as is ordinarily considered controllable by operators of oil and gas properties.~~

~~Written notice of intention to take inventory shall be given by Operator at least thirty (30) days before any inventory is to begin so that Non-Operator may be represented when any inventory is taken.~~

~~Failure of Non-Operator to be represented at an inventory shall bind Non-Operator to accept the inventory taken by Operator, who shall in that event furnish Non-Operator with a copy thereof.~~

~~2. Reconciliation and Adjustment of Inventories~~

~~Reconciliation of inventory with charges to the joint account shall be made by each party at interest, and a list of overages and shortages shall be jointly determined by Operator and Non-Operator.~~

~~Inventory adjustments shall be made by Operator with the joint account for overages and shortages, but Operator shall be held accountable to Non-Operator only for shortages due to lack of reasonable diligence.~~

~~3. Special Inventories~~

~~Special inventories may be taken, at the expense of the purchaser, whenever there is any sale or change of interest in the joint property; and it shall be the duty of the party selling to notify all other parties hereto as quickly as possible after the transfer of interest takes place. In such cases, both the seller and the purchaser shall be represented and shall be governed by the inventory so taken.~~

EXHIBIT A-E

INSURANCE PROCEDURE

(A) Unit Operator agrees that it will require its contractors or sub-contractors to carry insurance policies to cover drilling operations for the production of Unitized Substances on all lands subject to this Agreement:

- (1) Workmen's Compensation and Employer's Liability Insurance as required by the laws of the State of New Mexico, but in an amount not less than \$100,000.00;
- (2) Contractor's Public Liability Insurance in amounts of \$100,000.00 for injuries to one person; and \$200,000.00 for injuries in one accident and property damage covering premise operations with \$100,000.00 aggregate limit;
- (3) Automobile, Public Liability and Property Damage Insurance in amounts of \$100,000.00 for injuries to one person; \$200,000.00 for injuries in one accident; and \$100,000.00 for property damage.

(B) With respect to Unit operations (other than drilling operations) on all lands subject to this Agreement, Unit Operator shall carry Workmen's Compensation Insurance as required by the laws of the State of New Mexico, and Employer's Liability Insurance with minimum limits of \$100,000.00; Public Liability and Property Damage Insurance in amounts of \$100,000.00 for injury or death to one person; \$300,000.00 for one accident, and \$100,000.00 Property Damage; Automobile Public Liability and Property Damage Insurance in amounts of \$100,000.00 for injury or death to one person, \$250,000.00 for one accident, and \$100,000.00 for property damage.

(C) All insurance coverage required hereby shall be carried at the joint expense and for the benefit of the parties hereto. However, premiums for Automobile, Public Liability and Property Damage Insurance on Unit Operator's fully owned equipment shall not be charged directly to the joint account, but will be covered by the flat rate charges assessed for use of such equipment. Unit Operator will not carry fire, windstorm and explosion insurance covering operations hereunder. Unit Operator agrees to promptly furnish Working Interest

Operator shall be liable for damage to Unit property resulting from hazards not covered by insurance carried on the Joint account.

(D) The insurance program provided for in this paragraph shall be made effective by Unit Operator upon the effective date hereof. Changes in such insurance program may, however, hereafter be made by Working Interest Owners.