

OPERATING AGREEMENT

THIS AGREEMENT, made and entered into on this 10th day of April,  
1953, by and between SOUTHERN UNION GAS COMPANY, a Delaware corporation  
authorized to do business in the State of New Mexico, and having its principal  
office in Dallas, Texas (hereinafter called "Southern Union" or "Operator"), and  
SKELLY OIL COMPANY

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

(hereinafter called "Non-operator", whether one or more),

W I T N E S S E T H T H A T :

WHEREAS, under date of March 30, 1953, a certain communitiza-  
tion (or pooling) agreement was made and entered into providing for the commun-  
itization, pooling and consolidation of certain oil and gas leases therein  
described so as to form a drilling unit (hereinafter referred to as "unit"),  
embracing the following described land in San Juan County,  
New Mexico:

Township 31 North, Range 9 West, N.M.P.M.

Section 23: E $\frac{1}{2}$

to which agreement reference is here made for all purposes; and

WHEREAS, the parties hereto desire to provide for the economical and joint  
operation of said unit for the production of gas and associated liquid hydro-  
carbons producible from Mesaverde formation,  
subject to and in accordance with the terms and provisions of this agreement:

NOW, THEREFORE, in consideration of the premises and of the mutual covenants  
and promises herein contained, the parties hereto agree as follows:

I.

OPERATOR

Section 1. Southern Union Gas Company is hereby designated as Operator of

44529<sup>c</sup> 

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the above described unit and, subject to the terms and conditions of this agreement, shall have full control of and shall conduct and manage all operations on said unit for the joint account of the parties hereto. Southern Union may resign as Operator at any time by giving notice to each Non-operator in writing sixty (60) days in advance of the effective date of such resignation and, in such event, the working interest owners of said unit shall immediately select a successor.

Section 2. In the event Southern Union shall sell or otherwise dispose of all of its interest in said unit, the right of operation herein conferred shall not run with the transfer or assignment of such interest or inure to the benefit of Southern Union's assignee, but Non-operator and Southern Union's assignee shall immediately select a new Operator.

Section 3. The number of employees, the selection of such employees, the hours of labor and the compensation for services to be paid any and all employees, in connection with operations hereunder, shall be determined by Operator. All employees and contractors used in operations hereunder shall be employees and contractors of Operator and shall never be considered the employees or contractors of Non-operator.

## II.

### PERCENTAGE OF INTEREST

It is agreed that for purposes of this agreement the interest of each party hereto in said unit is as follows:

<u>NAME</u>	<u>INTEREST</u>
SOUTHERN UNION GAS COMPANY	50%
SKELLY OIL COMPANY	50%

III.

DRILLING OPERATIONS

Section 1. Subject to all other applicable provisions of this agreement, Operator, on or before sixty (60) days from approval of the above described  
commitment agreement by the United States Geological Survey, shall commence, or cause to be commenced, operations for the drilling of a well for the joint account of the parties hereto, at the following location:

Township 31 North, Range 9 West, N.M.P.M.

Section 23: NE<sup>1</sup>NE<sup>1</sup>

and cause said well to be diligently drilled without unnecessary delay and in a good workmanlike manner to a sufficient depth to test the Musavere formation, unless the parties hereto mutually agree to discontinue drilling operations at a lesser depth. It is understood and agreed that the commencement date for said well shall be extended for a reasonable period when necessary to perfect title to the lands committed to the unit.

~~Section 2. Upon request of Operator, each Non-operator shall furnish and deliver to Operator its proportionate share of casing and other equipment, except drilling equipment normally furnished by a drilling contractor, which will be required to complete and equip said well.~~ *gwa*

Section 3. Prior to commencement of drilling operations, as provided in Section 1 hereof, Operator shall furnish each Non-operator an estimate of the costs expected to be incurred in drilling and equipping said well.

Section 4. All costs and expenses incurred in connection with the drilling, completing, testing, equipping, and if a dry hole, the plugging and abandoning, of said well shall be borne by the parties hereto in the proportions set out under Article II hereof.

IV.

LOSS OR FAILURE OF TITLE

In the event of the loss or failure of the title, in whole or in part, of

any party hereto to any lease, or to any interest therein, the interest of such party in and to the production obtained from the unit shall be reduced in proportion to such loss or failure of title as of the date such loss or failure of title is finally determined; provided, that such revision of ownership interest shall not be retroactive as to operating costs and expenses incurred or as to revenues or production obtained prior to such date; and provided, further, that each party hereto whose title has been lost or has failed, as aforesaid, shall indemnify and hold the other parties hereto harmless from and against any and all loss, cost, damage and expense which may result from, or arise because of, the delivery to such party of production obtained hereunder or the payment of proceeds derived from the sale of any such production, prior to the date loss or failure of title is finally determined.

V.

TERM OF AGREEMENT

This agreement shall remain in full force and effect, unless sooner terminated by the mutual agreement of the parties hereto, as long as the communitization (or pooling) agreement hereinabove described shall remain in force and effect.

VI.

COSTS AND EXPENSES

Section 1. Unless Operator elects to require Non-operator to advance its share of the costs and expenses, as hereinafter provided, Operator shall initially advance and pay all costs and expenses for the drilling of the well provided for under Article III hereof as well as operation expenses of said unit and shall charge each Non-operator with its pro rata part thereof on the basis of its proportionate interest in the unit as set out under Article II hereof.

Section 2. All such costs, expenses, credits and related matters, and the method of handling the accounting with respect thereto, shall be in accordance with the provisions of the Accounting Procedure, attached hereto as Exhibit "A" and made a part hereof for all purposes.

Section 3. In the event that Operator elects to require any Non-operator

to advance its proportionate share of the above mentioned costs and expenses, Operator shall submit an itemized estimate of such costs and expenses for the succeeding calendar month to such Non-operator, showing therein the proportionate part of the estimated costs and expenses chargeable to such Non-operator. Within fifteen (15) days after receipt of said estimate, such Non-operator shall pay to the Operator its proportionate share of the estimated costs and expenses. If payment of the estimated costs and expenses is not made when due, the unpaid balance thereof shall bear interest at the rate of six per cent (6%) per annum from the due date until paid. Adjustments between estimated and actual costs and expenses shall be made by Operator at the close of each calendar month and the account of the respective parties adjusted accordingly.

Section 4. Operator shall make no single expenditure in excess of One Thousand Dollars (\$1,000.00) without first obtaining the consent thereto of each Non-operator. The approval of the drilling of the well provided for hereinabove, however, shall include all expenditures for the drilling, completing, testing and equipping of such well, including the necessary lines and separators.

#### VII.

##### DISPOSAL OF PRODUCTION

Each Non-operator shall own its proportionate share of all gas, casinghead gas and other hydrocarbon substances produced and saved from the unit, and shall be entitled to take all or any part thereof in kind, but if any Non-operator takes all or any part of its proportionate part of such production in kind, it shall bear any extra expense incurred by Operator in making such delivery in kind. In case of sales of production, each Non-operator shall collect direct from the purchaser or purchasers of such production for its proportionate part thereof.

#### VIII.

##### INSURANCE

Section 1. Operator, or Operator's contractors or subcontractors, shall carry for the benefit of the joint account insurance to cover drilling operations

on the unit as follows:

<u>KIND</u>	<u>POLICY FORM</u>	<u>MINIMUM LIMITS OF LIABILITY</u>
Workmen's Compensation	Statutory	Statutory
Contractor's Public Liability	Comprehensive (including coverage under all sections of policy)	B.I. (\$ 50,000 each person (\$100,000 each accident (\$100,000 aggregate) P.D. (\$ 10,000 each accident (\$ 50,000 aggregate)
Motor Vehicle	Comprehensive (including non-ownership liability and hired automobile coverage)	B.I. (\$ 50,000 each person (\$100,000 each accident P.D. (\$ 10,000 each accident

Section 2. With respect to producing operations conducted hereunder on the unit by the Operator for the joint account of the parties hereto, Operator shall maintain in effect at all times while operations are so conducted hereunder the following insurance coverage:

<u>KIND</u>	<u>POLICY FORM</u>	<u>MINIMUM LIMITS OF LIABILITY</u>
Workmen's Compensation	Statutory	Statutory
Contractor's Public Liability	Comprehensive (including coverage under all sections of policy)	B.I. (\$100,000 each person (\$300,000 each accident (\$300,000 aggregate) P.D. (\$100,000 each accident (\$100,000 aggregate)
Motor Vehicle	Comprehensive (including non-ownership liability and hired automobile coverage)	B.I. (\$100,000 each person (\$300,000 each accident P.D. (\$ 10,000 each accident

Operator will, upon request, furnish to Non-operator certificate(s) evidencing such insurance.

#### IX.

##### ABANDONMENT OF WELL

No well on the unit which is capable of producing gas and/or condensate from the formations covered by this agreement shall be abandoned without the mutual consent of the parties hereto. If any of the parties desire to abandon such well, such party or parties shall so notify the other party or parties in writing and the latter shall have ten (10) days after receipt of such notice in which to elect whether to agree to such abandonment. If all parties hereto agree to such abandonment, such well shall be abandoned and plugged by Operator at the expense of the joint account, and as much as possible of the casing and

other physical equipment in and on said well shall be salvaged for the benefit of the joint account. If any party or parties do not agree to said abandonment, such party or parties shall purchase the interest(s) of the party or parties desiring to abandon said well in the physical equipment therein and thereon; and, within twenty-five (25) days after the receipt of notice by the party or parties not electing to abandon, the party or parties desiring to abandon shall execute and deliver to the other party or parties an assignment, without warranty of title, of its or their interest in said well and physical equipment, and in the working interest and gas leasehold estate, insofar as it covers the formation(s) covered by this agreement, in said unit. In exchange for said assignment, the purchasing party or parties shall pay to the assigning party or parties the salvage value of the latter's interest in the salvable casing and other physical equipment in and on said well, such value to be determined in accordance with the provisions of the Accounting Procedure, attached hereto as Exhibit "A".

X.

TAXES

The Operator shall render, for ad valorem tax purposes, the entire leasehold rights and interests covered by this agreement and all physical property located thereon or used in connection therewith, or such part thereof as may be subject to ad valorem taxation under existing laws of the State of New Mexico, or which may be made subject to taxation under future laws, and shall pay for the benefit of the joint account all such ad valorem taxes at the time and in the manner required by law which may be assessed upon or against all or any portion of such leasehold rights and interests and the physical property located thereon or used in connection therewith. Operator shall bill each Non-operator for its proportionate share of such tax payments provided by the Accounting Procedure, attached hereto as Exhibit "A".

XI.

OPTION TO PURCHASE

Section 1. In the event that any party hereto receives a bona fide offer

which it is willing to accept for the purchase of its interest in the unit, or any part thereof, from a person, firm or corporation ready, able and willing to purchase such interest or part thereof, the party hereto receiving such offer shall immediately give written notice thereof to each of the other parties hereto, including in such notice the name and address of such offeror, the price offered and all other pertinent terms and conditions of the offer. The other parties hereto, for a period of seven (7) days after the receipt of the notice, shall have the prior and preferred right and option to purchase the lease or leases, or part thereof, covered by the offer, at the price and according to the terms and conditions specified therein.

Section 2. If the other parties hereto fail to exercise their right and option by giving written notice of acceptance within seven (7) days after receipt of the above mentioned notice, the party which received the offer shall accept it and complete the sale to the offeror in accordance with its offer within sixty (60) days after the expiration of said seven (7) day period; provided, that if the party which received the offer fails to accept it or to complete the sale within said period of sixty (60) days, the preferred right and option of the other parties hereto under this Article XI shall be considered as revived, and the party which received the offer shall not complete such sale to the offeror unless and until the offer again has been presented to the other parties hereto, as hereinabove provided, and the other parties again have failed to elect to purchase on the terms and conditions of the offer. All offers, except as hereinafter specifically excepted, at any time made to any party hereto for the purchase of its interest in the pooled unit, or a part thereof, shall be subject to all the terms and conditions of this Article XI.

Section 3. It is expressly agreed that the foregoing provisions of this Article XI shall not apply to a transfer by a corporate party hereto made in connection with a merger, consolidation or reorganization involving such party and its parent subsidiary or an affiliated company, nor the transfer by any party to a wholly owned subsidiary or to any other person, firm or corporation having an identity of interest or an option agreement covering any of the land

and leases subject to this agreement.

XIII,

RELATION OF PARTIES

The rights, duties, obligations and liabilities of the parties hereto shall be several and not joint or collective, it being the express purpose and intention of the parties hereto that their ownership in said unit shall be as tenants in common; and nothing herein contained shall ever be construed as creating a partnership of any kind, joint venture, an association or a trust or as imposing upon any one or more of the parties hereto any partnership duty, obligation or liability. Each party hereto shall be individually responsible only for its obligations, as set out in this agreement.

XIII.

ACCESS TO PREMISES, LOGS AND REPORTS

Operator shall keep accurate logs of the well drilled on said unit, which logs shall be available at all reasonable times for inspection by any Non-operator. Upon request by any Non-operator, Operator shall furnish to such Non-operator a copy of said logs, samples of cores and cuttings of formations encountered, and monthly progress reports relative to the development and operation of said unit, together with any other information which may be reasonably requested pertaining to such well. Each Non-operator shall have access to said unit and to all books and records pertaining to operations hereunder for the purpose of inspection at all reasonable times.

XIV.

SURRENDER, EXPIRATION, ABANDONMENT OR RELEASE OF LEASE

No lease or leases subject to this agreement shall be surrendered, let to expire, abandoned or released, in whole or in part, unless the parties mutually consent thereto in writing. In the event that less than all the parties hereto should elect to surrender, let expire, abandon or release all or any part of a lease or leases subject to this agreement and the other party or parties do not consent or agree, the party so electing shall notify the other party or parties not less than sixty (60) days in advance of such surrender, expiration, abandon-

ment or release and, if requested so to do by the party not so electing, immediately shall assign without warranty to the latter party or parties all of its rights, title and interest in and to said lease or leases, the well or wells located thereon, and the casing and other physical equipment in or on said well or wells. If the party or parties not so electing fail(s) to request such assignment within such sixty (60) day period, the party so electing shall have the right to surrender, let expire, abandon or release said lease or leases, or any part thereof. In the event such assignment is so requested, the party or parties to whom such assignment is made, upon the delivery thereof, shall pay to the assigning party the salvage value of its interest in all the salvable casing and other physical equipment in or on the unit, said value to be determined in accordance with the provisions of the Accounting Procedure, attached hereto as Exhibit "A". After the delivery of any such assignment, the party making the assignment shall be released from and discharged of all the duties and obligations thereafter accruing or arising hereunder, in connection with the operation and development of the unit, with respect to the assigned lease or leases.

XV.

LAWS AND REGULATIONS

This agreement shall be subject to all valid and applicable State and Federal laws, rules, regulations and orders, and the operations conducted hereunder shall be performed in accordance with said laws, rules, regulations and orders. In the event this agreement or any provision hereof is, or the operations contemplated hereby are found to be, inconsistent with or contrary to any such law, rule, regulation or order, the latter shall be deemed to control and this agreement shall be regarded as modified accordingly, and as so modified, shall continue in full force and effect.

XVI.

FORCE MAJEURE

Section 1. In the event that any party hereto is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make payments of amounts due hereunder, upon such

party's giving notice and reasonably full particulars of such force majeure in writing or by telegraph to the other parties hereto within a reasonable time after the occurrence of the cause relied upon, the obligations of the party giving said notice, so far as they are affected by such force majeure, shall be suspended during the continuance of any inability so caused, but for no longer period; and the cause of the force majeure as far as possible shall be remedied with all reasonable dispatch.

Section 2. The term "force majeure" as employed herein shall mean an act of God, strike, lockout or other industrial disturbance, act of the public enemy, war, blockade, riot, lightning, fire, storm, flood, explosion, governmental restraint and any other cause, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension.

Section 3. The settlement of strikes, lockouts and other labor difficulty shall be entirely within the discretion of the party having the difficulty. The above requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts or other labor difficulty by acceding to the demands of opponents therein when such course is inadvisable in the discretion of the party having the difficulty.

XVII.

NOTICES

Except as herein otherwise expressly provided, all notices, reports and other communications required or permitted hereunder shall be deemed to have been properly given or delivered when delivered personally or when sent by registered mail or telegraph, with all postage or charges fully prepaid, and addressed to the parties hereto, respectively, as follows:

To Non-operator:

Skelly Oil Company  
~~Box 4083, Station A~~  
~~Albuquerque, New Mexico~~  
1134 Building  
L.A.

To Operator:

Southern Union Gas Company  
1104 Burt Building  
Dallas 1, Texas

The date of service by mail shall be the date on which such written notice or other communication is deposited in the United States post office, addressed as above provided. Each party hereto shall have the right to change its address for all purposes of this Article XVII by notifying the other parties hereto thereof in writing.

XVIII.

ROYALTY, OVERRIDING ROYALTIES, PRODUCTION PAYMENTS, ETC.

Section 1. The provisions of this agreement are based on the assumption that the respective leases or operating rights owned by the parties hereto and made subject hereto provide for a royalty of 1/8th of the value of gas and associated liquid hydrocarbons produced, saved and sold. In the event any lease or leases subject hereto provide for a royalty on such products in excess of the current market value at the well of 1/8th of that produced, saved and sold, there shall be charged against the interest of the party owning such lease, leases or operating rights, the amount of such royalties in excess of the said 1/8th. The amount of cost and expense allocable to the leasehold interests hereunder shall not be affected by any such charge or by the existence of any such excess royalty.

Section 2. All overriding royalties, production payments, carried working interests and net profit obligations to which any party's interest in the unit is subject shall be borne and paid by such party in accordance with the provisions of the assignment or other instrument creating or pertaining to such obligation(s).

XIX.

EFFECT OF AGREEMENT

The terms, covenants and conditions of this agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns; and said terms, covenants and conditions shall be covenants running with the land and leasehold estates covered hereby and with each transfer or assignment of said land or leasehold estates.

OPERATOR'S LIEN

Operator shall have an express contract lien, which is hereby granted, upon the interest of each Non-operator in said unit, in the oil, gas or other minerals produced from such unit and in the materials and equipment located thereon, to secure the payment by each Non-operator of its proportionate part of the costs and expenses incurred or paid by Operator hereunder, and interest, if any, accrued on such part. Such lien may be enforced and foreclosed as any other contract lien. Moreover, Operator may to the full extent of any indebtedness owed by it to any such Non-operator, offset such debt against sums owing to Operator hereunder by such Non-operator.

IN WITNESS WHEREOF, the parties hereto have executed this agreement as of the day and year first above written.

SOUTHERN UNION GAS COMPANY

ATTEST:

H. M. Quinn  
Secretary

By J. C. Steil  
Vice President  
OPERATOR

SKELLY OIL COMPANY

ATTEST:

H. J. ...  
Secretary

By [Signature]  
President

NON-OPERATOR

STATE OF Texas )  
COUNTY OF Harris ) SS

On this 4<sup>th</sup> day of April, 1933, before me appeared [Signature], to me personally known, who, being by me duly sworn did say that he is the vice President of [Signature] and that the seal affixed to the foregoing instrument is the corporate seal of said corporation and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said [Signature] acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have set my hand and seal of office on this 14<sup>th</sup> day of April, 1933.

My Commission Expires: [Signature]  
[Signature] Notary Public in and for Harris County, Texas

ETHEL L. MORR  
Notary Public - Dallas County, Texas  
My Commission expires June 1, 1933

STATE OF \_\_\_\_\_ )  
COUNTY OF \_\_\_\_\_ ) SS

On this \_\_\_\_\_ day of \_\_\_\_\_, 1933, before me appeared \_\_\_\_\_, to me personally known, who, being by me duly sworn, did say that he is the \_\_\_\_\_ President of \_\_\_\_\_ and that the seal affixed to the foregoing instrument is the corporate seal of said corporation and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said \_\_\_\_\_ acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have set my hand and seal of office on this \_\_\_\_\_ day of \_\_\_\_\_, 1933.

My Commission Expires: \_\_\_\_\_  
HAZEL M. BRADY  
Notary Public, Tulse County, Oklahoma  
My Commission Expires January 21, 1957  
\_\_\_\_\_  
Notary Public in and for \_\_\_\_\_ County, \_\_\_\_\_

Attached to and made a part of Operating Agreement, dated April 10,  
1953, between Southern Union Gas Company and Shelly Oil  
Company

## ACCOUNTING PROCEDURE (UNIT AND JOINT LEASE OPERATIONS)

### I. GENERAL PROVISIONS

1. **Definitions**  
The term "joint property" as herein used shall be construed to mean the subject area covered by the agreement to which this "Accounting Procedure" is attached.  
The term "Operator" as herein used shall be construed to mean the party designated to conduct the development and operation of the leased premises for the joint account.  
The term "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 Sub-Paragraph A 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;
    - (2) Statement of all other charges and credits to the joint account summarized by appropriate classifications indicative of the nature thereof; and
    - (3) Statement of any other receipts and credits.
3. **Payments by Non-Operator**  
Each party shall pay its proportion of all such bills within fifteen (15) 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. **Audits**  
Payment of any such bills shall not prejudice the right of Non-Operator to protest or question the correctness thereof. All statements rendered to Non-Operator by Operator during any calendar year shall be conclusively presumed to be true and correct after eighteen months following the close of any such calendar year, unless within said eighteen months 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 the making of claims for adjustment thereon. 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, within eighteen months next following the close of any calendar year. Non-Operator shall have six months next following the examination of the Operator's records within which to take written exception to and make any and all claims on Operator. The provisions of this paragraph shall not prevent adjustments resulting from the physical inventory of property as provided for in Section VI, Inventories, hereof.

### 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 direct to royalty owners by the purchaser of the oil, gas, casinghead gas, or other products.
2. **Labor, Transportation, and Services**  
Labor, transportation, and other services necessary for the development, maintenance, and operation of the joint property. Labor shall include (A) Operator's cost of vacation, sickness and disability benefits of employees, and expenditures or contributions imposed or assessed by governmental authority applicable to such labor, and (B) Operator's current cost of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of like nature, applicable to Operator's field payroll; provided that the charges under Part (B) of this paragraph shall not exceed five per cent (5%) of the total of such labor charged to the joint account.
3. **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 required for immediate use, and the accumulation of surplus stocks shall be avoided.
4. **Moving Material to Joint Property**  
Moving material to the joint property from Vendor's or from Operator's warehouse in the district or from the other properties of Operator, but in either of the last two events 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.

5. **Moving Surplus Material from Joint Property**

Moving surplus material from the joint property to outside vendees, if sold f.o.b. destination, or minor returns to Operator's warehouse or other storage point. No charge shall be made to the joint account for moving major surplus material to Operator's warehouse or other storage point for a distance greater than the distance to the nearest reliable supply store or railway receiving point, except by special agreement with Non-Operator; and 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. **Use of Operator's Equipment and Facilities**

Use of and service by Operator's exclusively owned equipment and facilities as provided in Paragraph 4, of Section III, "Basis of Charges to Joint Account."

7. **Damages and Losses**

Damages or losses incurred by fire, flood, storm, or any other cause not controllable by Operator through the exercise of reasonable diligence. Operator shall furnish Non-Operator written notice of damage or losses incurred by fire, storm, flood, or other natural or accidental causes as soon as practicable after report of the same has been received by Operator.

8. **Litigation, Judgments, and Claims**

All costs and expenses of litigation, or legal services otherwise necessary or expedient for the protection of the joint interests, including attorney's fees and expenses as hereinafter provided, together with all judgments obtained against the joint account or the subject matter of this agreement; 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.

A. 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 the services rendered may be made against the joint account, but no such charge shall be made until approved by the legal department of or attorneys for the respective parties hereto.

B. 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 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**

A. Premiums paid for insurance 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 carrier.

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**

A proportionate share of the salaries and expenses of Operator's District Superintendent and other general district or field employees serving the joint property, whose time is not allocated direct to the joint property, and a proportionate share of maintaining and operating a district office and all necessary camps, including housing facilities for employees if necessary, in conducting the operations on the joint property and other leases owned and operated by Operator in the same locality. The expense of, less any revenue from, these facilities shall include depreciation or a fair monthly rental in lieu of depreciation on the investment. Such charges shall be apportioned to all leases served on some equitable basis consistent with Operator's accounting practice, **but shall not exceed \$125.00 per month per drilling well or \$25.00 per month per producing well.**

12. **Overhead**

Overhead charges, which shall be in lieu of any charges for any part of the compensation or salaries paid to managing officers and employees of Operator, ~~including the division superintendent, the entire staff and expenses of the division office located at \_\_\_\_\_~~, and any portion of the office expense of the principal business office located at Dallas, Texas, but which are not in lieu of district or field office expenses incurred in operating any such properties, or any other expenses of Operator incurred in the development and operation of said properties; and Operator shall have the right to assess against the joint property covered hereby the following overhead charges:

A. ~~\$ 100.00~~ \$ 35.00 per month for each drilling well, beginning on the date the well is spudded and terminating when it is on production or is 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. ~~per well per month for the first five (5) producing wells.~~

C. ~~per well per month for the second five (5) producing wells.~~

D. ~~per well per month for all producing wells over ten (10).~~

- E. In connection with overhead charges, the status of wells shall be as follows:
  - (1) In-put or key wells shall be included in overhead schedule the same as producing oil wells.
  - (2) Producing gas wells shall be included in overhead schedule the same as producing oil wells.
  - (3) Wells permanently shut down but on which plugging operations are deferred, shall be dropped from 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.
  - (4) Wells being plugged back or drilled deeper shall be included in overhead schedule the same as drilling wells.
  - (5) Various wells may be shut down temporarily and later replaced on production. If and when a well is shut down (other than for proration) and not produced or worked upon for a period of a full calendar month, it shall not be included in the overhead schedule for such month.
  - (6) Salt water disposal wells shall not be included in overhead schedule.

F. **Non-Operator's proportionate share of actual salaries and expenses of a drilling superintendent and geologist while supervising drilling operations.**

- F. The above overhead schedule on producing wells shall be applied to individual leases; provided that, whenever leases covered by this agreement are operated as a unitized project in the interest of economic development, the schedule shall be applied to the total number of wells, irrespective of individual leases.
- G. 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. **Warehouse Handling Charges** **None**

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14. **Other Expenditures**

Any other expenditure incurred by 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, rigs, pumps, sucker rods, boilers, and engines. Tubular goods (2" and over), shall be priced on carload 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.
- (3) Cash discount shall not be allowed.

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 75% of new price.
- (2) Material which cannot be classified as Condition "B" but which,
  - (a) After reconditioning will be further serviceable for original function as good second hand material (Condition "B"), or
  - (b) Is serviceable for original function but substantially not suitable for reconditioning, shall be classed as Condition "C" and priced at 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, derricks, buildings, and other equipment involving erection costs shall be charged at applicable percentage of knocked-down new price.

3. **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.

4. **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 service, fuel gas, power, and compressor service:** At rates commensurate with cost of providing and furnishing such service to the joint account but not exceeding rates currently prevailing in the field where the joint property is located.
- B. **Automotive Equipment:** Rates commensurate with cost of ownership and operation. Such rates should generally be in line with 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, tractor, and pulling unit rates shall 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.
- D. Whenever requested, Operator shall inform Non-Operator in advance of the rates it proposes to charge.
- E. 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. Derricks, tanks, buildings, and other major items shall not be removed by Operator from the joint property without the approval of Non-Operator. Operator shall not sell major items of material to an outside party without giving Non-Operator an opportunity either to purchase same at the price offered or to take Non-Operator's share in kind.

1. **Material Purchased by Operator**  
Material purchased by Operator shall be credited to the joint account and included in the monthly statement of operations for the month in which the material is removed from the joint property.
2. **Material Purchased by Non-Operator**  
Material purchased by Non-Operator shall be invoiced by Operator and paid for by Non-Operator to Operator immediately following receipt of invoice. The Operator shall pass credit to the joint account and include the same in the monthly statement of operations.
3. **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, and such credits shall appear in the monthly statement of operations.
4. **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 Vendee. Any claims by Vendee 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 100% of current new price.
3. **Good Used Material**  
Good used material (Condition "B"), being used material in sound and serviceable condition, suitable for reuse without reconditioning,
  - A. At 75% of current new price if material was charged to joint account as new, or
  - B. At 75% of current new price less depreciation consistent with their usage on and service to the joint property, if material was originally charged to the joint property as secondhand at 75% of new price.
4. **Other Used Material**  
Used Material (Condition "C"), being used material which
  - A. After reconditioning will be further serviceable for original function as good secondhand material (Condition "B"), or
  - B. Is serviceable for original function but substantially not suitable for reconditioning, at 50% of current new price.
5. **Bad-Order Material**  
Used material (Condition "D"), being material which cannot be classified as Condition "B" or Condition "C", shall be priced at a value commensurate with its use.
6. **Junk**  
Junk (Condition "E"), being obsolete and scrap material, at prevailing prices.
7. **Temporarily Used Material**  
When the use of material is of a temporary nature and its service to the joint account does not justify the reduction in price as provided in Paragraph 3B, 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**  
Periodic 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.
2. **Notice**  
Notice of intention to take inventory shall be given by Operator at least ten days before any inventory is to begin, so that Non-Operator may be represented when any inventory is taken.
3. **Failure to be Represented**  
Failure of Non-Operator to be represented at the physical inventory shall bind Non-Operator to accept the inventory taken by Operator, who shall in that event furnish Non-Operator with a copy thereof.
4. **Reconciliation of Inventory**  
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.
5. **Adjustment of Inventory**  
Inventory adjustments shall be made by Operator with the joint account for overages and shortages, but Operator shall only be held accountable to Non-Operator for shortages due to lack of reasonable diligence.
6. **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.