

**Chronological of  
Correspondence & Communications  
Section 20-20S-28E**

September 3, 1996	#1	Receive Farmout Request from InterCoast on Section 20-20S-28E - no specifics as to what part of Sec. 20 or spacing unit.
September 17, 1996		Phone conversation between Rock Quinn (InterCoast) and Janet Richardson (YPC) - Yates does not want to farmout - Quinn says he will send OA & AFE.
September 30, 1996	#2	Receive Force Pooling Notice - InterCoast is pooling N/2 of Sec. 20 - they own 47.5%. Hearing set for 10-17-96.
October 9, 1996	#3	Receive proposal letter from InterCoast with AFE and OA attached. Only proposed to YPC and Hayes Properties with no working interest percentages shown. (This was after phone call to Bill Carr, attorney for InterCoast at that time, telling him that we had not received a proposal.)  Hearing is postponed to November 7, 1996 to allow Yates time to review proposal
October 24, 1996		Phone conversation with Quinn - told him that we preferred a different location in the N/2
October 28, 1996		Quinn sets up meeting with Yates for Wednesday, October 30, 1996. I told him that I didn't think they owned 47.5%.
October 29, 1996		Quinn calls and cancels meeting - might be several weeks before they can come
October 29, 1996	#4	Yates proposes Stonewall DD St. Com. #3 to owners in Stonewall Unit
October 31, 1996	#5	Yates proposes Stonewall DD St. Com. #3 to InterCoast
November 7, 1996		Meeting with InterCoast in Artesia: 1. They insist they own 47.5% - ask who is Diamond Head Properties. 2. Neither geologist wants to give on their location for a N/2 well. 3. They propose going W/2 and E/2 and drilling both wells. 4. We agreed to try and get management approval for this proposal.
November 13, 1996		Phone conversation with Quinn - Management has approved going E/2 and W/2 and drilling both wells but ask that the largest working interest owner in E/2 operate. InterCoast does not agree and say they want to operate. I told him that I didn't know if that was problem or not - would run it by management.
November 14, 1996	#6	We propose Stonewall DD St. #3 on a W/2 basis
November 18, 1996	#7	Received proposals from InterCoast on E/2 and N/2 (Both letters dated 11-11-96)
November 19, 1996		Phone conversation with Quinn - I have been unable to discuss with Management. He states that they are continuing their N/2 pooling to see what happens the next two weeks.
November 22, 1996	#8	Letter to InterCoast stating why we should operate the E/2
November 22, 1996	#9	Yates proposes Stonewall AQK St. Com. #1 (InterCoast received on 11-25-96)
December 2, 1996	#10	Letter from Diamond Head Properties requesting that we send OA for their review for an E/2 well
December 4, 1996	#11	Letter to Diamond Head with revised pages to update OA previously sent
December 6, 1996	#12	Letter from Diamond Head questioning date in OA
December 12, 1996	#13	Letter to Diamond Head explaining date in OA with revised page
December 13, 1996	#14	Letter from InterCoast
December 13, 1996	#15	Response letter to InterCoast



*Key Dear  
What do you  
think  
Janet*

InterCoast Oil and Gas Company  
7130 South Lewis Avenue  
Suite 700  
Tulsa, Oklahoma 74136  
918 488-8283 Telephone  
918 488-8182 Fax

August 30, 1996

Yates Petroleum Corp.  
105 S. 4th St.  
Artesia, NM 87196

RECEIVED  
SEP - 3 1996

RE: Farmout Request  
Section 20-20S-28E  
Eddy County, NM  
IOGC's Angell Prospect

*9-3-96  
C=20S-28E-20-X*

Gentlemen:

InterCoast Oil and Gas Company (formerly named Medallion Production Company) is interested in the drilling of a well to be located in the NE/4 of Section 20-20S-28E, Eddy County, New Mexico. InterCoast proposes that the test well be drilled to a depth of approximately 11,250' in order to sufficiently test the Morrow Sand formation. Dry hole costs are estimated to be \$405,000, with total completed well costs estimated at \$697,000.

In connection with the test well, InterCoast proposes that you grant us a farmout of your contractual ownership in that certain Stonewall Unit Operating Agreement dated 11/1/73 under the following terms:

1. On or before 120 days following the execution date of a definitive agreement, InterCoast would commence or cause the commencement of an 11,250' Morrow Sand test at a location 990' FNL and 990' FEL of Section 20-20S-28E, Eddy County, New Mexico.
2. In the event the test well results in a well capable of producing in commercial quantities, InterCoast would earn an assignment of your interest in the dedicated unit within Section 20 from the surface of the earth to the total depth drilled in the test well.
3. You would reserve in such assignment a 1/8th of 8/8ths overriding royalty interest which would absorb all burdens in excess of the usual 1/8th royalty, and would be proportionately reduced to the interest being assigned.

An InterCoast Energy Company

*9-13-96  
Ray Beck - no F/O  
JAH - no F/O*

*9-17-96  
Qinn called - 1 hold firm  
no F/O + to send to ill  
Send OA + AFE.*

*N/2 Probdly?*

We would appreciate hearing your thoughts on this request at your earliest convenience. If you have any questions or would like to discuss this proposal, please contact me at 491-4176.

Very truly yours,

A handwritten signature in cursive script that reads "Rock A. Quinn". The signature is written in black ink and is positioned above the typed name.

Rock A. Quinn  
Senior Landman

RAQ:rkw

CAMPBELL, CARR, BERGE  
8 SHERIDAN, P.A.  
LAWYERS

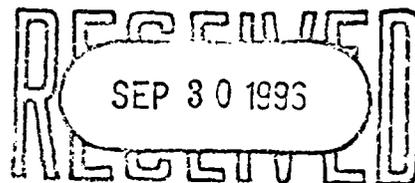
MICHAEL B. CAMPBELL  
WILLIAM F. CARR  
BRADFORD C. BERGE  
MARK F. SHERIDAN

MICHAEL H. FELDEWERT  
TANYA M. TRUJILLO  
PAUL R. OWEN

JACK M. CAMPBELL  
OF COUNSEL

JEFFERSON PLACE  
SUITE 1 - 110 NORTH GUADALUPE  
POST OFFICE BOX 2208  
SANTA FE, NEW MEXICO 87504-2208  
TELEPHONE: (505) 988-4421  
TELECOPIER: (505) 983-6043

September 26, 1996



**CERTIFIED MAIL**  
**RETURN RECEIPT REQUESTED**

TO AFFECTED INTEREST OWNERS:

Re: Application of InterCoast Oil & Gas Company for Compulsory Pooling and  
an Unorthodox Well Location, Eddy County, New Mexico

Gentlemen:

This letter is to advise you that InterCoast Oil & Gas Company has filed the enclosed application with the New Mexico Oil Conservation Division seeking the force pooling of all mineral interests in the N/2 of Section 20, Township 20 South, Range 28 East, N.M.P.M., Eddy County, New Mexico. InterCoast proposes to dedicate the referenced pooled unit to its InterCoast State 20 Well No.1 to be drilled to the Morrow formation, Burton Flat - Morrow Pool at an unorthodox location 990 feet from the North line and 990 feet from the East line of said Section 20.

This application has been set for hearing before a Division Examiner on October 17, 1996. You are not required to attend this hearing, but as an owner of an interest that may be affected by this application, you may appear and present testimony. Failure to appear at that time and become a party of record will preclude you from challenging the matter at a later date.

Parties appearing in cases have been requested by the Division (Memorandum 2-90) to file a Prehearing Statement substantially in the form prescribed by the Division. Prehearing statements should be filed by 4:00 o'clock p.m. on the Friday before a scheduled hearing.

Very truly yours,

A handwritten signature in cursive script that reads "Tanya Trujillo".

WILLIAM F. CARR  
ATTORNEY FOR INTERCOAST OIL & GAS COMPANY  
WFC:mlh  
Enclosure

BEFORE THE

SEP 8 1996

OIL CONSERVATION DIVISION

Oil Conservation Division

NEW MEXICO DEPARTMENT OF ENERGY, MINERALS AND NATURAL RESOURCES

IN THE MATTER OF THE APPLICATION  
OF INTERCOAST OIL AND GAS COMPANY  
FOR COMPULSORY POOLING AND  
AN UNORTHODOX WELL LOCATION,  
EDDY COUNTY, NEW MEXICO.

CASE NO. \_\_\_\_\_

APPLICATION

INTERCOAST OIL AND GAS COMPANY ("InterCoast"), through its undersigned attorneys, hereby makes application pursuant to the provisions of N.M.Stat. Ann. § 70-2-17, (1978), for an order pooling all mineral interests for all formations developed on 320-acre spacing in the N/2 of Section 20, Township 20 South, Range 28 East, N.M.P.M., Eddy County, New Mexico, and in support thereof states:

1. InterCoast owns or represents approximately 47% of the working interest in the N/2 of said Section 20, and has the right to drill thereon.
2. InterCoast proposes to dedicate the above-referenced spacing or proration unit to its InterCoast State 20 Well No. 1 which it proposes to drill at an unorthodox well location 990 feet from the North line and 990 feet from the East line of said Section 20.
3. InterCoast proposes to drill to a depth sufficient to test all formations on 320-acre spacing from the surface to the base of the Morrow formation.
4. InterCoast has sought and been unable to obtain either voluntary agreement for

pooling or farmout from certain interest owners in the N/2 of said Section 20.

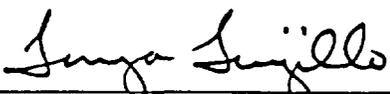
5. Said pooling of interests will prevent waste and will protect correlative rights.

6. In order to permit InterCoast to obtain its just and fair share of the oil and gas underlying the subject lands, all mineral interests should be pooled, and Applicant should be designated the operator of the well to be drilled at the proposed unorthodox well location.

WHEREFORE, InterCoast Oil and Gas Company prays that this application be set for hearing before an examiner of the Oil Conservation Division on October 17, 1996 and, after notice and hearing as required by law, the Division enter its order pooling the lands, including provisions for Applicant to recover its costs of supervision of the well, including overhead charges, imposing a risk factor for the risk assumed by the Applicant in drilling, completing and equipping the well and approving an unorthodox location for the well 990 feet from the North line and 990 feet from the East line of said Section 20.

Respectfully submitted,

CAMPBELL, CARR, BERGE  
& SHERIDAN, P.A.

By: 

WILLIAM F. CARR  
TANYA M. TRUJILLO  
Post Office Box 2208  
Santa Fe, New Mexico 87504  
Telephone: (505) 988-4421

ATTORNEYS FOR INTERCOAST OIL  
AND GAS COMPANY

CASE \_\_\_\_\_:

Application of InterCoast Oil and Gas Company for compulsory pooling and an unorthodox well location, Eddy County, New Mexico. Applicant in the above-styled cause seeks an order pooling all mineral interests for all formations developed on 320-acre spacing in the N/2 of Section 20, Township 20 South, Range 28 East, from the surface to the base of the Morrow formation. Said unit is to be dedicated to its InterCoast State 20 Well No. 1 which will be drilled at an unorthodox location 990 feet from the North line and 990 feet from the East line of said Section 20. Also to be considered will be the cost of drilling and completing said well and the allocation of the cost thereof as well as actual operating costs and charges for supervision, designation of applicant as operator of the well and a charge for risk involved in drilling said well. Said area is located approximately \_\_\_\_\_ miles \_\_\_\_\_ of \_\_\_\_\_, New Mexico.

RECEIVED

SEP 24 1998

OIL CONSERVATION DIVISION

October 1, 1996

Yates Petroleum Corp.  
105 South 4th Street  
Artesia, NM 87196

Attention: Ms Janet Richardson *Mecca*

RE: State of New Mexico #20-1 *10-9-96*  
Section 20-20S-28E-A *C=*  
Eddy County, New Mexico  
IOGC's Angell Ranch Prospect

RECEIVED  
OCT - 9 1996

Gentlemen:

Enclosed for your review and comments please find a copy of InterCoast Oil and Gas Company's proposed Operating Agreement covering the captioned unit.

Also enclosed are two (2) copies of our AFE for the drilling of the captioned well.

Should you desire to participate, please sign, date and return one (1) copy of the AFE together with any comments you may have in regard to our proposed Operating Agreement. At such time as the working interests are finalized and any comments reviewed, we will furnish each working interest owner with a signed copy of the Operating Agreement for their execution and return.

Should you wish to discuss any proposed changes to the Agreement, please feel free to contact me at 918/491-4176.

Very truly yours,



Rock A. Quinn  
Senior Landman

RAQ:rkw  
Enclosures

stnmjua

**AUTHORIZATION FOR EXPENDITURES**

Description of Work: Footage Drill, Log, DST, complete and equip a single zone Morrow Sand gas well

Prospect	<u>Angell Ranch</u>	Date	<u>8/28/96</u>
Lease	<u>To Be Determined</u>	Well No.	<u>1</u>
Location	<u>990' FNL-990' FEL</u>	Section	<u>20</u>
Field	<u>Atoka Morrow</u>	County	<u>Eddy</u>
Well TD	<u>11250'</u>	Prim. Obj.	<u>Morrow</u>
		AFE No.	
		Twp	<u>20S</u> Range <u>28E</u>
		State	<u>New Mexico</u>
		Sec. Obj.	

	Before	After	Total	Before	After	Total
	Csg Point	Csg Point		Csg Point	Csg Point	
<b>INTANGIBLE COSTS</b>	<b>BCP-820</b>	<b>ACP-840</b>		<b>BCP-830</b>	<b>ACP-850</b>	
.01 Location/Damage Payment	4,500		4,500	.01 Cattle Guards & Fencing	0	0
.02 Location Construction	17,500	1,500	19,000	.02 Csg: Cond.	0	X 0
.03 Contracted Equipment	0	0	0	.03 Csg: Surface	8,125	X 8,125
.04 Rotary Rig: MI, RU, RD, MO	0	0	0	500' 13-3/8" 48# H-40		
.05 Rotary Rig: Daywork	11,000	11,000	22,000	.04 Csg: Intermediate	30,500	X 30,500
.06 Rotary Rig: Footage	191,250	0	191,250	000' 8-5/8" 32#		
.07 Fuel	2,000	0	2,000	.05 Csg: Production	X	56,900 56,900
.08 Drilling Bits	0	0	0	4-1/2" @ 11250'		
.09 Drilling Fluid	37,500	1,000	38,500	.06 Float Equip, Centrizers, etc.		2,000 2,000
.10 Mud Disposal	3,000	X	3,000	.07 Well Head	8,800	11,500 20,300
.11 Drill Stem Tests	4,000	X	4,000	.08 Tubing	X	26,700 26,700
.12 Cement and Cementing Service	18,000	12,000	30,000	2-3/8", 4.7#, N-80		
.13 Casing Crew, Equipment	3,500	3,500	7,000	.09 Pump Unit	X	0 0
.14 Logging: Open Hole	9,500	X	9,500	.10 Motor/Engine	X	0 0
.15 Completion Rig	X	15,000	15,000	.11 Rods & Pump	X	0 0
.16 Stimulation	X	75,000	75,000	.12 Pkr & Sub-surface Equip.	X	10,000 10,000
.17 Misc. Pumping Services	0	3,500	3,500	.13 Tanks	X	6,000 6,000
.18 Log & Perf Cased Hole	X	8,000	8,000	.14 Separator/Production Unit	X	8,000 8,000
.19 Rentals	5,000	5,000	10,000	.15 Heater Treater/Dehydrator	X	8,000 8,000
.20 Water/Water Hauling	10,500	6,000	16,500	.16 Fittings & Small Pipe	X	12,500 12,500
.21 Hauling/Freight	0	1,000	1,000	.17 Other Equipment	0	0 0
.22 Tubular Inspection	1,500	2,500	4,000	.18 Installation Costs	X	12,500 12,500
.23 Well Testing	1,500	1,000	2,500	.19 Miscellaneous		
.24 Labor: Contract	2,500	2,500	5,000	.20 Contingency		
.25 Company Geologist/Engineer	2,500	0	2,500			
.26 Overhead	3,700	1,000	4,700			
.27 Professional Services	17,500	6,000	23,500			
.28 Insurance	1,700	0	1,700			
.29 Miscellaneous tax	14,000	7,550	21,550			
.30 Contingency	500	0	500			
.31 Coiled Tubing Work	0	3,500	3,500			
.32 Packer Redress	X	0	0			
	Subtotal	\$362,650	\$166,550	\$529,200		

Pipeline		PL-880		<b>TOTAL WELL COSTS</b>	<b>\$410,075</b>	<b>\$345,650</b>	<b>\$755,725</b>
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.01 Tapping Fee	X			Total Well Cost to Casing Point		\$410,075
.02 Purchased Right of Way	X			Plugging Cost		\$15,000
.03 Damage Payments	X			Total Dry & Abandonment Cost		\$425,075
.04 Right of Way Acquisition	X			Total Cost Through Evaluation of Zone of Interest		\$673,725
.05 Permits	X			Prepared By:	<u>LCF/TLR</u>	
.06 Freight	X			Estimated Spud Date		
.07 PL & Meter Sta. Construction	X			InterCoast WIO %		
.08 Surveying and Drafting	X			InterCoast Net Expenditure		\$0
.09 Field Construction Sup.	X			Supplement No.		
.10 Misc. and Contingency	X			Original AFE Amount		
	Subtotal			Amount This Supplement		

<b>TOTAL INTANGIBLE COSTS</b>	<b>\$362,650</b>	<b>\$166,550</b>	<b>\$529,200</b>	Revised AFE Amount		
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INTERCOAST OIL AND GAS COMPANY APPROVED

By: [Signature] Date: \_\_\_\_\_  
 By: \_\_\_\_\_ Date: \_\_\_\_\_  
 By: \_\_\_\_\_ Date: \_\_\_\_\_

WORKING INTEREST OWNER APPROVED

Company Name: Yates Petroleum Corp.  
 By: \_\_\_\_\_ Date: \_\_\_\_\_  
 Name: \_\_\_\_\_

A.A.P.L. FORM 610-1982

MODEL FORM OPERATING AGREEMENT



Use of this identifying mark is prohibited  
except when authorized in writing by the  
American Association of Petroleum Landmen

OPERATING AGREEMENT

DATED

September 26, 1996,

OPERATOR INTERCOAST OIL AND GAS COMPANY

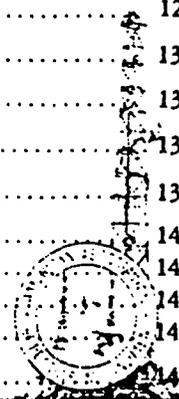
CONTRACT AREA N/2 Section 20-20S-28E

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

STATE OF NEW MEXICO #20-1

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between INTERCOAST OIL AND GAS COMPANY, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators".

WITNESSETH:

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

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.  
DEFINITIONS

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

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

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

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

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

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

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

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

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

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

ARTICLE II.  
EXHIBITS

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

- A. Exhibit "A", shall include the following information:
  - (1) Identification of lands subject to this agreement,
  - (2) Restrictions, if any, as to depths, formations, or substances,
  - (3) Percentages or fractional interests of parties to this agreement,
  - (4) Oil and gas leases and/or oil and gas interests subject to this agreement,
  - (5) Addresses of parties for notice purposes.
- B. Exhibit "B", Form of Lease.
- C. Exhibit "C", Accounting Procedure.
- D. Exhibit "D", Insurance.
- E. Exhibit "E", Gas Balancing Agreement.
- F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.
- G. Exhibit "G", Tax Partnership.

If any provision of any exhibit, except Exhibits "E" and "G", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

- H. Exhibit "H", Form of Security Supplement to Operating Agreement.



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ARTICLE XVI.  
MISCELLANEOUS

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

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

IN WITNESS WHEREOF, this agreement shall be effective as of \_\_\_\_\_ day of \_\_\_\_\_, 1996.

ATTEST:

OPERATOR  
INTERCOAST OIL AND GAS COMPANY

\_\_\_\_\_  
Chris Girouard, Vice President - Land

NON-OPERATORS

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



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EXHIBIT "A"

Attached to and made a part of that certain Operating Agreement by and between InterCoast Oil and Gas Company, as Operator, and \_\_\_\_\_, et al, as Non-Operators.

I. LANDS SUBJECT TO THIS AGREEMENT

N/2 Section 20-20S-28E, Eddy County, New Mexico.

II. RESTRICTIONS, IF ANY, AS TO DEPTHS OR FORMATIONS

None.

III. INTERESTS OF THE PARTIES TO THIS AGREEMENT

	Before	After
	<u>Payout</u>	<u>Payout</u>

InterCoast Oil and Gas Company  
7130 S. Lewis, Suite 700  
Tulsa, OK 74136

Hayes Properties Inc.  
P. O. Box 3700  
Midland, TX 79702

Yates Petroleum Corp.  
105 South 4th Street  
Artesia, NM 87196

EXHIBIT " C "

Attached to and made a part of \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**ACCOUNTING PROCEDURE  
JOINT OPERATIONS**

**I. GENERAL PROVISIONS**

**1. Definitions**

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

"Prime rate" shall be deemed to be the prime rate of interest established by the Chase Manhattan Bank, N.A., New York on the business day immediately preceding the date of

**2. Statement and Billings** billing.

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

**3. Advances and Payments by Non-Operators**

A. Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation within fifteen (15) days after receipt of the billing or by the first day of the month for which the advance is required, whichever is later. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

\*2% above

B. Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the prime rate in effect at Chase Manhattan Bank on the first day of the month in which delinquency occurs plus 1% or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts.

C. The operator shall have the right, with or without cause, to reject any and all letters of credit, which may be submitted by non-operator as security for advance payment of such non-operator's proportionate share of costs and expenses of the joint property.

**4. Adjustments**

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

**5. Audits**

- A. A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct a joint audit in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator. The audits shall not be conducted more than once each year without prior approval of Operator, except upon the resignation or removal of the Operator, and shall be made at the expense of those Non-Operators approving such audit.
- B. The Operator shall reply in writing to an audit report within 180 days after receipt of such report.

**6. Approval By Non-Operators**

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

**II. DIRECT CHARGES**

Operator shall charge the Joint Account with the following items:

**1. Ecological and Environmental**

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

**2. Rentals and Royalties**

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

**3. Labor**

- A. (1) Salaries and wages of Operator's field employees directly employed on the Joint Property in the conduct of Joint Operations.
- (2) Salaries of First Level Supervisors in the field.
- (3) Salaries and wages of Technical Employees directly employed on the Joint Property if such charges are excluded from the overhead rates.
- (4) Salaries and wages of Technical Employees either temporarily or permanently assigned to and directly employed in the operation of the Joint Property if such charges are excluded from the overhead rates.
- B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II. Such costs under this Paragraph 3B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 3A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.
- C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II.
- D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II.

**4. Employee Benefits**

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

26% or

**5. Material**

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

**6. Transportation**

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

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

- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store where like material is normally available, or railway receiving point nearest the Joint Property unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.
- C. In the application of subparagraphs A and B above, the option to equalize or charge actual trucking cost is available when the actual charge is \$400 or less excluding accessorial charges. The \$400 will be adjusted to the amount most recently recommended by the Council of Petroleum Accountants Societies.

#### Services

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

#### 8. Equipment and Facilities Furnished By Operator

- A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on gross investment less accumulated depreciation not to exceed           \*  
~~percent (          %) per annum.~~ Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property. \*Prime rate plus 2%
- B. In lieu of charges in paragraph 8A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property, ~~less 20%.~~ For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

#### 9. Damages and Losses to Joint Property

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

#### 10. Legal Expense

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

In addition to

#### 11. Taxes

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

#### 12. Insurance

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

#### 13. Abandonment and Reclamation

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

#### 14. Communications

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

#### 15. Other Expenditures

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

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

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

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

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

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

- ~~( ) shall be covered by the overhead rates, or~~
- (X) shall not be covered by the overhead rates.

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

- ~~( ) shall be covered by the overhead rates, or~~
- (X) shall not be covered by the overhead rates.

A. Overhead - Fixed Rate Basis

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

Drilling Well Rate \$ 5,819.00  
 (Prorated for less than a full month)

Producing Well Rate \$ 564.00

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

(a) Drilling Well Rate

- (1) Charges for drilling wells shall begin on the date the well is spudded and terminate on the date the drilling rig, completion rig, or other units used in completion of the well is released, whichever is later, except that no charge shall be made during suspension of drilling or completion operations for fifteen (15) or more consecutive calendar days.
- (2) Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive work days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig or other units used in workover, commence through date of rig or other unit release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive calendar days.

(b) Producing Well Rates

- (1) An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.
  - (2) Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.
  - (3) An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.
  - (4) A one-well charge shall be made for the month in which plugging and abandonment operations are completed on any well. This one-well charge shall be made whether or not the well has produced except when drilling well rate applies.
  - (5) All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.
- (3) The well rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

~~B. Overhead - Percentage Basis~~

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

~~(a) Development~~

~~\_\_\_\_\_ Percent ( \_\_\_\_\_ %) of the cost of development of the Joint Property exclusive of costs provided under Paragraph 10 of Section II and all salvage credits.~~

~~(b) Operating~~

~~\_\_\_\_\_ Percent ( \_\_\_\_\_ %) of the cost of operating the Joint Property exclusive of costs provided under Paragraphs 2 and 10 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.~~

~~(2) Application of Overhead - Percentage Basis shall be as follows:~~

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

**2. Overhead - Major Construction**

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

- A. \_\_\_\_\_\* % of first \$100,000 or total cost if less, plus  
 B. \_\_\_\_\_\* % of costs in excess of \$100,000 but less than \$1,000,000, plus \*To be negotiated.  
 C. \_\_\_\_\_\* % of costs in excess of \$1,000,000.

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

**3. Catastrophe Overhead**

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

- A. \_\_\_\_\_\* % of total costs through \$100,000; plus  
 B. \_\_\_\_\_\* % of total costs in excess of \$100,000 but less than \$1,000,000; plus \*To be negotiated.  
 C. \_\_\_\_\_\* % of total costs in excess of \$1,000,000.

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

**4. Amendment of Rates**

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

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

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

**1. Purchases**

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

**2. Transfers and Dispositions**

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

## A. New Material (Condition A)

### (1) Tubular Goods Other than Line Pipe

- (a) Tubular goods, sized 2½ inches OD and larger, except line pipe, shall be priced at Eastern mill published carload base prices effective as of date of movement plus transportation cost using the 80,000 pound carload weight basis to the railway receiving point nearest the Joint Property for which published rail rates for tubular goods exist. If the 80,000 pound rail rate is not offered, the 70,000 pound or 90,000 pound rail rate may be used. Freight charges for tubing will be calculated from Lorain, Ohio and casing from Youngstown, Ohio.
- (b) For grades which are special to one mill only, prices shall be computed at the mill base of that mill plus transportation cost from that mill to the railway receiving point nearest the Joint Property as provided above in Paragraph 2.A.(1)(a). For transportation cost from points other than Eastern mills, the 30,000 pound Oil Field Haulers Association interstate truck rate shall be used.
- (c) Special end finish tubular goods shall be priced at the lowest published out-of-stock price, f.o.b. Houston, Texas, plus transportation cost, using Oil Field Haulers Association interstate 30,000 pound truck rate, to the railway receiving point nearest the Joint Property.
- (d) Macaroni tubing (size less than 2½ inch OD) shall be priced at the lowest published out-of-stock prices f.o.b. the supplier plus transportation costs, using the Oil Field Haulers Association interstate truck rate per weight of tubing transferred, to the railway receiving point nearest the Joint Property.

### (2) Line Pipe

- (a) Line pipe movements (except size 24 inch OD and larger with walls ¼ inch and over) 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain, Ohio.
  - (b) Line pipe movements (except size 24 inch OD and larger with walls ¼ inch and over) less than 30,000 pounds shall be priced at Eastern mill published carload base prices effective as of date of shipment, plus 20 percent, plus transportation costs based on freight rates as set forth under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain, Ohio.
  - (c) Line pipe 24 inch OD and over and ¼ inch wall and larger shall be priced f.o.b. the point of manufacture at current new published prices plus transportation cost to the railway receiving point nearest the Joint Property.
  - (d) Line pipe, including fabricated line pipe, drive pipe and conduit not listed on published price lists shall be priced at quoted prices plus freight to the railway receiving point nearest the Joint Property or at prices agreed to by the Parties.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint Property.
  - (4) Unused new Material, except tubular goods, moved from the Joint Property shall be priced at the current new price, in effect on date of movement, as listed by a reliable supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint Property. Unused new tubulars will be priced as provided above in Paragraph 2 A (1) and (2).

## B. Good Used Material (Condition B)

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

### (1) Material moved to the Joint Property

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

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

- (a) At seventy-five percent (75%) of current new price, as determined by Paragraph A, if Material was originally charged to the Joint Account as new Material or
- (b) At sixty-five percent (65%) of current new price, as determined by Paragraph A, if Material was originally charged to the Joint Account as used Material.

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

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

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

## C. Other Used Material

### (1) Condition C

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

**(2) Condition D**

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

- (a) Casing, tubing, or drill pipe used as line pipe shall be priced as Grade A and B seamless line pipe of comparable size and weight. Used casing, tubing or drill pipe utilized as line pipe shall be priced at used line pipe prices.
- (b) Casing, tubing or drill pipe used as higher pressure service lines than standard line pipe, e.g. power oil lines, shall be priced under normal pricing procedures for casing, tubing, or drill pipe. Upset tubular goods shall be priced on a non upset basis.

**(3) Condition E**

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

**D. Obsolete Material**

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

**E. Pricing Conditions**

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

**3. Premium Prices**

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

**4. Warranty of Material Furnished By Operator**

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

**V. INVENTORIES**

The Operator shall maintain detailed records of Controllable Material.

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

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

**2. Reconciliation and Adjustment of Inventories**

Adjustments to the Joint Account resulting from the reconciliation of a physical inventory shall be made within six months following the taking of the inventory. Inventory adjustments shall be made by Operator to the Joint Account for overages and shortages, but, Operator shall be held accountable only for shortages due to lack of reasonable diligence.

**3. Special Inventories**

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

**4. Expense of Conducting Inventories**

- A. The expense of conducting periodic inventories shall not be charged to the Joint Account unless agreed to by the Parties.
- B. The expense of conducting special inventories shall be charged to the Parties requesting such inventories, except inventories required due to change of Operator shall be charged to the Joint Account.

EXHIBIT "D"

INSURANCE

1. Operator shall procure and maintain insurance of the types and in amounts as follows:
  - a) Workers Compensation Coverage as required by the laws of the various states in which operations will be conducted and also to include Employers Liability with limit of not less than \$500,000 each occurrence.
  - b) Commercial General Liability with limits as follows: \$1,000,000 each occurrence, \$2,000,000 general aggregate, \$1,000,000 products/completed operations aggregate and \$1,000,000 for personal injury liability. Coverage is included for blowout, underground resources and equipment and explosion.
  - c) Automobile Liability with a combined single limit of \$1,000,000 each occurrence and including hired and non-owned auto liability coverage.
  - d) Excess Liability, Umbrella Form with limits of \$1,000,000 each occurrence and \$1,000,000 aggregate.
  - e) Pollution Liability on a claims made basis with limits of \$500,000 per incident and \$500,000 aggregate.
  - f) Operator Extra Expense or Care, Custody and Control Coverage or other coverages as agreed to mutually between/among the parties.
2. The insurance described in 1. above, shall be carried at the joint expense of the parties hereto, and all premiums and other costs and expenses related thereto shall be charged to the Joint Account in accordance with the Accounting Procedure attached as Exhibit "C" to this Agreement.
3. Operator shall not be Liable to Non-Operators for loss suffered because of insufficiency of the insurance coverage set forth herein. Nor shall Operator be liable to Non-Operators for any loss occurring by reason of Operator's inability to procure or maintain the insurance provided herein if Operator has notified Non-Operators of Operator's inability to procure or maintain the insurance set forth herein at least 30 days prior to commencement of operations or at least 30 days prior to expiration of the insurance provided.
4. In the event of loss not covered by the insurance provided for herein, such loss shall be charged to the Joint Account and borne by the parties in accordance with their respective percentage of participation as determined by this Agreement.
5. Any party hereto may individually, and at its own expense, procure such additional insurance as it desires; provided, however, that such party shall make a good faith effort to obtain waivers by the insurer of all right of subrogation in favor of other parties.

EXHIBIT "E"

THERE IS NO EXHIBIT "E" TO THIS AGREEMENT.

EXHIBIT "F"

NON-DISCRIMINATION AND CERTIFICATION OF NON-SEGREGATED FACILITIES

If any interest in any of the lands described in Exhibit "A" hereto or any lease described in, or covering lands described in, such Exhibit "A" is subject to Executive Order 11246 and the Regulations issued thereunder (as amended), then during the performance of this contract, Operator agrees as follows:

1. The Operator will not discriminate against any employee or applicant for employment because of race, religion, sex, color, or national origin. The operator will take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without regard to their race, religion, sex, color, or national origin. Such action 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.
2. The Operator will, in all solicitations or advertisements for employees placed by or on behalf of the Operator, state that all qualified applicants will receive consideration for employment without regard to race, religion, sex, color, or national origin.
3. The Operator will comply with all provisions of Executive Order 11246 of September 24, 1965, and of the rules, and regulations and relevant orders of the Secretary of Labor.
4. The Operator will furnish all information and reports required by Executive Order 11246 of September 24, 1965, and by the rules, regulations, and orders of the Secretary of Labor, or pursuant thereto, and will permit access to its books, records, and accounts by the contracting agency (as defined in the regulations published under Title 41, Chapter 60 of the Code of Federal Regulations) and by the Secretary of Labor for purposes of investigation to ascertain compliance with such rules, regulations, and orders.
5. In the event of the Operator's noncompliance with the non-discrimination clauses of this contract or with any of such rules, regulations, or orders, this contract may be canceled, terminated, or suspended, in whole or in part, and the Operator may be declared ineligible for further Government contracts in accordance with procedures authorized in Executive Order 11246 of September 24, 1965, and such other sanctions may be imposed and remedies invoked as provided in Executive Order 11246 of September 24, 1965, or by rule, regulations or order of the Secretary of Labor of as otherwise provided by law.

EXHIBIT "H"

Attached to and made a part of that certain Operating Agreement dated \_\_\_\_\_, by and between InterCoast Oil and Gas Company, as Operator and \_\_\_\_\_, as Non-Operator(s).

SECURITY SUPPLEMENT TO OPERATING AGREEMENT

THIS AGREEMENT, made and entered into this \_\_\_\_ day of \_\_\_\_\_, 19\_\_ is by and between \_\_\_\_\_ ("Non-Operator", whether one or more) and InterCoast Oil and Gas Company ("Operator").

WHEREAS, concurrently herewith, by and Operating Agreement dated of even date herewith (the "Operating Agreement"), Operator and Non-Operator agreed to explore and/or develop certain oil and gas leases and/ or oil and gas interests in lands more particularly described below; and

WHEREAS, under the Operating Agreement, Operator and Non-Operator agreed to bear and pay costs, and expenses incurred in operations thereunder according to their respective fractional interests as specified therein, and Non-Operator agreed to reimburse Operator for Non-Operator's share of such costs and expenses as may be advanced by Operator; and

WHEREAS, under the Operating Agreement, Non-Operator agreed to enter into this Security Supplement to Operating Agreement in order to secure Operator's advances of such costs and expenses;

NOW, THEREFORE, in consideration of the premises, Operator and Non-Operator agree as follows:

1. Each Non-Operator grants to Operator a mortgage lien upon its oil and gas rights, including without limitation its leasehold interests, unleased fee interests and other mineral interests, in the following described tract(s) of land (the "Contract Area"):
2. Each Non-Operator grants to Operator a security interest in its share of oil and gas produced, or to be produced, from the Contract Area, in its interest in all equipment and general intangibles acquired, or to be acquired, with respect to operations in the Contract Area and in all accounts, contract rights, general intangibles, proceeds and products of, arising from or related to such collateral.
3. Such mortgage lien and security interest are given to secure such Non-Operator's share of all costs and expenses incurred under the Operating Agreement and advanced, or to be advanced in the future, thereunder by Operator, plus interest at the rate specified in the Operating Agreement.
4. Upon default by Non-Operator in the payment of its share of costs and expenses incurred under the Operating Agreement, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting Non-Operator's share of oil and gas from the Contract Area until the amount owed by the defaulting Non-Operator, plus interest, has been paid. Each purchaser shall be entitled to rely upon Operator's written notice stating the amount of any default, and upon receipt of such notice, is hereby authorized and directed by Non-Operator to treat Operator as the assignee and transferee of Non-Operator and entitled in the place and stead of Non-Operator to receive all proceeds due Non-Operator to the full extent of the default set forth in Operator's notice to purchaser. Non-Operator further agrees that it shall assert no claim against any purchaser for honoring such notice of default and treating Operator as Non-Operator's

assignee and transferee thereafter and that its only remedy in the event the amount of default is mistaken shall be against Operator. Non-Operator hereby authorizes and empowers Operator to demand, collect and receive said proceeds from purchaser in the event of default and to execute any and all transfer orders, division orders and other instruments that may be necessary to effect such demand, collection and receipt.

5. This Agreement is part and parcel of the Operating Agreement, and its terms and provisions shall be interpreted accordingly. Nothing in this Agreement shall be deemed to impose upon Operator any greater duty to advance costs and expenses on behalf of Non-Operator than may already exist under the Operating Agreement. To the extent that this Agreement expands or enlarges the mortgage lien or security rights of the Operator, this Agreement shall prevail in the event of any conflict with the Operating Agreement.
6. If any provision of this Agreement or the application thereof to any person or circumstance shall be invalid or unenforceable to any extent, the remainder of this Agreement or the application of such provision to other persons or circumstances shall not be affected thereby and shall be enforced to the greatest extent permitted by law.
7. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.
8. This Agreement may be executed in any number of counterparts, each of which shall be considered an original for all purposes.
9. The mailing addresses of the parties hereto, from which information concerning the outstanding indebtedness and security rights hereunder may be obtained, are as follows:

InterCoast Oil and Gas Company

\_\_\_\_\_  
Operator/Secured Party

7130 S. Lewis, Suite 700  
Tulsa, OK 74136

\_\_\_\_\_  
Non-Operator/Debtor

IN WITNESS WHEREOF, the parties to this Agreement have duly executed it on the day and year first written above.

ATTEST:

INTERCOAST OIL AND GAS COMPANY

BY: \_\_\_\_\_  
Randall E. Lawrence, Asst. Secretary

BY: \_\_\_\_\_  
Chris Girouard, Vice President - Land

ATTEST:

BY: \_\_\_\_\_

BY: \_\_\_\_\_

WITNESS:

BY: \_\_\_\_\_

BY: \_\_\_\_\_

STATE OF OKLAHOMA )  
 ) SS  
COUNTY OF TULSA )

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 199\_\_, by Chris Girouard, Vice President - Land of InterCoast Oil and Gas Company a Delaware corporation, on behalf of said corporation.

\_\_\_\_\_  
Notary Public

My Commission Expires:

\_\_\_\_\_

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

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 199\_\_, by \_\_\_\_\_ a \_\_\_\_\_ corporation, on behalf of said corporation.

\_\_\_\_\_  
Notary Public

My Commission Expires:

\_\_\_\_\_

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

Before me, the undersigned, a Notary Public, in and for said County and State, on this \_\_\_\_ day of \_\_\_\_\_, 199\_\_, personally appeared \_\_\_\_\_ personally known to be to be the identical person who executed the within and foregoing instrument, and acknowledged to me that he executed the same as his free and voluntary act and deed, for the uses and purposes therein set forth.

In witness whereof, I have hereunto set my official signature and affixed my official seal the day and year first above written.

\_\_\_\_\_  
Notary Public

My Commission Expires:

\_\_\_\_\_

MARTIN YATES, III  
1912 - 1985  
FRANK W. YATES  
1936 - 1986



105 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

JOHN A. YATES  
PRESIDENT  
PEYTON YATES  
EXECUTIVE VICE PRESIDENT  
RANDY G. PATTERSON  
SECRETARY  
DENNIS G. KINSEY  
TREASURER

October 29, 1996

To: Working Interest Owners  
Addressee List Attached

CERTIFIED MAIL  
Return Receipt Requested

RE: Stonewall DD St. Com. #3  
Township 20 South, Range 28 East  
Section 20: N/2  
Eddy County, New Mexico

Gentlemen:

Yates Petroleum Corporation is proposing to drill the Stonewall DD St. Com. #3 at a location of 990' FNL and 990' FWL of Section 20-20S-38E to test the Morrow formation. Enclosed for your review are two (2) copies of our AFE to drill along with a copy of our proposed Operating Agreement.

If you wish to participate in the drilling of this well, please sign and return one (1) executed copy of the AFE along with the signature page to the Operating Agreement to our office.

Should you have any questions concerning this proposal, please feel free to give me a call.

Very truly yours,

YATES PETROLEUM CORPORATION

Mecca Mauritsen  
Landman

MM:bn  
enclosure(s)

1700 Broadway, Suite 2300  
Denver, CO 80290-2301

Addressee List

PO BOX 10020  
Midland, TX 79702-7626

Ernie Bello  
3325 Ala Akulikuli  
Honolulu, HI 96818-2215

Frances B. Bunn  
2493 Makiki Heights Drive  
Honolulu, HI 96822

Claremont Corporation  
PO Box 549  
Claremore, OK 74018

Devon Energy Corporation  
20 North Broadway, Suite 1500  
Oklahoma City, OK 73102-8260

Diamond Head Properties, L.P.  
PO Box 2127  
Midland, TX 79702-2127

J.W. Gendron  
1280 Encino Drive  
San Marion, CA 91108

David Goodnow  
230 Ridgefield Road  
Wilton, CT 06897

Hayes Properties, Inc.  
PO Box 51510  
Midland, TX 79710-1510

Edward H. Judson  
PO Box 3340  
Midland, TX 79702-3340

Joseph R. Hodge  
3815 Roxbury Ct.  
Colorado Springs, CO 80906

Sanford J. Hodge, III  
4324 Hanover Avenue  
Dallas, TX 75225

E.G. Holden Test. Trust  
2524 Union Street  
San Francisco, CA 94123

Mary Hudson Ard  
4808 Westridge Avenue  
Fort Worth, TX 76116

W.A. & E.R. Hudson, Inc.  
616 Texas Street  
Fort Worth, TX 76102-4612

Dr. Isaac A. Kawasaki  
734 Kalanipuu  
Honolulu, HI 96825

Betsy H. Keller  
2524 Union Street  
San Francisco, CA 94123

Kerr-McGee Corporation  
PO Box 25861  
Oklahoma City, OK 73125

Martin Living Trust  
400 W. Illinois, Suite 1120  
Midland, TX 79701

Charles Cline Moore  
138 Harvard Avenue  
Mill Valley, CA 94941

Unit Petroleum Corporation  
PO Box 702500  
Tulsa, Ok 74170-2500

Frederick Van Vranken, Jr.  
PO Box 264  
Jericho, NY 11753

Pennzoil Exp. & Prod. Company  
PO Box 2967  
Houston, TX 77252-2967

Agnes Cluthe Oliver Trust  
Brown Bros. Harriman Trust Co.  
2001 Ross Avenue, Suite 1150  
Dallas, TX 75201

Adolph P. Schuman  
400 Sansome Street  
San Francisco, CA 94111

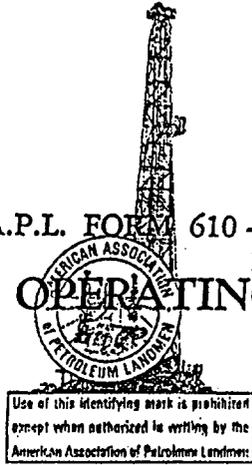
Space Building Corporation  
250 Cape Highway  
Route 44  
East Taunton, MA 02718

William B. Oliver Trust  
Brown Bros. Harriman Trust Co.  
2001 Ross Avenue, Suite 1150  
Dallas, TX 75201

Yates Petroleum Corporation  
Yates Drilling Company  
Abo Petroleum Corporation  
Myco Industries, Inc.  
105 South Fourth Street  
Artesia, NM 88210

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

MODEL FORM OPERATING AGREEMENT



STONEWALL DD ST. COM. #3

OPERATING AGREEMENT

DATED

October 25, 1996,

OPERATOR YATES PETROLEUM CORPORATION

CONTRACT AREA TOWNSHIP 20 SOUTH, RANGE 28 EAST

SECTION 20: N/2

COUNTY OR PARISH OF EDDY STATE OF NEW MEXICO

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This stamping mark is prohibited except when authorized in writing by the American Association of Petroleum Landmen.

OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between YATES PETROLEUM CORPORATION, a New Mexico corporation, 105 S. 4th St., Artesia, N.M., hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators",

WITNESSETH:

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

NOW, THEREFORE, it is agreed as follows:

ARTICLE I. DEFINITIONS

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

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

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

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

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

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

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

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

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

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

ARTICLE II. EXHIBITS

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

[X] A. Exhibit "A", shall include the following information:

- (1) Identification of lands subject to agreement,
(2) Restrictions, if any, as to depths or formations,
(3) Percentages or fractional interests of parties to this agreement,
(4) Oil and gas leases and/or oil and gas interests subject to this agreement,
(5) Addresses of parties for notice purposes.

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

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

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

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

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

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



ATTACHED TO AND MADE A PART OF OPERATING AGREEMENT DATED OCTOBER 25, 1996, BETWEEN YATES PETROLEUM CORPORATION, "OPERATOR" AND UNIT PETROLEUM COMPANY, ET AL, "NON-OPERATORS," COVERING LANDS LOCATED IN EDDY COUNTY, NEW MEXICO.

NON-OPERATORS

ERNIE BELLO

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

FRANCES B. BUNN

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

J.W. GENDRON

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

DAVID GOODNOW

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

JOSEPH R. HODGE

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

SANFORD J. HODGE, III

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

E.G. HOLDEN TEST. TRUST

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

ISAAC A. KAWASAKI

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

BETSY H. KELLER

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

CHARLES CLINE MOORE

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

AGNES CLUTHE OLIVER TRUST

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

WILLIAM B. OLIVER TRUST

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

ADOLPH P. SCHUMAN

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

SPACE BUILDING CORPORATION

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

FREDERICK VAN VRANKEN

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

CLAREMONT CORPORATION

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

MARY HUDSON ARD

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

W.A. & E.R. HUDSON, Inc.

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

HAYES PROPERTIES, INC.

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

KERR-McGEE CORPORATION

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

DIAMOND HEAD PROPERTIES, L.P.

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

R. KEN WILLIAMS

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

PENNZOIL EXPLORATION & PRODUCTION Co.

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

EDWARD H. JUDSON

\_\_\_\_\_

MARTIN LIVING TRUST

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

DEVON ENERGY CORPORATION

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

WHITING PETROLEUM CORPORATION

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



ATTACHED TO AND MADE A PART OF OPERATING AGREEMENT DATED OCTOBER 25, 1996, BETWEEN YATES PETROLEUM CORPORATION, "OPERATOR" AND UNIT PETROLEUM COMPANY, ET AL, "NON-OPERATORS," COVERING LANDS LOCATED IN EDDY COUNTY, NEW MEXICO.

EXHIBIT "A"

I. Lands Subject to Agreement:

Township 20 South, Range 28 East  
 Section 20: N/2  
 Eddy County, New Mexico

II. Depth Restriction:

None

III. Percentage Interests of Parties Under the Agreement:

	ACRES	% OF UNIT	INITIAL TEST WELL BEFORE PAYOUT	INITIAL TEST WELL AFTER PAYOUT & SUBSEQUENT WELLS
Yates Petroleum Corporation	55.023931	17.194979 %	17.194979 %	17.194979 %
Yates Drilling Company	16.261392	5.081685	5.081685	5.081685
Abo Petroleum Corporation	5.420470	1.693897	1.693897	1.693897
Myco Industries, Inc.	16.261392	5.081685	5.081685	5.081685
Unit Petroleum Company	18.543890	5.794966	5.794966	5.794966
Whiting Petroleum Corporation	4.625477	1.445461	1.445461	1.445461
Ernie Bello	0.042521	0.013288	0.013288	0.013288
Frances B. Bunn	0.042521	0.013288	0.013288	0.013288
J. W. Gendron	0.063790	0.019934	0.019934	0.019934
David Goodnow	0.042521	0.013288	0.013288	0.013288
Joseph R. Hodge	0.007090	0.002215	0.002215	0.002215
Sanford J. Hodge, III	0.007090	0.002215	0.002215	0.002215
E. G. Holden Test. Trust	0.021285	0.006652	0.006652	0.006652
Isaac A. Kawasaki	0.042521	0.013288	0.013288	0.013288
Betsy H. Keller	0.021285	0.006652	0.006652	0.006652
Charles Cline Moore	0.106327	0.033227	0.033227	0.033227
Agnes Cluthe Oliver Trust	0.042521	0.013288	0.013288	0.013288
William B. Oliver Trust	0.042521	0.013288	0.013288	0.013288
Adolph P. Schuman	0.042521	0.013288	0.013288	0.013288
Space Building Corp.	0.106327	0.033227	0.033227	0.033227
Frederick Van Vranken	0.042521	0.013288	0.013288	0.013288
Claremont Corporation	1.247131	0.389728	0.389728	0.389728
Mary Hudson Ard	6.651422	2.078569	2.078569	2.078569
W.A. & E.R. Hudson, Inc.	13.302845	4.157139	4.157139	4.157139
Hayes Properties, Inc.	15.461460	4.831706	4.831706	4.831706
Kerr-McGee Corporation	1.202359	0.375737	0.375737	0.375737
Kerr-McGee Corporation	77.123584	24.101120	24.101120	24.101120
Diamond Head Properties, L.P.	76.043646	23.763640	23.763640	23.763640
Pennzoil Exploration & Production Company	5.798016	1.811880	1.811880	1.811880
R. Ken Williams	0.831427	0.259821	0.259821	0.259821
Edward H. Judson	0.831427	0.259821	0.259821	0.259821
Martin Living Trust	0.831425	0.259820	0.259820	0.259820
Devon Energy Corporation	3.865344	1.207920	1.207920	1.207920
	<u>320.000000</u>	<u>100.000000 %</u>	<u>100.000000 %</u>	<u>100.000000 %</u>

ATTACHED TO AND MADE A PART OF OPERATING AGREEMENT DATED OCTOBER 25, 1996, BETWEEN YATES PETROLEUM CORPORATION, "OPERATOR" AND UNIT PETROLEUM COMPANY, ET AL, "NON-OPERATORS," COVERING LANDS LOCATED IN EDDY COUNTY, NEW MEXICO.

**IV. Oil & Gas Leases Subject to Agreement:**

1. Lessee: State of New Mexico  
Original Lessee: Socony Mobil Oil Company, Inc. 100.000000 %  
Present Lessee: Hayes Properties, Inc. 100.000000 %  
Expiration Date: HBP  
Serial No. K-3402  
Description: Township 20 South, Range 28 East  
Section 20: NW/4  
Net Acres: 160.00000

2. Lessee: State of New Mexico  
Original Lessee: Redfem Development Corporation 100.000000 %  
Present Lessee: Kerr-McGee Corporation 100.000000 %  
Expiration Date: HBP  
Serial No. K-6599  
Description: Township 20 South, Range 28 East  
Section 20: NE/4  
Net Acres: 160.00000

**V. Addresses of Parties to which notices should be sent:**

Yates Petroleum Corporation  
Yates Drilling Company  
Abo Petroleum Corporation  
Myco Industries, Inc.  
105 South Fourth Street  
Artesia, NM 88210

Whiting Petroleum Corporation  
1700 Broadway, Suite 2300  
Denver, CO 80290-2301  
Midland, TX 79702

J. W. Gendron  
1280 Encino Drive  
San Marino, CA 91108

Joseph R. Hodge  
3815 Roxbury Ct.  
Colorado Springs, CO 80906

E. G. Holden Test. Trust  
2524 Union Street  
San Francisco, CA 94123

Betsy H. Keller  
2524 Union Street  
San Francisco, CA 94123

Unit Petroleum Company  
P.O. Box 702500  
Tulsa, OK 74170-2500

Emie Bello  
3325 Ala Akulikuli  
Honolulu, HI 96818-2215

Frances B. Bunn  
2493 Makiki Heights Drive  
Honolulu, HI 96822

David Goodnow  
230 Ridgefield Road  
Wilton, CT 06897

Sanford J. Hodge, III  
4324 Hanover Avenue  
Dallas, TX 75225

Isaac A. Kawasaki  
734 Kalanipuu  
Honolulu, HI 96825

Charles Cline Moore  
138 Harvard Avenue  
Mill Valley, CA 94941

ATTACHED TO AND MADE A PART OF OPERATING AGREEMENT DATED OCTOBER 25, 1996, BETWEEN YATES PETROLEUM CORPORATION, "OPERATOR" AND UNIT PETROLEUM COMPANY, ET AL, "NON-OPERATORS," COVERING LANDS LOCATED IN EDDY COUNTY, NEW MEXICO.

Agnes Cluthe Oliver Trust  
Brown Brothers Harriman Trust Company  
2001 Ross Avenue, Suite 1150  
Dallas, TX 75201

Adolph P. Schuman  
400 Sansome Street  
San Francisco, CA 94111

Frederick Van Vranken  
P.O. Box 264  
Jericho, NY 11753

Mary Hudson Ard  
4808 Westridge Avenue  
Fort Worth, TX 76116

Hayes Properties, Inc.  
P.O. Box 51510  
Midland, TX 79710-1510

Diamond Head Properties, L. P.  
P.O. Box 2127  
Midland, TX 79702-2127

Pennzoil Exploration & Production Company  
P.O. Box 2967  
Houston, TX 77252-2967

Edward J. Judson  
P.O. Box 3340  
Midland, TX 79702-3340

William B. Oliver Trust  
Brown Brothers Harriman Trust Company  
2001 Ross Avenue, Suite 1150  
Dallas, TX 75201

Space Building Corporation  
250 Cape Highway  
Route 44  
East Tauton, MA 02718

Claremont Corporation  
P.O. Box 549  
Claremore, OK 74018

W. A. & E. R. Hudson, Inc.  
616 Texas Street  
Fort Worth, TX 76102-4612

Kerr-McGee Corporation  
P.O. Box 25861  
Oklahoma City, OK 73125

R. Ken Williams  
P.O. Box 10626  
Midland, TX 79702-7626

Martin Living Trust  
400 W. Illinois, Suite 1120  
Midland, TX 79701

Devon Energy Corporation  
20 North Broadway, Suite 1500  
Oklahoma City, OK 73102-8260

## EXHIBIT " C "

Attached to and made a part of Operating Agreement dated October 25, 1996, between Yates Petroleum Corporation, "Operator" and Unit Petroleum Company, et al, "Non-Operators", covering lands located in Eddy County, New Mexico.

## ACCOUNTING PROCEDURE JOINT OPERATIONS

### I. GENERAL PROVISIONS

#### 1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

#### 2. Statement and Billings

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

#### 3. Advances and Payments by Non-Operators

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

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

#### 4. Adjustments

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

#### 5. Audits

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

#### 6. Approval by Non-Operators

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

## II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

### 1. Rentals and Royalties

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

### 2. Labor

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

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

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

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

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

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

### 3. Employee Benefits

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

### 4. Material

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

### 5. Transportation

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

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

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

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

### 6. Services

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

### 7. Equipment and Facilities Furnished by Operator

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

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

### 8. Damages and Losses to Joint Property

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

### 9. Legal Expense

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

B. Expenses incurred by Operator in representing the Joint Property at hearings or proceedings before state or federal regulatory or administrative agencies.

## 10. Taxes

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

## 11. Insurance

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

## 12. Other Expenditures

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

## III. OVERHEAD

### 1. Overhead - Drilling and Producing Operations

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

- ( XX ) Fixed Rate Basis, Paragraph 1A, or  
( ) Percentage Basis, Paragraph 1B.

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

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

### A. Overhead - Fixed Rate Basis

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

Drilling Well Rate \$ 5,400.00  
Producing Well Rate \$ 540.00

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

#### (a) Drilling Well Rate

- [1] Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.
- [2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.
- [3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

#### (b) Producing Well Rates

- [1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.
- [2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.
- [3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.
- [4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.
- [5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

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

**B. Overhead - Percentage Basis**

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

**(a) Development**

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

**(b) Operating**

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

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

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

**2. Overhead - Major Construction**

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess of \$ 25,000.00 :

- A. 5 % of total costs if such costs are more than \$ 25,000.00 but less than \$ 100,000.00 ; plus  
 B. 3 % of total costs in excess of \$ 100,000.00 but less than \$1,000,000; plus  
 C. 2 % of total costs in excess of \$1,000,000.

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

**3. Amendment of Rates**

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

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

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

**1. Purchases**

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

**2. Transfers and Dispositions**

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

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

- (1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.
- (2) Line Pipe
  - (a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.
  - (b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

**B. Good Used Material (Condition B)**

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

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

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

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

**C. Other Used Material (Condition C and D)**

**(1) Condition C**

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

**(2) Condition D**

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

**D. Obsolete Material**

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

**E. Pricing Conditions**

- (1) Loading and unloading costs may be charged to the Joint Account at the rate of fifteen cents (15¢) per hundred weight on all tubular goods movements, in lieu of loading and unloading costs sustained, when actual hauling cost of such tubular goods are equalized under provisions of Paragraph 5 of Section II.
- (2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

**3. Premium Prices**

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

**4. Warranty of Material Furnished by Operator**

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

**V. INVENTORIES**

The Operator shall maintain detailed records of Controllable Material.

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

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

**2. Reconciliation and Adjustment of Inventories**

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

**3. Special Inventories**

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

**4. Expense of Conducting Periodic Inventories**

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

EXHIBIT "D"

ATTACHED TO AND MADE A PART OF  
OPERATING AGREEMENT

ADDITIONAL INSURANCE PROVISIONS

Operator, during the term of this agreement, shall carry insurance for the benefit and at the expense of the parties hereto, as follows:

(A) Workman's Compensation Insurance as contemplated by the state in which operations will be conducted, and Employer's Liability Insurance with limits of not less than \$100,000.00 per employee.

(B) Public Liability Insurance:  
Bodily Injury and Property Damage - \$500,000.00 single limit each occurrence.

(C) Automobile Public Liability Insurance:  
Bodily Injury \$250,000.00 each person.  
\$500,000.00 each occurrence.

Property Damage - \$100,000.00 each accident.

(or)

Bodily Injury and Property Damage - \$500,000.00 combined single limit.

Except as authorized by this Exhibit "D", Operator shall not make any charge to the joint account for insurance premiums. Losses not covered by Operator's insurance (or by insurance required by this agreement to be carried for the benefit and at the expense of the parties hereto) shall be charged to the joint account.

EXHIBIT "E"

GAS BALANCING AGREEMENT

The parties to the Operating Agreement to which this agreement is attached own the working interest in the gas rights underlying the lands covered by such agreement (the "Contract Area") in accordance with the percentages of participation as set forth in Exhibit "A" to the Operating Agreement (the "participation percentage").

In accordance with the terms of the Operating Agreement, each party thereto has the right to take its share of gas produced from the Contract Area and market the same. In the event any of the parties hereto collectively owning participation percentages of less than 50% are not at any time taking or marketing their share of gas or have contracted to sell their share of gas produced from the Contract Area to a purchaser which does not at any time while this agreement is in effect take the full share of gas attributable to the interest of such parties, this agreement shall automatically become effective upon the terms hereinafter set forth.

1. During the period or periods when any parties hereto collectively owning participation percentages of less than 50% have no market for their share of gas produced from any proration unit within the Contract Area, or their purchaser does not take its full share of gas produced from such proration unit, other parties collectively owning participation percentages of more than 50% shall be entitled to produce each month 100% of the lesser of a) allowable gas production assigned to such proration unit by applicable state regulatory authority or b) the delivery capacity of gas from such proration unit; provided, however, no party who does not have gas in place shall be entitled to take or deliver to a purchaser gas production in excess of 200% of the lesser of c) its share of the volumes of gas capable of being delivered on a daily basis or d) its share of allowable gas production. All parties hereto shall share in and own the liquid hydrocarbons recovered from such gas by lease equipment in accordance with their respective interests and subject to the Operating Agreement to which this agreement is attached, but the party or parties taking such gas shall own all of the gas delivered to its or their purchaser.

2. On a cumulative basis, each party not taking or marketing its full share of the gas produced shall be credited with gas in place equal to its full share of the gas produced under this agreement, less its share of gas used in lease operations, vented or lost, and less that portion such party took or delivered to its purchaser. The Operator will maintain a current account of gas balance between the parties and will furnish all parties hereto monthly statements showing the total quantity of gas produced, the amount used in lease operations, vented or lost, the total quantity of liquid hydrocarbons recovered therefrom, and the monthly and cumulative over and under account of each party.

3. At all times while gas is produced from the Contract Area, each party hereto will make settlement with the respective royalty owners to whom they are each accountable, just as if each party were taking or delivering to a purchaser its share, and its share only. Each party hereto agrees to hold each other party harmless from any and all claims for royalty payments asserted by royalty owners to whom each party is accountable. The term "royalty owner" shall include owners of royalty, overriding royalties, production payments and other similar interests.

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

4. After notice to the Operator, any party at any time may begin taking or delivering to its purchaser its full share of the gas produced from a proration unit under which it has gas in place less such party's share of gas used in operations, vented or lost. In addition to such share, each party, including the Operator, until it has recovered its gas in place and balanced the gas account as to its interest, shall be entitled to take or deliver to its purchaser a share of gas determined by multiplying 50% of the interest in the current gas production of the party or parties without gas in place by a fraction, the numerator of which is the interest in the proration unit of such party with gas in

place and the denominator of which is the total percentage interest in such proration unit of all parties with gas in place currently taking or delivering to a purchaser.

5. Nothing herein shall be construed to deny any party the right, from time to time, to produce and take or deliver to its purchaser its full share of the allowable gas production to meet the deliverability tests required by its purchaser, provided that said test should be reasonable in length, normally not to exceed 72 hours.

6. If a proration unit ceases to produce gas and/or liquid hydrocarbons in paying quantities before the gas account is balanced, settlement will be made between the underproduced and overproduced parties. In making such settlement, the underproduced party or parties will be paid a sum of money by the overproduced party or parties attributable to the overproduction which said overproduced party received, less applicable taxes theretofore paid, at the applicable price defined below for the delivery of a volume of gas equal to that for which settlement is made. For gas, the price of which is not regulated by federal, state or other governmental agencies, the price basis shall be the price received for the sale of the gas. For gas, the price of which is subject to regulation by federal, state or other governmental authorities, the price basis shall be the rate collected, from time to time, which is not subject to possible refund, as provided by the Federal Energy Regulatory Commission or any other governmental authority, pursuant to final order or settlement applicable to the gas sold from such well, plus any additional collected amount which is not ultimately required to be refunded by such authority, such additional collected amount to be accounted for at such time as final determination is made with respect hereto.

7. Notwithstanding the provisions of ¶6, it is expressly agreed that any underproduced party shall have the optional right, with respect to each proration unit, to receive a cash settlement bringing such underproduced party's gas account into balance at any time and from time to time prior to the final settlement, by first giving each overproduced party 90 days' written notice of demand for cash settlement. If such option is so exercised, settlement shall be made (as of 7:00 o'clock A.M. on the first day of the calendar month following the date of such written demands) within 90 days following the actual receipt of such written demands by the overproduced parties, in the same manner provided for in ¶6. The option provided for in this paragraph may be exercised, from time to time, but only one time in each calendar year.

8. Nothing herein shall change or affect each party's obligation to pay its proportionate share of all costs and liabilities incurred, as its share thereof is set forth in the Operating Agreement.

9. This agreement shall constitute a separate agreement as to each proration unit approved by the applicable regulatory authority for a pool within the Contract Area, but such proration unit shall not include any producing horizon which is not within the vertical limits of said pool. This agreement shall remain in force and effect so long as the Operating Agreement to which it is attached remains in effect, and shall inure to the benefit of and be binding upon the parties hereto, their heirs, successors, legal representatives and assigns.

EXHIBIT "F"

EQUAL EMPLOYMENT OPPORTUNITY PROVISION

During the performance of this contract, the Operator agrees as follows:

- (1) The Operator will not discriminate against any employee or applicant for employment because of race, color, religion, national origin or sex. The Operator will take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without regard to their race, color, religion, national origin or sex. Such action 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 Operator agrees to post in conspicuous places, available to employees and applicants for employment notices to be provided for the contracting officer setting forth the provisions of this non-discrimination clause.
- (2) The Operator will, in all solicitations or advertisements for employees placed by or on behalf of the Operator, state that all qualified applicants will receive consideration for employment without regard to race, color, religion, national origin or sex.
- (3) The Operator will send to each labor union or representative of workers with which it has a collective bargaining agreement or other contract or understanding, a notice to be provided by the agency contracting officer, advising the labor union or workers' representative of the Operator's commitments under Section 202 of Executive Order 11246 of September 24, 1965, and shall post copies of the notice in conspicuous places available to employees and applicants for employment.
- (4) The Operator will comply with all provisions of Executive Order 11246 of September 24, 1965, and of the rules, regulations, and relevant orders of the Secretary of Labor.
- (5) The Operator will furnish all information and reports required by Executive Order 11246 of September 24, 1965, and by the rules, regulations, and orders of the Secretary of Labor, or pursuant thereto, and will permit access to its books, records, and accounts by the contracting agency and the Secretary of Labor for purposes of investigation to ascertain compliance with such rules, regulations, and orders.
- (6) In the event of the Operator's non-compliance with the non-discrimination clauses of this contract or with any of such rules, regulations, or orders, this contract may be canceled, terminated or suspended in whole or in part and the Operator may be declared ineligible for further Government contracts in accordance with procedures authorized in Executive Order 11246 of September 24, 1965, and such other sanctions may be imposed and remedies invoked as provided in Executive Order 11246 of September 24, 1965, or by rule, regulation, or order of the Secretary of Labor, or as otherwise provided by law.

(7) The Operator will include the provisions of Paragraphs (1) through (7) in every subcontract or purchase order unless exempted by rules, regulations, or orders of the Secretary of Labor issued pursuant to Section 204 of Executive Order 11246 of September 24, 1965, so that such provisions will be binding upon each subcontractor or vendor. The Operator will take such action with respect to any subcontract or purchase order as the contracting agency may direct as a means of enforcing such provisions including sanctions for non-compliance: Provided, however, that in the event the Operator becomes involved in, or is threatened with, litigation with a subcontractor or vendor as a result of such direction by the contracting agency, the Operator may request the United States to enter into such litigation to protect the interests of the United States.

Operator acknowledges that it may be required to file Standard Form 100 (EEO-1) promulgated jointly by the Office of Federal Contract Compliance, the Equal Employment Opportunity Commission and Plans for Progress with Joint Reporting Committee, Federal Depot, Jeffersonville, Indiana, within thirty (30) days of the date of contract award if such report has not been filed for the current year and otherwise comply with or file such other compliance reports as may be required under Executive Order 11246, as amended and Rules and Regulations adopted thereunder.

Operator further acknowledges that he may be required to develop a written affirmative action compliance program as required by the Rules and Regulations approved by the Secretary of Labor under authority of Executive Order 11246 and supply Non-Operators with a copy of such program if they so request.

#### CERTIFICATION OF NON-SEGREGATED FACILITIES

Operator assures Non-Operators that it does not and will not maintain or provide for its employees any segregated facilities at any of its establishments, and that it does not and will not permit its employees to perform their services at any location, under its control, where segregated facilities are maintained. For this purpose, it is understood that the phrase "segregated facilities" includes facilities which are in fact segregated on a basis of race, color, religion, or national origin, because of habit; local custom or otherwise. It is further understood and agreed that maintaining or providing segregated facilities for its employees or permitting its employees to perform their services at any location under its control where segregated facilities are maintained is a violation of the equal opportunity clause required by Executive Order 11246 of September 24, 1965.

Operator further understands and agrees that a breach of the assurance herein contained subjects it to the provisions of the Order at 41 CFR Chapter 60 of the Secretary of Labor dated May 21, 1968, and the provisions of the equal opportunity clause enumerated in contracts between the United States of America and Non-Operators.

Whoever knowingly and willfully makes any false, fictitious or fraudulent representation may be liable to criminal prosecution under 18 U. S. C. - 1001 .

MARTIN YATES, III  
1912 - 1985  
FRANK W. YATES  
1936 - 1986



JOHN A. YATES  
PRESIDENT  
PEYTON YATES  
EXECUTIVE VICE PRESIDENT  
RANDY G. PATTERSON  
SECRETARY  
DENNIS G. KINSEY  
TREASURER

105 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

October 31, 1996

InterCoast Oil & Gas Company  
7130 South Lewis Avenue  
Suite 700  
Tulsa, OK 74136

CERTIFIED MAIL  
Return Receipt Requested

Attention: Mr. Rock Quinn

RE: Stonewall DD St. Com. #3  
Township 20 South, Range 28 East  
Section 20: N/2  
Eddy County, New Mexico

Gentlemen:

Yates Petroleum Corporation is proposing to drill the Stonewall DD St. Com. #3 at a location of 990' FNL and 990' FWL of Section 20-20S-38E to test the Morrow formation. Enclosed for your review are two (2) copies of our AFE to drill along with a copy of our proposed Operating Agreement.

You have indicated to us that you have a farmout from Kerr-McGee covering their interest in the NE/4 of Section 20. Kerr-McGee's interest has been split to reflect this interest as well as their small interest that was committed to the Stonewall Unit.

If you wish to participate in the drilling of this well, please sign and return one (1) executed copy of the AFE along with the signature page to the Operating Agreement to our office.

Should you have any questions concerning this proposal, please feel free to give me a call.

Very truly yours,

YATES PETROLEUM CORPORATION

Mecca Mauritsen  
Landman

MM:bn  
enclosure(s)

Is your RETURN ADDRESS completed on the reverse side?

**SENDER:**

- Complete items 1 and/or 2 for additional services.
- Complete items 3, 4a, & 4b.
- Print your name and address on the reverse of this form so that we can return this card to you.
- Attach this form to the front of the mailpiece, or on the back if space does not permit.
- Write "Return Receipt Requested" on the mailpiece below the article number.
- The Return Receipt will show to whom the article was delivered and the date delivered.

I also wish to receive the following services (for an extra fee):

- 1.  Addressee's Address
- 2.  Restricted Delivery

Consult postmaster for fee.

3. Article Addressed to:  
 INTER COAST OIL + GAS COMPANY  
 7130 LEWIS AVE. - SUITE 700  
 TULSA, OK 74136  
 Attention: MR. ROCK QUINN

4a. Article Number  
P 274 898 011

4b. Service Type  
 Registered  Certified  
 Express Mail  Insured  
 Return Receipt for Merchandise  COD

7. Date of Delivery  
11-5-96

5. Received By: (Print Name)

8. Addressee's Address (Only if requested and fee is paid)

6. Signature: (Addressee or Agent)  
X [Signature]

DD#3

PS Form 3811, December 1994

Domestic Return Receipt

Thank you for using Return Receipt Service.

1912-1985  
FRANK W. YATES  
1936-1986



PRESIDENT  
PEYTON YATES  
EXECUTIVE VICE PRESIDENT  
RANDY G. PATTERSON  
SECRETARY  
DENNIS G. KINSEY  
TREASURER

105 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

November 14, 1996

To: Working Interest Owners  
Addressee List Attached

CERTIFIED MAIL  
Return Receipt Requested

RE: Stonewall DD State #3  
Township 20 South, Range 28 East  
Section 20: W/2  
Eddy County, New Mexico

Gentlemen:

Per my letter of October 29, 1996, we proposed to drill the captioned well at 990' FNL and 990' FWL of Section 20-T20S-R28E on a N/2 spacing. Intercoast Oil & Gas had also proposed a well in the N/2 at 990' FNL and 990' FEL.

Since our proposal, we have met with Intercoast and have decided to drill both wells but change the spacing to W/2 and E/2. This will allow us to drill our location under the Stonewall Unit Operating Agreement without the need of a new Operating Agreement.

With the change in spacing, the working interests for this well have also changed. Enclosed are two (2) copies of our AFE with the revised interests along with a worksheet that shows how we arrived at those percentages. If you would like to participate in the drilling of this well, please sign and return one (1) copy of the AFE to my attention within the thirty (30) day time period allowed.

Should you have any questions, please feel free to give me a call.

Thank you.

Very truly yours,

YATES PETROLEUM CORPORATION

Mecca Mauritsen  
Landman

MM:bn  
enclosure(s)

Denver, CO 80290-2301

Midland, TX 79702-7626

Ernie Bello  
3325 Ala Akulikuli  
Honolulu, HI 96818-2215

Frances B. Bunn  
2493 Makiki Heights Drive  
Honolulu, HI 96822

Claremont Corporation  
PO Box 549  
Claremore, OK 74018

Devon Energy Corporation  
20 North Broadway, Suite 1500  
Oklahoma City, OK 73102-8260

Diamond Head Properties, L.P.  
PO Box 2127  
Midland, TX 79702-2127

J.W. Gendron  
1280 Encino Drive  
San Marion, CA 91108

David Goodnow  
230 Ridgefield Road  
Wilton, CT 06897

Hayes Properties, Inc.  
PO Box 51510  
Midland, TX 79710-1510

Edward H. Judson  
PO Box 3340  
Midland, TX 79702-3340

Joseph R. Hodge  
3815 Roxbury Ct.  
Colorado Springs, CO 80906

Sanford J. Hodge, III  
4324 Hanover Avenue  
Dallas, TX 75225

E.G. Holden Test. Trust  
2524 Union Street  
San Francisco, CA 94123

Mary Hudson Ard  
4808 Westridge Avenue  
Fort Worth, TX 76116

W.A. & E.R. Hudson, Inc.  
616 Texas Street  
Fort Worth, TX 76102-4612

Dr. Isaac A. Kawasaki  
734 Kalanipuu  
Honolulu, HI 96825

Betsy H. Keller  
2524 Union Street  
San Francisco, CA 94123

Kerr-McGee Corporation  
PO Box 25861  
Oklahoma City, OK 73125

Martin Living Trust  
400 W. Illinois, Suite 1120  
Midland, TX 79701

Charles Cline Moore  
138 Harvard Avenue  
Mill Valley, CA 94941

Unit Petroleum Corporation  
PO Box 702500  
Tulsa, Ok 74170-2500

Frederick Van Vranken, Jr.  
PO Box 264  
Jericho, NY 11753

Pennzoil Exp. & Prod. Company  
PO Box 50090  
Midland, TX 79710

Agnes Cluthe Oliver Trust  
Brown Bros. Harriman Trust Co.  
2001 Ross Avenue, Suite 1150  
Dallas, TX 75201

Adolph P. Schuman  
400 Sansome Street  
San Francisco, CA 94111

Space Building Corporation  
250 Cape Highway  
Route 44  
East Taunton, MA 02718

William B. Oliver Trust  
Brown Bros. Harriman Trust Co.  
2001 Ross Avenue, Suite 1150  
Dallas, TX 75201

Yates Petroleum Corporation  
Yates Drilling Company  
Abo Petroleum Corporation  
Myco Industries, Inc.  
105 South Fourth Street  
Artesia, NM 88210

**Stonewall DD St. #3**  
W/2 Section 20-20S-28E

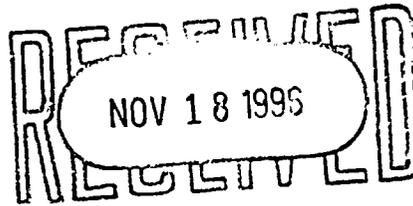
	SW/4 BPO	SW/4 APO and NW/4 BPO/APO	WI % BPO	WI % APO
Yates Petroleum Corporation	33.228400 %	32.752340 %	32.990370 %	32.752340 %
Yates Drilling Company	15.000000	9.679400	12.339700	9.679400
Abo Petroleum Corporation	5.000000	3.226470	4.113235	3.226470
Myco Industries, Inc.	15.000000	9.679400	12.339700	9.679400
Unit Petroleum Company	17.105450	11.038030	14.071740	11.038030
Whiting Petroleum Corporation	4.266610	2.753260	3.509935	2.753260
Ernie Bello	0.039230	0.025310	0.032270	0.025310
Frances B. Bunn	0.039230	0.025310	0.032270	0.025310
J. W. Gendron	0.058850	0.037970	0.048410	0.037970
David Goodnow	0.039230	0.025310	0.032270	0.025310
Joseph R. Hodge	0.006540	0.004220	0.005380	0.004220
Sanford J. Hodge, III	0.006540	0.004220	0.005380	0.004220
E. G. Holden Test. Trust	0.019610	0.012670	0.016140	0.012670
Isaac A. Kawasaki	0.039230	0.025310	0.032270	0.025310
Betsy H. Keller	0.019610	0.012670	0.016140	0.012670
Charles Cline Moore	0.098080	0.063290	0.080685	0.063290
Agnes Cluthe Oliver Trust	0.039230	0.025310	0.032270	0.025310
William B. Oliver Trust	0.039230	0.025310	0.032270	0.025310
Adolph P. Schuman	0.039230	0.025310	0.032270	0.025310
Space Building Corp.	0.098080	0.063290	0.080685	0.063290
Frederick Van Vranken	0.039230	0.025310	0.032270	0.025310
Claremont Corporation	0.575200	0.742340	0.658770	0.742340
Mary Hudson Ard	3.067730	3.959180	3.513455	3.959180
W.A. & E.R. Hudson, Inc.	6.135460	7.918360	7.026910	7.918360
Hayes Properties, Inc.	- 0 -	9.203250	4.601625	9.203250
Kerr-McGee Corporation	- 0 -	0.715690	0.357845	0.715690
Diamond Head Properties, L.P.	- 0 -	0.694780	0.347390	0.694780
Pennzoil Exploration & Production Company	- 0 -	3.451200	1.725600	3.451200
R. Ken Williams	- 0 -	0.494897	0.247449	0.494897
Edward H. Judson	- 0 -	0.494897	0.247448	0.494897
Martin Living Trust	- 0 -	0.494896	0.247448	0.494896
Devon Energy Corporation	- 0 -	2.300800	1.150400	2.300800
	100.000000 %	100.000000 %	100.000000 %	100.000000 %



**InterCoast  
Oil and Gas**

InterCoast Oil and Gas Company  
7130 South Lewis Avenue  
Suite 700  
Tulsa, Oklahoma 74136  
918 488-8283 Telephone  
918 488-8182 Fax

November 11, 1996



Yates Drilling Company  
110 South 4th Street  
Yates Building  
Artesia, NM 88210-2123

RE: Well Proposal  
E/2 Section 20-20S-28E-A  
Eddy County, NM  
IOGC's Angell Ranch Prospect

11-18-96

C=

Gentlemen:

InterCoast Oil and Gas Company ("IOGC") hereby proposes the drilling of a well to be located 990' FNL and 990' FEL of Section 20-20S-28E, Eddy County, New Mexico. IOGC proposes that the test well be drilled to a depth of approximately 11,250' in order to sufficiently test the Morrow Sand formation. Dry hole costs are estimated to be \$405,000, with total completed well costs estimated at \$697,000.

Enclosed are two copies of the AFE for your review and approval. If you should desire to participate, please sign and return one copy of the AFE together with any comments you may have regarding the Operating Agreement previously submitted for your consideration. IOGC has acquired the interest of Kerr-McGee in the NE/4 of Section 20. As you are aware, IOGC has previously proposed the drilling of this well on the basis of a N/2 Section 20 unit. Pursuant to our recent meeting with Yates Petroleum Corporation, it was mutually agreed that an E/2 Section 20 unit would accommodate additional drilling opportunities in the W/2 thereof.

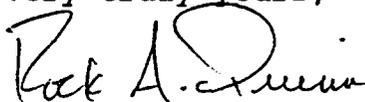
If you do not wish to participate in the proposed test well, IOGC proposes that you grant us a farmout of your interest in the E/2 of Section 20-20S-28E under the following terms:

1. On or before 60 days following the execution date of a definitive agreement, IOGC would commence or cause the commencement of an 11,250' Morrow Sand test at a location 990' FNL and 990' FEL of Section 20-20S-28E, Eddy County, New Mexico.

2. In the event the test well results in a well capable of producing in commercial quantities, IOGC would earn an assignment of your interest in the E/2 of Section 20 from the surface of the earth to the total depth drilled in the test well.
3. You would reserve in such assignment a 1/8th of 8/8ths overriding royalty interest which would absorb all burdens in excess of the usual 1/8th royalty, and would be proportionately reduced to the interest being assigned.

Due to time constraints on the commencement of the proposed well, IOGC has filed an application for compulsory pooling and an unorthodox well location with the New Mexico Oil Conservation Division. This matter will be heard at 8:15 a.m. on Thursday, December 5, 1996 at the Division's office at 2040 South Pacheco Street, Santa Fe, New Mexico. Failure to appear at that time will preclude you from contesting this matter at a later date. However, we would like to obtain your voluntary joinder in the well, and we would appreciate discussing this proposal with you at your earliest convenience.

Very truly yours,



Rock A. Quinn  
Senior Landman

RAQ:rkw  
Enclosures (2)

**AUTHORIZATION FOR EXPENDITURES**

Description of Work: Footage Drill, Log, DST, complete and equip a single zone Morrow Sand gas well

Prospect	<u>Angell Ranch</u>	Well No.	<u>1</u>	Date	<u>8/28/96</u>
Lease	<u>To Be Determined</u>	Section	<u>20</u>	AFE No.	
Location	<u>990' FNL-990' FEL</u>	County	<u>Eddy</u>	Twp	<u>20S Range 28E</u>
Field	<u>Atoka Morrow</u>	Prim. Obj.	<u>Morrow</u>	State	<u>New Mexico</u>
Well TD	<u>11250'</u>	Sec. Obj.			

	Before	After	Total	Before	After	Total
	Csg Point	Csg Point		Csg Point	Csg Point	
<b>INTANGIBLE COSTS</b>	<b>BCP-820</b>	<b>ACP-840</b>		<b>BCP-830</b>	<b>ACP-850</b>	
.01 Location/Damage Payment	4,500		4,500	.01 Cattle Guards & Fencing	0	0
.02 Location Construction	17,500	1,500	19,000	.02 Csg: Cond.	0	X 0
.03 Contracted Equipment	0	0	0	.03 Csg: Surface	8,125	X 8,125
.04 Rotary Rig: MI, RU, RD, MO	0	0	0	500' 13-3/8" 48# H-40		
.05 Rotary Rig: Daywork	11,000	11,000	22,000	.04 Csg: Intermediate	30,500	X 30,500
.06 Rotary Rig: Footage	191,250	0	191,250	000' 8-5/8" 32#		
.07 Fuel	2,000	0	2,000	.05 Csg: Production	X	56,900 56,900
.08 Drilling Bits	0	0	0	4-1/2" @ 11250'		
.09 Drilling Fluid	37,500	1,000	38,500	.06 Float Equip, Centrizers, etc.		2,000 2,000
.10 Mud Disposal	3,000	X	3,000	.07 Well Head	8,800	11,500 20,300
.11 Drill Stem Tests	4,000	X	4,000	.08 Tubing	X	- 26,700 26,700
.12 Cement and Cementing Service	18,000	12,000	30,000	2-3/8", 4.7#, N-80		
.13 Casing Crew, Equipment	3,500	3,500	7,000	.09 Pump Unit	X	0 0
.14 Logging: Open Hole	9,500	X	9,500	.10 Motor/Engine	X	0 0
.15 Completion Rig	X	15,000	15,000	.11 Rods & Pump	X	0 0
.16 Stimulation	X	75,000	75,000	.12 Pkr & Sub-surface Equip.	X	10,000 10,000
.17 Misc. Pumping Services	0	3,500	3,500	.13 Tanks	X	6,000 6,000
.18 Log & Perf Cased Hole	X	8,000	8,000	.14 Separator/Production Unit	X	8,000 8,000
.19 Rentals	5,000	5,000	10,000	.15 Heater Treater/Dehydrator	X	8,000 8,000
.20 Water/Water Hauling	10,500	6,000	16,500	.16 Fittings & Small Pipe	X	12,500 12,500
.21 Hauling/Freight	0	1,000	1,000	.17 Other Equipment	0	0 0
.22 Tubular Inspection	1,500	2,500	4,000	.18 Installation Costs	X	12,500 12,500
.23 Well Testing	1,500	1,000	2,500	.19 Miscellaneous		
.24 Labor: Contract	2,500	2,500	5,000	.20 Contingency		
.25 Company Geologist/Engineer	2,500	0	2,500	Subtotal	\$47,425	\$154,100 \$201,525
.26 Overhead	3,700	1,000	4,700			
.27 Professional Services	17,500	6,000	23,500	Pipeline		PL-880
.28 Insurance	1,700	0	1,700	.01 Line Pipe	X	25,000 25,000
.29 Miscellaneous tax	14,000	7,550	21,550	.02 Metering Equipment	X	0 0
.30 Contingency	500	0	500	.03 Meter Sta. Valves, Fittings	X	0 0
.31 Coiled Tubing Work	0	3,500	3,500	Subtotal		\$25,000 \$25,000
.32 Packer Redress	X		0	<b>TOTAL TANGIBLE COSTS</b>	<b>\$47,425</b>	<b>\$179,100 \$226,525</b>
Subtotal	\$362,650	\$166,550	\$529,200	<b>TOTAL WELL COSTS</b>	<b>\$410,075</b>	<b>\$345,650 \$755,725</b>

	Pipeline	PL-880	
.01 Tapping Fee	X		
.02 Purchased Right of Way	X		Total Well Cost to Casing Point \$410,075
.03 Damage Payments	X		Plugging Cost \$15,000
.04 Right of Way Acquisition	X		Total Dry & Abandonment Cost \$425,075
.05 Permits	X		Total Cost Through Evaluation of Zone of Interest \$673,725
.06 Freight	X		Prepared By: LCF/TLR
.07 PL & Meter Sta. Construction	X		Estimated Spud Date
.08 Surveying and Drafting	X		InterCoast WIO %
.09 Field Construction Sup.	X		InterCoast Net Expenditure \$0
.10 Misc. and Contingency	X		Supplement No.
Subtotal			Original AFE Amount
<b>TOTAL INTANGIBLE COSTS</b>	<b>\$362,650</b>	<b>\$166,550</b>	<b>\$529,200</b>
			Amount This Supplement
			Revised AFE Amount

INTERCOAST OIL AND GAS COMPANY APPROVED

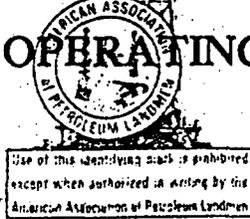
By: [Signature] Date: \_\_\_\_\_  
 By: \_\_\_\_\_ Date: \_\_\_\_\_  
 By: \_\_\_\_\_ Date: \_\_\_\_\_

WORKING INTEREST OWNER APPROVED

Company Name: \_\_\_\_\_  
 By: \_\_\_\_\_ Date: \_\_\_\_\_  
 Name: \_\_\_\_\_

A.A.P.L. FORM 610-1982

MODEL FORM OPERATING AGREEMENT



OPERATING AGREEMENT

DATED

September 26, 19 96,

OPERATOR INTERCOAST OIL AND GAS COMPANY

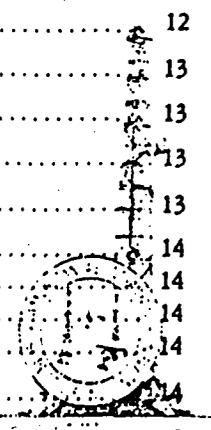
CONTRACT AREA N/2 Section 20-20S-28E

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

STATE OF NEW MEXICO #20-1

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between INTERCOAST OIL AND GAS COMPANY, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators".

WITNESSETH:

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

NOW, THEREFORE, it is agreed as follows:

ARTICLE I. DEFINITIONS

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

- A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.
B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.
C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.
D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".
E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.
F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.
G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.
H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

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

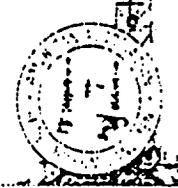
ARTICLE II. EXHIBITS

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

- [X] A. Exhibit "A", shall include the following information:
(1) Identification of lands subject to this agreement,
(2) Restrictions, if any, as to depths, formations, or substances,
(3) Percentages or fractional interests of parties to this agreement,
(4) Oil and gas leases and/or oil and gas interests subject to this agreement,
(5) Addresses of parties for notice purposes.
[ ] B. Exhibit "B", Form of Lease.
[X] C. Exhibit "C", Accounting Procedure.
[X] D. Exhibit "D", Insurance.
[ ] E. Exhibit "E", Gas Balancing Agreement.
[X] F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.
[ ] G. Exhibit "G", Tax Partnership.

If any provision of any exhibit, except Exhibits "E" and "G", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

- [X] H. Exhibit "H", Form of Security Supplement to Operating Agreement.



ARTICLE XVI.  
MISCELLANEOUS

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

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

IN WITNESS WHEREOF, this agreement shall be effective as of \_\_\_\_\_ day of \_\_\_\_\_, 1996.

ATTEST:

OPERATOR  
INTERCOAST OIL AND GAS COMPANY

\_\_\_\_\_  
Chris Girouard, Vice President - Land

NON-OPERATORS

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

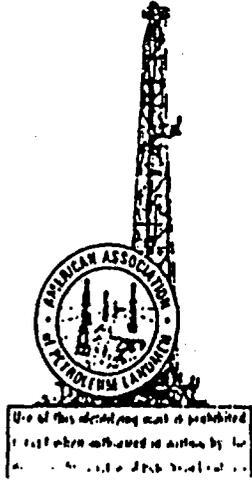


EXHIBIT "A"

Attached to and made a part of that certain Operating Agreement dated September 26, 1996, by and between InterCoast Oil and Gas Company, as Operator, and \_\_\_\_\_, et al, as Non-Operators.

I. LANDS SUBJECT TO THIS AGREEMENT

N/2 Section 20-20S-28E, Eddy County, New Mexico

II. RESTRICTIONS, IF ANY, AS TO DEPTHS OR FORMATIONS

None.

III. INTERESTS OF THE PARTIES TO THIS AGREEMENT

InterCoast Oil and Gas Company  
7130 S. Lewis, Suite 700  
Tulsa, OK 74136

Hayes Properties, Inc.  
P. O. Box 51510  
Midland, TX 79710-1510

Yates Petroleum Corp.  
Yates Drilling Company  
Abo Petroleum Corporation  
Myco Industries, Inc.  
105 South 4th Street  
Artesia, NM 88210

Sanford J. Hodge, III  
4324 Hanover  
Dallas, TX 75225

Space Building Corporation  
250 Cape Highway, Route 44  
East Taunton, MA 02718

Ernie Bello  
3325 Ala Akulikuli  
Honolulu, Hawaii 96818-2215

Frederick Van Vranken  
Cedar Swamp Road, Box 264  
Jericho, NY 11753

Karen V. Martin and William  
H. Martin, Trustees of the  
Martin Living Trust  
400 West Illinois, Suite 1120  
Midland, TX 79701

Brown Brothers Harriman Trust  
Company, Trustee of the William  
B. Oliver Trust and Successor  
Trustee of the Agnes Cluth  
Oliver Trust  
2001 Ross Ave., Suite 1150  
Dallas, TX 75201

EXHIBIT "A" (CONTINUED)

Mary Hudson Ard  
4808 Westridge Ave.  
Ft. Worth, TX 76116

David Goodnow  
230 Ridgefield Road  
Wilton, CT 06897

Edward H. Judson and  
Marilyn M. Judson  
P. O. Box 3340  
Midland, TX 79702-3340

Devon Energy Corporation  
20 North Broadway, Suite 1500  
Oklahoma City, OK 73102

Frances B. Bunn  
2493 Makiki Heights Drive  
Honolulu, Hawaii 96822

Unit Petroleum Corporation  
7130 South Lewis  
Tulsa, OK 74136

Pennzoil Exploration & Production Company  
P. O. Box 2967  
Houston, TX 77252

Whiting Petroleum Corporation  
1700 Broadway, Suite 2300  
Denver, CO 80290-2301

J. W. Gendron  
1280 Encino Drive  
San Marino, CA 91108

E. G. Holden Test. Trust  
2524 Union Street  
San Francisco, CA 94123

Joseph R. Hodge  
3815 Roxbury Ct.  
Colorado Springs, CO 80906

Betsy H. Keller  
2524 Union Street  
San Francisco, CA 94123

Isaac A. Kawasaki  
734 Kalanipuu  
Honolulu, HI 96825

Charles Cline Moore  
138 Harvard Avenue  
Mill Valley, CA 94941

Adolph P. Schuman  
400 Sansome Street  
San Francisco, CA 94111

Diamond Head Properties, L.P.  
P. O. Box 2127  
Midland, TX 79702-2127

Claremont Corporation  
P. O. Box 549  
Claremore, OK 74018

EXHIBIT "A" (CONTINUED)

W. A. & E. R. Hudson, Inc.  
616 Texas Street  
Fort Worth, TX 76102-4612

R. Ken Williams  
P. O. Box 10626  
Midland, TX 79702-7626

EXHIBIT " C "

Attached to and made a part of \_\_\_\_\_

ACCOUNTING PROCEDURE  
JOINT OPERATIONS

I. GENERAL PROVISIONS

1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

"Prime rate" shall be deemed to be the prime rate of interest established by the Chase Manhattan Bank, N.A., New York on the business day immediately preceding the date of billing.

2. Statement and Billings

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

3. Advances and Payments by Non-Operators

A. Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation within fifteen (15) days after receipt of the billing or by the first day of the month for which the advance is required, whichever is later. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

\*2% above

B. Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the prime rate in effect at Chase Manhattan Bank on the first day of the month in which delinquency occurs plus 1% or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts.

C. The operator shall have the right, with or without cause, to reject any and all letters of credit, which may be submitted by non-operator as security for advance

4. Adjustments payment of such non-operator's proportionate share of costs and expenses of the joint property.

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

## 5. Audits

- A. A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct a joint audit in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator. The audits shall not be conducted more than once each year without prior approval of Operator, except upon the resignation or removal of the Operator, and shall be made at the expense of those Non-Operators approving such audit.
- B. The Operator shall reply in writing to an audit report within 180 days after receipt of such report.

## 6. Approval By Non-Operators

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

## II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

### 1. Ecological and Environmental

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

### 2. Rentals and Royalties

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

### 3. Labor

- A. (1) Salaries and wages of Operator's field employees directly employed on the Joint Property in the conduct of Joint Operations.
- (2) Salaries of First Level Supervisors in the field.
- (3) Salaries and wages of Technical Employees directly employed on the Joint Property if such charges are excluded from the overhead rates.
- (4) Salaries and wages of Technical Employees either temporarily or permanently assigned to and directly employed in the operation of the Joint Property if such charges are excluded from the overhead rates.
- B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II. Such costs under this Paragraph 3B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 3A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.
- C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II.
- D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II.

### 4. Employee Benefits

Operator's current costs of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II shall be Operator's actual cost not to exceed the percent most recently recommended by the Council of Petroleum Accountants Societies. 26% or

### 5. Material

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

### 6. Transportation

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

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

- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store where like material is normally available, or railway receiving point nearest the Joint Property unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.
- C. In the application of subparagraphs A and B above, the option to equalize or charge actual trucking cost is available when the actual charge is \$400 or less excluding accessorial charges. The \$400 will be adjusted to the amount most recently recommended by the Council of Petroleum Accountants Societies.

7. Services

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

8. Equipment and Facilities Furnished By Operator

A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on gross investment less accumulated depreciation not to exceed     \*     percent (%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property. \*Prime rate plus 2%

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

9. Damages and Losses to Joint Property

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

10. Legal Expense

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

11. Taxes

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

12. Insurance

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

13. Abandonment and Reclamation

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

14. Communications

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

15. Other Expenditures

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

### III. OVERHEAD

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

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

Fixed Rate Basis, Paragraph 1A, or  
 Percentage Basis, Paragraph 1B

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

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

shall be covered by the overhead rates, or  
 shall not be covered by the overhead rates.

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

shall be covered by the overhead rates, or  
 shall not be covered by the overhead rates.

#### A. Overhead - Fixed Rate Basis

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

Drilling Well Rate \$ 5,819.00  
 (Prorated for less than a full month)

Producing Well Rate \$ 564.00

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

##### (a) Drilling Well Rate

- (1) Charges for drilling wells shall begin on the date the well is spudded and terminate on the date the drilling rig, completion rig, or other units used in completion of the well is released, whichever is later, except that no charge shall be made during suspension of drilling or completion operations for fifteen (15) or more consecutive calendar days.
- (2) Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive work days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig or other units used in workover, commence through date of rig or other unit release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive calendar days.

##### (b) Producing Well Rates

- (1) An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.
- (2) Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.
- (3) An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.
- (4) A one-well charge shall be made for the month in which plugging and abandonment operations are completed on any well. This one-well charge shall be made whether or not the well has produced except when drilling well rate applies.
- (5) All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.
- (3) The well rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

#### ~~B. Overhead - Percentage Basis~~

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

~~(a) Development~~

~~\_\_\_\_\_ Percent ( \_\_\_\_\_ %) of the cost of development of the Joint Property exclusive of costs provided under Paragraph 10 of Section II and all salvage credits.~~

~~(b) Operating~~

~~\_\_\_\_\_ Percent ( \_\_\_\_\_ %) of the cost of operating the Joint Property exclusive of costs provided under Paragraphs 2 and 10 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.~~

~~(2) Application of Overhead - Percentage Basis shall be as follows:~~

~~For the purpose of determining charges on a percentage basis under Paragraph 1B of this Section III, development shall include all costs in connection with drilling, re-drilling, deepening, or any remedial operations on any or all wells involving the use of drilling rig and crew capable of drilling to the producing interval on the Joint Property; also, preliminary expenditures necessary in preparation for drilling and expenditures incurred in abandoning when the well is not completed as a producer, and original cost of construction or installation of fixed assets, the expansion of fixed assets and any other project clearly discernible as a fixed asset, except Major Construction as defined in Paragraph 2 of this Section III. All other costs shall be considered as operating.~~

2. Overhead - Major Construction

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

- A. \_\_\_\_\_\* % of first \$100,000 or total cost if less, plus
- B. \_\_\_\_\_\* % of costs in excess of \$100,000 but less than \$1,000,000, plus \*To be negotiated.
- C. \_\_\_\_\_\* % of costs in excess of \$1,000,000.

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

3. Catastrophe Overhead

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

- A. \_\_\_\_\_\* % of total costs through \$100,000; plus
- B. \_\_\_\_\_\* % of total costs in excess of \$100,000 but less than \$1,000,000; plus \*To be negotiated.
- C. \_\_\_\_\_\* % of total costs in excess of \$1,000,000.

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

4. Amendment of Rates

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

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

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

1. Purchases

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

2. Transfers and Dispositions

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

## A. New Material (Condition A)

### (1) Tubular Goods Other than Line Pipe

- (a) Tubular goods, sized 2½ inches OD and larger, except line pipe, shall be priced at Eastern mill published carload base prices effective as of date of movement plus transportation cost using the 80,000 pound carload weight basis to the railway receiving point nearest the Joint Property for which published rail rates for tubular goods exist. If the 80,000 pound rail rate is not offered, the 70,000 pound or 90,000 pound rail rate may be used. Freight charges for tubing will be calculated from Lorain, Ohio and casing from Youngstown, Ohio.
- (b) For grades which are special to one mill only, prices shall be computed at the mill base of that mill plus transportation cost from that mill to the railway receiving point nearest the Joint Property as provided above in Paragraph 2.A.(1)(a). For transportation cost from points other than Eastern mills, the 30,000 pound Oil Field Haulers Association interstate truck rate shall be used.
- (c) Special end finish tubular goods shall be priced at the lowest published out-of-stock price, f.o.b. Houston, Texas, plus transportation cost, using Oil Field Haulers Association interstate 30,000 pound truck rate, to the railway receiving point nearest the Joint Property.
- (d) Macaroni tubing (size less than 2½ inch OD) shall be priced at the lowest published out-of-stock prices f.o.b. the supplier plus transportation costs, using the Oil Field Haulers Association interstate truck rate per weight of tubing transferred, to the railway receiving point nearest the Joint Property.

### (2) Line Pipe

- (a) Line pipe movements (except size 24 inch OD and larger with walls ¾ inch and over) 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain, Ohio.
  - (b) Line pipe movements (except size 24 inch OD and larger with walls ¾ inch and over) less than 30,000 pounds shall be priced at Eastern mill published carload base prices effective as of date of shipment, plus 20 percent, plus transportation costs based on freight rates as set forth under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain, Ohio.
  - (c) Line pipe 24 inch OD and over and ¾ inch wall and larger shall be priced f.o.b. the point of manufacture at current new published prices plus transportation cost to the railway receiving point nearest the Joint Property.
  - (d) Line pipe, including fabricated line pipe, drive pipe and conduit not listed on published price lists shall be priced at quoted prices plus freight to the railway receiving point nearest the Joint Property or at prices agreed to by the Parties.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint Property.
  - (4) Unused new Material, except tubular goods, moved from the Joint Property shall be priced at the current new price, in effect on date of movement, as listed by a reliable supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint Property. Unused new tubulars will be priced as provided above in Paragraph 2 A (1) and (2).

## B. Good Used Material (Condition B)

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

### (1) Material moved to the Joint Property

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

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

- (a) At seventy-five percent (75%) of current new price, as determined by Paragraph A, if Material was originally charged to the Joint Account as new Material or
- (b) At sixty-five percent (65%) of current new price, as determined by Paragraph A, if Material was originally charged to the Joint Account as used Material.

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

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

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

## C. Other Used Material

### (1) Condition C

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

## (2) Condition D

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

- (a) Casing, tubing, or drill pipe used as line pipe shall be priced as Grade A and B seamless line pipe of comparable size and weight. Used casing, tubing or drill pipe utilized as line pipe shall be priced at used line pipe prices.
- (b) Casing, tubing or drill pipe used as higher pressure service lines than standard line pipe, e.g. power oil lines, shall be priced under normal pricing procedures for casing, tubing, or drill pipe. Upset tubular goods shall be priced on a non upset basis.

## (3) Condition E

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

## D. Obsolete Material

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

## E. Pricing Conditions

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

## 3. Premium Prices

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

## 4. Warranty of Material Furnished By Operator

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

## V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

## 1. Periodic Inventories, Notice and Representation

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

## 2. Reconciliation and Adjustment of Inventories

Adjustments to the Joint Account resulting from the reconciliation of a physical inventory shall be made within six months following the taking of the inventory. Inventory adjustments shall be made by Operator to the Joint Account for overages and shortages, but, Operator shall be held accountable only for shortages due to lack of reasonable diligence.

## 3. Special Inventories

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

## 4. Expense of Conducting Inventories

- A. The expense of conducting periodic inventories shall not be charged to the Joint Account unless agreed to by the Parties.
- B. The expense of conducting special inventories shall be charged to the Parties requesting such inventories, except inventories required due to change of Operator shall be charged to the Joint Account.

EXHIBIT "D"

INSURANCE

1. Operator shall procure and maintain insurance of the types and in amounts as follows:
  - a) Workers Compensation Coverage as required by the laws of the various states in which operations will be conducted and also to include Employers Liability with limit of not less than \$500,000 each occurrence.
  - b) Commercial General Liability with limits as follows: \$1,000,000 each occurrence, \$2,000,000 general aggregate, \$1,000,000 products/completed operations aggregate and \$1,000,000 for personal injury liability. Coverage is included for blowout, underground resources and equipment and explosion.
  - c) Automobile Liability with a combined single limit of \$1,000,000 each occurrence and including hired and non-owned auto liability coverage.
  - d) Excess Liability, Umbrella Form with limits of \$1,000,000 each occurrence and \$1,000,000 aggregate.
  - e) Pollution Liability on a claims made basis with limits of \$500,000 per incident and \$500,000 aggregate.
  - f) Operator Extra Expense or Care, Custody and Control Coverage or other coverages as agreed to mutually between/among the parties.
2. The insurance described in 1. above, shall be carried at the joint expense of the parties hereto, and all premiums and other costs and expenses related thereto shall be charged to the Joint Account in accordance with the Accounting Procedure attached as Exhibit "C" to this Agreement.
3. Operator shall not be Liable to Non-Operators for loss suffered because of insufficiency of the insurance coverage set forth herein. Nor shall Operator be liable to Non-Operators for any loss occurring by reason of Operator's inability to procure or maintain the insurance provided herein if Operator has notified Non-Operators of Operator's inability to procure or maintain the insurance set forth herein at least 30 days prior to commencement of operations or at least 30 days prior to expiration of the insurance provided.
4. In the event of loss not covered by the insurance provided for herein, such loss shall be charged to the Joint Account and borne by the parties in accordance with their respective percentage of participation as determined by this Agreement.
5. Any party hereto may individually, and at its own expense, procure such additional insurance as it desires; provided, however, that such party shall make a good faith effort to obtain waivers by the insurer of all right of subrogation in favor of other parties.

EXHIBIT "E"

THERE IS NO EXHIBIT "E" TO THIS AGREEMENT.

## EXHIBIT "F"

### NON-DISCRIMINATION AND CERTIFICATION OF NON-SEGREGATED FACILITIES

If any interest in any of the lands described in Exhibit "A" hereto or any lease described in, or covering lands described in, such Exhibit "A" is subject to Executive Order 11246 and the Regulations issued thereunder (as amended), then during the performance of this contract, Operator agrees as follows:

1. The Operator will not discriminate against any employee or applicant for employment because of race, religion, sex, color, or national origin. The operator will take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without regard to their race, religion, sex, color, or national origin. Such action 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.
2. The Operator will, in all solicitations or advertisements for employees placed by or on behalf of the Operator, state that all qualified applicants will receive consideration for employment without regard to race, religion, sex, color, or national origin.
3. The Operator will comply with all provisions of Executive Order 11246 of September 24, 1965, and of the rules, and regulations and relevant orders of the Secretary of Labor.
4. The Operator will furnish all information and reports required by Executive Order 11246 of September 24, 1965, and by the rules, regulations, and orders of the Secretary of Labor, or pursuant thereto, and will permit access to its books, records, and accounts by the contracting agency (as defined in the regulations published under Title 41, Chapter 60 of the Code of Federal Regulations) and by the Secretary of Labor for purposes of investigation to ascertain compliance with such rules, regulations, and orders.
5. In the event of the Operator's noncompliance with the non-discrimination clauses of this contract or with any of such rules, regulations, or orders, this contract may be canceled, terminated, or suspended, in whole or in part, and the Operator may be declared ineligible for further Government contracts in accordance with procedures authorized in Executive Order 11246 of September 24, 1965, and such other sanctions may be imposed and remedies invoked as provided in Executive Order 11246 of September 24, 1965, or by rule, regulations or order of the Secretary of Labor or as otherwise provided by law.

## EXHIBIT "H"

Attached to and made a part of that certain Operating Agreement dated \_\_\_\_\_, by and between InterCoast Oil and Gas Company, as Operator and \_\_\_\_\_, as Non-Operator(s).

### SECURITY SUPPLEMENT TO OPERATING AGREEMENT

THIS AGREEMENT, made and entered into this \_\_\_ day of \_\_\_\_\_, 19\_\_ is by and between \_\_\_\_\_ ("Non-Operator", whether one or more) and InterCoast Oil and Gas Company ("Operator").

WHEREAS, concurrently herewith, by and Operating Agreement dated of even date herewith (the "Operating Agreement"), Operator and Non-Operator agreed to explore and/or develop certain oil and gas leases and/ or oil and gas interests in lands more particularly described below; and

WHEREAS, under the Operating Agreement, Operator and Non-Operator agreed to bear and pay costs, and expenses incurred in operations thereunder according to their respective fractional interests as specified therein, and Non-Operator agreed to reimburse Operator for Non-Operator's share of such costs and expenses as may be advanced by Operator; and

WHEREAS, under the Operating Agreement, Non-Operator agreed to enter into this Security Supplement to Operating Agreement in order to secure Operator's advances of such costs and expenses;

NOW, THEREFORE, in consideration of the premises, Operator and Non-Operator agree as follows:

1. Each Non-Operator grants to Operator a mortgage lien upon its oil and gas rights, including without limitation its leasehold interests, unleased fee interests and other mineral interests, in the following described tract(s) of land (the "Contract Area"):
2. Each Non-Operator grants to Operator a security interest in its share of oil and gas produced, or to be produced, from the Contract Area, in its interest in all equipment and general intangibles acquired, or to be acquired, with respect to operations in the Contract Area and in all accounts, contract rights, general intangibles, proceeds and products of, arising from or related to such collateral.
3. Such mortgage lien and security interest are given to secure such Non-Operator's share of all costs and expenses incurred under the Operating Agreement and advanced, or to be advanced in the future, thereunder by Operator, plus interest at the rate specified in the Operating Agreement.
4. Upon default by Non-Operator in the payment of its share of costs and expenses incurred under the Operating Agreement, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting Non-Operator's share of oil and gas from the Contract Area until the amount owed by the defaulting Non-Operator, plus interest, has been paid. Each purchaser shall be entitled to rely upon Operator's written notice stating the amount of any default, and upon receipt of such notice, is hereby authorized and directed by Non-Operator to treat Operator as the assignee and transferee of Non-Operator and entitled in the place and stead of Non-Operator to receive all proceeds due Non-Operator to the full extent of the default set forth in Operator's notice to purchaser. Non-Operator further agrees that it shall assert no claim against any purchaser for honoring such notice of default and treating Operator as Non-Operator's

assignee and transferee thereafter and that its only remedy in the event the amount of default is mistaken shall be against Operator. Non-Operator hereby authorizes and empowers Operator to demand, collect and receive said proceeds from purchaser in the event of default and to execute any and all transfer orders, division orders and other instruments that may be necessary to effect such demand, collection and receipt.

5. This Agreement is part and parcel of the Operating Agreement, and its terms and provisions shall be interpreted accordingly. Nothing in this Agreement shall be deemed to impose upon Operator any greater duty to advance costs and expenses on behalf of Non-Operator than may already exist under the Operating Agreement. To the extent that this Agreement expands or enlarges the mortgage lien or security rights of the Operator, this Agreement shall prevail in the event of any conflict with the Operating Agreement.
6. If any provision of this Agreement or the application thereof to any person or circumstance shall be invalid or unenforceable to any extent, the remainder of this Agreement or the application of such provision to other persons or circumstances shall not be affected thereby and shall be enforced to the greatest extent permitted by law.
7. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.
8. This Agreement may be executed in any number of counterparts, each of which shall be considered an original for all purposes.
9. The mailing addresses of the parties hereto, from which information concerning the outstanding indebtedness and security rights hereunder may be obtained, are as follows:

InterCoast Oil and Gas Company

\_\_\_\_\_  
Operator/Secured Party

7130 S. Lewis, Suite 700  
Tulsa, OK 74136

\_\_\_\_\_  
Non-Operator/Debtor

IN WITNESS WHEREOF, the parties to this Agreement have duly executed it on the day and year first written above.

ATTEST:

INTERCOAST OIL AND GAS COMPANY

BY: \_\_\_\_\_  
Randall E. Lawrence, Asst. Secretary

BY: \_\_\_\_\_  
Chris Girouard, Vice President - Land

ATTEST:

BY: \_\_\_\_\_

BY: \_\_\_\_\_

WITNESS:

BY: \_\_\_\_\_

BY: \_\_\_\_\_

STATE OF OKLAHOMA )  
 ) SS  
COUNTY OF TULSA )

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 199\_\_, by Chris Girouard, Vice President - Land of InterCoast Oil and Gas Company a Delaware corporation, on behalf of said corporation.

\_\_\_\_\_  
Notary Public

My Commission Expires:  
  
\_\_\_\_\_

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

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 199\_\_, by \_\_\_\_\_ a \_\_\_\_\_ corporation, on behalf of said corporation.

\_\_\_\_\_  
Notary Public

My Commission Expires:  
  
\_\_\_\_\_

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

Before me, the undersigned, a Notary Public, in and for said County and State, on this \_\_\_\_ day of \_\_\_\_\_, 199\_\_, personally appeared \_\_\_\_\_ personally known to be to be the identical person who executed the within and foregoing instrument, and acknowledged to me that he executed the same as his free and voluntary act and deed, for the uses and purposes therein set forth.

In witness whereof, I have hereunto set my official signature and affixed my official seal the day and year first above written.

\_\_\_\_\_  
Notary Public

My Commission Expires:  
  
\_\_\_\_\_

MARTIN YATES, III  
1912 - 1985  
FRANK W. YATES  
1936 - 1986



CHAIRMAN OF THE BOARD  
JOHN A. YATES  
PRESIDENT  
PEYTON YATES  
EXECUTIVE VICE PRESIDENT  
RANDY G. PATTERSON  
SECRETARY  
DENNIS G. KINSEY  
TREASURER

105 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

November 22, 1996

InterCoast Oil & Gas  
7130 S. Lewis Ave. - Suite 700  
Tulsa, OK 74136  
Attention: Mr. Rock Quinn

RE: Stonewall Area  
Township 20 South, Range 28 East  
Section 20: E/2  
Eddy County, New Mexico

Dear Rock:

On November 7, 1996, we met with you concerning the two wells proposed in Section 20-T20S-R28E. You proposed that both wells be drilled with one in the W/2 and the other in the E/2.

We reviewed this proposal with management and they agreed that this was the best solution. The only question raised was who should operate the well in the E/2. They suggested that the largest owner operate and, upon reviewing this with you, you indicated that this wasn't acceptable and that you wanted to operate.

Upon further discussion with management, we have decided to propose our own well on the E/2 and propose that Yates Petroleum Corporation operate. The reasons for this decision are as follows:

1. Yates is the largest owner in the E/2 with approximately 35%.
2. YPC has drilled and operated twenty-one (21) wells in the Stonewall Unit since 1973.
3. Several of the other owners in the Stonewall Unit have requested that YPC operate and will support YPC as Operator.
4. The Stonewall Unit area is very complex and as Operator, YPC is the most familiar with it and the most able to deal with the land and accounting work.
5. We agreed to your E/2-W/2 proposal but your decision to continue the N/2 force pooling contradicts this proposal.

We are preparing a well proposal and AFE and will be furnishing it to you shortly.

Very truly yours,

YATES PETROLEUM CORPORATION

Mecca Mauritsen  
Landman

MM:bn

MARTIN YATES, III  
1912-1983  
FRANK W. YATES  
1936-1986



105 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

J. F. YATES  
CHAIRMAN OF THE BOARD  
JOHN A. YATES  
PRESIDENT  
PEYTON YATES  
EXECUTIVE VICE PRESIDENT  
RANDY G. PATTERSON  
SECRETARY  
DENNIS G. KINSEY  
TREASURER

---

# Fax Cover Sheet

**To:** MR. ROCK QUINN  
**Company:** INTERCOAST OIL & GAS  
**Phone:**  
**Fax:** (918) 488-8182

**From:** MECCA MAURITSEN  
**Company:** Yates Petroleum Corporation  
**Phone:** 505-748-1471  
**Fax:** 505-748-4572

**Date:** 11-22-96  
**Pages including this cover page:** 2

**Comments:**

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[ TRANSMIT ]

NO.	DATE	TIME	DESTINATION STATION	PG.	DURATION	MODE	RESULT
4115	11-22	13:19	918 488 8182	2	0°01'13"	NORM.E	OK
				2	0°01'13"		



105 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

JOHN A. YATES  
PRESIDENT  
PEYTON YATES  
EXECUTIVE VICE PRESIDENT  
RANDY G. PATTERSON  
SECRETARY  
DENNIS G. KINSEY  
TREASURER

November 22, 1996

To: Working Interest Owners  
Addressee List Attached

**CERTIFIED MAIL**  
Return Receipt Requested

RE: Stonewall AQK St. Com #1  
Township 20 South, Range 28 East  
Section 20: E/2  
Eddy County, New Mexico

Gentlemen:

Yates Petroleum Corporation is proposing to drill the Stonewall AQK St. Com. #1 at a location of 990' FNL and 990' FEL of Section 20-20S-38E to test the Morrow formation. Enclosed for your review are two (2) copies of our AFE to drill.

If you wish to participate in the drilling of this well, please sign and return one (1) executed copy of the AFE within the thirty (30) days provided in the Operating Agreement. The parties not subject to the Operating Agreement will need to also execute a Limited Ratification to the Operating Agreement if they desire to participate in this well. A Ratification has been enclosed for those parties.

Should you have any questions, please call me at the above number.

Very truly yours,

**YATES PETROLEUM CORPORATION**

Mecca Mauritsen  
Landman

MM:bn  
enclosure(s)

1700 Broadway, Suite 2300  
Denver, CO 80290-2301

7130 S. Lewis Ave. - Suite 700  
Tulsa, OK 74136

PO Box 10626  
Midland, TX 79702-7626

Ernie Bello  
3325 Ala Akulikuli  
Honolulu, HI 96818-2215

Frances B. Bunn  
2493 Makiki Heights Drive  
Honolulu, HI 96822

Claremont Corporation  
PO Box 549  
Claremore, OK 74018

Devon Energy Corporation  
20 North Broadway, Suite 1500  
Oklahoma City, OK 73102-8260

Diamond Head Properties, L.P.  
PO Box 2127  
Midland, TX 79702-2127

J.W. Gendron  
1280 Encino Drive  
San Marion, CA 91108

David Goodnow  
230 Ridgefield Road  
Wilton, CT 06897

Hayes Properties, Inc.  
PO Box 51510  
Midland, TX 79710-1510

Edward H. Judson  
PO Box 3340  
Midland, TX 79702-3340

Joseph R. Hodge  
3815 Roxbury Ct.  
Colorado Springs, CO 80906

Sanford J. Hodge, III  
4324 Hanover Avenue  
Dallas, TX 75225

E.G. Holden Test. Trust  
2524 Union Street  
San Francisco, CA 94123

Mary Hudson Ard  
4808 Westridge Avenue  
Fort Worth, TX 76116

W.A. & E.R. Hudson, Inc.  
616 Texas Street  
Fort Worth, TX 76102-4612

Dr. Isaac A. Kawasaki  
734 Kalanipuu  
Honolulu, HI 96825

Betsy H. Keller  
2524 Union Street  
San Francisco, CA 94123

Kerr-McGee Corporation  
PO Box 25861  
Oklahoma City, OK 73125

Martin Living Trust  
400 W. Illinois, Suite 1120  
Midland, TX 79701

Charles Cline Moore  
138 Harvard Avenue  
Mill Valley, CA 94941

Unit Petroleum Corporation  
PO Box 702500  
Tulsa, Ok 74170-2500

Frederick Van Vranken, Jr.  
PO Box 264  
Jericho, NY 11753

Pennzoil Exp. & Prod. Company  
PO Box 50090  
Midland, TX 79710

Agnes Cluthe Oliver Trust  
Brown Bros. Harriman Trust Co.  
2001 Ross Avenue, Suite 1150  
Dallas, TX 75201

Adolph P. Schuman  
400 Sansome Street  
San Francisco, CA 94111

Space Building Corporation  
250 Cape Highway  
Route 44  
East Taunton, MA 02718

William B. Oliver Trust  
Brown Bros. Harriman Trust Co.  
2001 Ross Avenue, Suite 1150  
Dallas, TX 75201

Yates Petroleum Corporation  
Yates Drilling Company  
Abo Petroleum Corporation  
Myco Industries, Inc.  
105 South Fourth Street  
Artesia, NM 88210

LIMITED RATIFICATION OF OPERATING AGREEMENT

STATE OF NEW MEXICO )
:
COUNTY OF EDDY )

InterCoast Oil & Gas, is the owner of an interest in the leasehold estate in an oil and gas lease covering the following lands in the County and State named above:

Township 20 South, Range 28 East
Section 20: NE/4

A portion of these lands are subject to the Stonewall Unit Operating Agreement dated November 1, 1973, naming Yates Petroleum Corporation as Operator.

For adequate consideration, InterCoast Oil & Gas ratifies, affirms, and adopts the terms of the Stonewall Unit Operating Agreement and agrees that the interest that they own in these lands shall be subject to all of its terms and provisions only insofar as the Operating Agreement covers the E/2 of Section 20, Township 20 South, Range 28 East.

Executed this \_\_\_\_ day of \_\_\_\_\_, 1996 but effective December 1, 1996.

INTERCOAST OIL & GAS

By \_\_\_\_\_

7130 S. Lewis Avenue - Suite 700
Tulsa, Oklahoma 74136

STATE OF \_\_\_\_\_ )
:
COUNTY OF \_\_\_\_\_ )

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 1996 by \_\_\_\_\_ for InterCoast Oil & Gas, a \_\_\_\_\_ corporation on behalf of said corporation.

My commission expires: \_\_\_\_\_

\_\_\_\_\_  
Notary Public

LIMITED RATIFICATION OF OPERATING AGREEMENT

STATE OF NEW MEXICO )
:
COUNTY OF EDDY )

Diamond Head Properties, L.P., is the owner of an interest in the leasehold estate in an oil and gas lease covering the following lands in the County and State named above:

Township 20 South, Range 28 East
Section 20: NE/4

A portion of these lands are subject to the Stonewall Unit Operating Agreement dated November 1, 1973, naming Yates Petroleum Corporation as Operator.

For adequate consideration, Diamond Head Properties, L.P. ratifies, affirms, and adopts the terms of the Stonewall Unit Operating Agreement and agrees that the interest that they own in these lands shall be subject to all of its terms and provisions only insofar as the Operating Agreement covers the E/2 of Section 20, Township 20 South, Range 28 East.

Executed this \_\_\_\_ day of \_\_\_\_\_, 1996 but effective December 1, 1996.

DIAMOND HEAD PROPERTIES, L.P.

By \_\_\_\_\_

PO Box 2127
Midland, Texas 79702-2127

STATE OF \_\_\_\_\_ )
:
COUNTY OF \_\_\_\_\_ )

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 1996 by \_\_\_\_\_ for Diamond Head Properties, L.P., a \_\_\_\_\_ on behalf of said \_\_\_\_\_

My commission expires: \_\_\_\_\_

\_\_\_\_\_  
Notary Public

Is your RETURN ADDRESS completed on the reverse side?

**SENDER:**

- Complete items 1 and 4b. for additional services.
- Complete items 3, 4a, and 4b.
- Print your name and address on the reverse of this form so that we can return this card to you.
- Attach this form to the front of the mailpiece, or on the back if space does not permit.
- Write "Return Receipt Requested" on the mailpiece below the article number.
- The Return Receipt will show to whom the article was delivered and the date delivered.

I also wish to receive the following services (for an extra fee):

- 1.  Addressee's Address
- 2.  Restricted Delivery

Consult postmaster for fee.

3. Article Addressed to:

InterCoast Oil & Gas  
7130 S. Lewis Ave. - Suite 700  
Tulsa, OK 74136

4a. Article Number  
P 059 489 336

4b. Service Type

Registered  Certified  
 Express Mail  Insured  
 Return Receipt for Merchandise  COD

7. Date of Delivery  
NOV 25 1996

5. Received By: (Print Name)

8. Addressee's Address (Only if requested and fee is paid)

6. Signature: (Addressee or Agent)  
X Bob

Stonewall A Q K

Thank you for using Return Receipt Service.

# DIAMOND HEAD PROPERTIES, L.P.

Redfern Enterprises, Inc., General Partner

P.O. Box 2127  
Midland, TX 79702-2127

Telephone (915) 683-9137  
Facsimile (915) 682-5639

December 2, 1996

FAXED  
12/02/96

VIA FACSIMILE TO 505-748-4572

Ms. Mecca Mauritsen  
Yates Petroleum Corp.  
105 South Fourth Street  
Artesia, NM 88210

RECEIVED  
DEC 03 1996

Re: Section 20 T-20-S R-28-E  
Eddy County, NM

Dear Ms. Mauritsen:

Thank you for talking with us before Thanksgiving about proposed wells in Section 20.

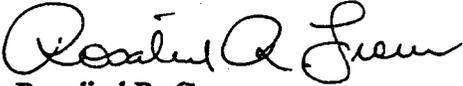
In that conversation, you stated to us that Yates intends to drill a well almost immediately in the NW/4 of Section 20 under the Stonewall Operating Agreement, and intends to drill a well in the NE/4 of Section 20 prior to the time that InterCoast's farmout from Kerr-McGee expires in mid-January of 1997. You stated that Yates intends to go to the Division meeting on December 5 with a request to dismiss the application for 1 well with N/2 spacing, and with a request instead for 2 wells with W/2 and E/S spacing with Yates as the operator of both wells.

We stated to you that we thought you could appreciate that we are caught in the middle between Yates and InterCoast in these competing proposals. We have no objections to N/2 spacing, nor do we object to E/2 and W/2 spacing. Our main goal is to assure ourselves that a well will be drilled utilizing our interest in the NE/4. Based on your representations to us, it is our understanding that Yates will do so.

If our understanding is not correct, and Yates will not drill a well which utilizes our interest in the NE/4 before the expiration of InterCoast's farmout from Kerr-McGee, please notify us immediately.

Also, please submit an Operating Agreement to us for review on the well in the NE/4.

Sincerely,

  
Rosalind R. Grover

cc: John A. Yates, Yates Petroleum Corporation  
Rock Quinn, InerCoast Oil & Gas

FRANK W. YATES  
1936 - 1986



105 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

PRESIDENT  
PEYTON YATES  
EXECUTIVE VICE PRESIDENT  
RANDY G. PATTERSON  
SECRETARY  
DENNIS G. KINSEY  
TREASURER

December 4, 1996

Diamond Head Properties, L.P.  
PO Box 2127  
Midland, Texas 79702-2127

Attention: Shirley Choate

RE: Operating Agreement  
Stonewall AQK St. Com. #1  
Township 20 South, Range 28 East  
Section 20: E/2  
Eddy County, New Mexico

Dear Ms. Choate:

Per our phone conversation, please find enclosed the revised pages to the Operating Agreement covering the captioned area.

Thank you.

Very truly yours,

YATES PETROLEUM CORPORATION

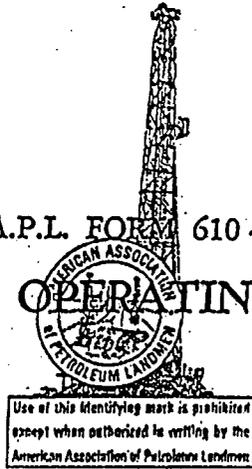
A handwritten signature in cursive script that reads "Mecca Mauritsen" followed by the initials "BN".

Mecca Mauritsen  
Landman

MM:bn  
enclosure(s)

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

MODEL FORM OPERATING AGREEMENT



STONEWALL AQK ST. COM #1

OPERATING AGREEMENT

DATED

December 2, 1996

OPERATOR YATES PETROLEUM CORPORATION

CONTRACT AREA TOWNSHIP 20 SOUTH, RANGE 28 EAST

SECTION 20: E/2

COUNTY OR PARISH OF EDDY STATE OF NEW MEXICO

B. Resignation or Removal of Operator and Selection of Successor:

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

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

C. Employees:

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

D. Drilling Contracts:

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

ARTICLE VI. DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the 1st day of May, 1997, Operator shall commence the drilling of a well for oil and gas at the following location:

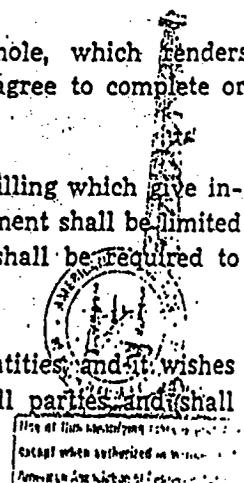
990 FNL & 990 FEL of Section 20  
Township 20 South, Range 28 East

and shall thereafter continue the drilling of the well with due diligence to adequately test the Morrow formation at approximately 11,500'.

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

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

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E.1. hereof.



ATTACHED TO AND MADE A PART OF OPERATING AGREEMENT DATED DECEMBER 2, 1996, BETWEEN YATES PETROLEUM CORPORATION, "OPERATOR" AND DIAMOND HEAD PROPERTIES, L. P., "NON-OPERATOR," COVERING LANDS LOCATED IN EDDY COUNTY, NEW MEXICO.

EXHIBIT "A"

I. Lands Subject to Agreement:

Township 20 South, Range 28 East  
Section 20: E/2  
Eddy County, New Mexico

II. Depth Restriction:

None

III. Percentage Interests of Parties Under the Agreement:

	INITIAL TEST WELL BEFORE PAYOUT	INITIAL TEST WELL AFTER PAYOUT & SUBSEQUENT WELLS
Yates Petroleum Corporation	17.433008 %	17.194978 %
Yates Drilling Company	7.741985	5.081685
Abo Petroleum Corporation	2.580662	1.693897
Myco Industries, Inc.	7.741985	5.081685
Diamond Head Properties, L.P.	23.416249	23.763639
Other Owners	<u>41.086111</u>	<u>47.184116</u>
	100.000000 %	100.000000 %

IV. Oil & Gas Leases Subject to Agreement:

1. Lessee: State of New Mexico

Original Lessee: Redfern Development Corporation 100.000000 %

Present Lessee: Kerr-McGee Corporation 100.000000 %

Expiration Date: HBP

Serial No. K-6599

Description: Township 20 South, Range 28 East  
Section 20: NE/4, NE/4SE/4

Net Acres: 200.00000

2. Lessee: State of New Mexico

Original Lessee: Pennzoil United, Inc. 100.000000 %

Present Lessee: Pennzoil Company 100.000000 %

Expiration Date: HBP

Serial No. L-1611

Description: Township 20 South, Range 28 East  
Section 20: NW/4SE/4, S/2SE/4

Net Acres: 120.00000

ATTACHED TO AND MADE A PART OF OPERATING AGREEMENT DATED DECEMBER 2, 1996, BETWEEN YATES PETROLEUM CORPORATION, "OPERATOR" AND DIAMOND HEAD PROPERTIES, L. P., "NON-OPERATOR," COVERING LANDS LOCATED IN EDDY COUNTY, NEW MEXICO.

**V. Addresses of Parties to which notices should be sent:**

Yates Petroleum Corporation  
Yates Drilling Company  
Abo Petroleum Corporation  
Myco Industries, Inc.  
105 South Fourth Street  
Artesia, NM 88210

Diamond Head Properties, L. P.  
P.O. Box 2127  
Midland, TX 79702-2127

## EXHIBIT " C "

Attached to and made a part of Operating Agreement dated December 2, 1996, between Yates Petroleum Corporation, "Operator" and Diamond Head Properties, L.P., "Non-Operator", covering lands located in Eddy County, New Mexico.

## ACCOUNTING PROCEDURE JOINT OPERATIONS

### I. GENERAL PROVISIONS

#### 1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

#### 2. Statement and Billings

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

#### 3. Advances and Payments by Non-Operators

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

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

#### 4. Adjustments

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

#### 5. Audits

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

#### 6. Approval by Non-Operators

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

# DIAMOND HEAD PROPERTIES, L.P.

Redfern Enterprises, Inc., General Partner

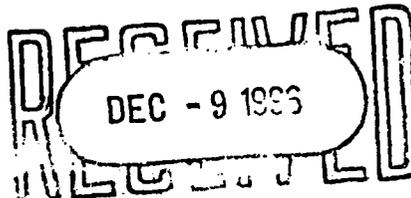
P.O. Box 2127  
Midland, TX 79702-2127

Telephone (915) 683-9137  
Facsimile (915) 682-5639

December 6, 1996

VIA FACSIMILE TO 505-748-4572

Ms. Mecca Mauritsen  
Yates Petroleum Corp.  
105 South Fourth Street  
Artesia, NM 88210



Re: Section 20 T-20-S R-28-E  
Eddy County, NM

Dear Ms. Mauritsen:

Thank you for the terms of the proposed Operating Agreement which you faxed to us.

While I have not had an opportunity to review all of it, and will have some comments about it next week, I want to clear up an apparent misunderstanding right away.

As I outlined to you in my letter of December 2, it is our understanding that Yates intends to drill the well in the NE/4 prior to the termination of InterCoast's farmout from Kerr-McGee. Yet in the proposed Operating Agreement under "Article VI A Initial Well", it states that Yates will commence the drilling of a well on or before May 1st, which is considerably beyond the terms of InterCoast's farmout.

I would like to get this clarified right away so that there is no misunderstanding about Yates' intentions. I would appreciate your faxing me a page which reflects the intentions of the parties.

Sincerely,

  
Rosalind R. Grover

cc: John A. Yates, Yates Petroleum Corporation  
Rock Quinn, InterCoast Oil & Gas

MARTIN YATES, III  
1912 - 1985  
FRANK W. YATES  
1936 - 1986



JORNAL YATES  
PRESIDENT  
PEYTON YATES  
EXECUTIVE VICE PRESIDENT  
RANDY G. PATTERSON  
SECRETARY  
DENNIS G. KINSEY  
TREASURER

105 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

December 12, 1996

Diamond Head Properties, L.P.  
P.O. Box 2127  
Midland, TX 79702-2127

Attention: Ms. Rosalind R. Grover

Re: Stonewall AQK St. Com. #1  
Township 20 South, Range 28 East  
Section 20: E/2  
Eddy County, New Mexico

Dear Ms. Grover:

As I discussed with Ms. Shirley Choate on Monday, Yates Petroleum will spud the captioned well by January 17, 1997 if named Operator pursuant to the hearing on December 19, 1996.

The only reason we put a later date is that the Operating Agreement terminates on that date if the well is not spud. There are two factors that can make this occur. One is that we do not get an order in time. The second is that if we are named Operator, InterCoast has the right to file for a De Novo hearing which means the case will be heard again at a later date. It is very unlikely that it will be heard before January 17th. Of course, we will assume that if InterCoast files for a De Novo hearing that they will have been granted an extension to their farmout from Kerr-McGee.

I have enclosed a new page 4 with the January 17, 1997 date inserted into it. We will be willing to use this page as long as are able to discuss a new date with you if for the above reasons we are unable to spud the well on time.

As I have said, we understand your position in this matter and really appreciate your discussing it with us. If you have any further questions, please give me a call.

Thank you.

Very truly yours,

YATES PETROLEUM CORPORATION

Mecca Mauritsen  
Landman

MM:bn  
enclosure(s)

1 B. Resignation or Removal of Operator and Selection of Successor:  
2

3 1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice  
4 thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the  
5 Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any  
6 action by Non-Operator, except the selection of a successor. Operator may be removed if it fails or  
7 refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership,  
8 by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on owner-  
9 ship as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting  
10 interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M.  
11 on the first day of the calendar month following the expiration of ninety (90) days after the giving of  
12 notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor  
13 Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effect-  
14 ive date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of  
15 a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary,  
16 parent or successor corporation shall not be the basis for removal of Operator.  
17

18 2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Op-  
19 erator shall be selected by the Parties. The successor Operator shall be selected from the parties owning  
20 an interest in the Contract Area at the time such successor Operator is selected. If the Operator that  
21 is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the  
22 affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown  
23 on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the  
24 Operator that was removed.  
25

26 C. Employees:  
27

28 The number of employees used by Operator in conducting operations hereunder, their selection,  
29 and the hours of labor and the compensation for services performed, shall be determined by Operator,  
30 and all such employees shall be the employees of Operator.  
31

32 D. Drilling Contracts:  
33

34 All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual  
35 rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the  
36 drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate  
37 of such charges shall be agreed upon by the parties in writing before drilling operations are com-  
38 menced, and such work shall be performed by Operator under the same terms and conditions as are  
39 customary and usual in the area in contracts of independent contractors who are doing work of a sim-  
40 ilar nature.  
41

42 ARTICLE VI.  
43 DRILLING AND DEVELOPMENT  
44

45 A. Initial Well:  
46

47 On or before the 17th day of January, 1997, Operator shall commence the drill-  
48 ing of a well for oil and gas at the following location:

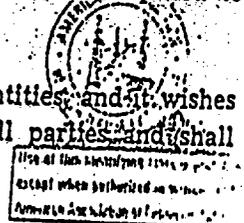
49 990 FNL & 990 FEL of Section 20  
50 Township 20 South, Range 28 East  
51

52  
53 and shall thereafter continue the drilling of the well with due diligence to adequately test the  
54 Morrow formation at approximately 11,500'.  
55

56  
57  
58 unless granite or other practically impenetrable substance or condition in the hole, which renders  
59 further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or  
60 abandon the well at a lesser depth.  
61

62 Operator shall make reasonable tests of all formations encountered during drilling which give in-  
63 dication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited  
64 in its application to a specific formation or formations, in which event Operator shall be required to  
65 test only the formation or formations to which this agreement may apply.  
66

67 If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes  
68 to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall  
69 plug and abandon same as provided in Article VI.E.1, hereof.  
70



December 12, 1996

Ms. Mecca Mauritsen  
Yates Petroleum Corporation  
105 South Fourth Street  
Artesia, NM 88210

RE: State of New Mexico 20-1 Well  
Angell Ranch Prospect  
Section 20-20S-28E  
Eddy County, NM

Dear Mecca:

I am in receipt of your letter dated November 22, 1996, advising that Yates would propose their own well in the E/2 of Section 20, with Yates as operator. This comes to us as a surprise, especially in view of the impression we received from Yates at our November 7th meeting in Artesia. You will recall that Yates was opposed to the drilling of our proposed test well in the NE/4 and we agreed to compromise and reorient our proposed drilling unit from a N/2 unit to an E/2 unit so as to accommodate your preferred drilling location in the NW/4. This approach would allow both Yates and InterCoast to drill and operate each of their respective prospects and we have proceeded accordingly.

It wasn't until November 19th when Yates' interest in operating was first mentioned to InterCoast, and even then you did not think it would be a sticking point.

Mecca, we do not question Yates' qualification as a competent operator; but InterCoast generated the prospect, was the first to propose the well and attempted to address all of Yates' concerns as a working interest partner.

In view of the fact that I have not been provided an AFE or formal well proposal to your proposed well in the E/2, I question whether Yates is prepared to represent InterCoast's best interests by commencing the actual drilling of the well in accordance with our Kerr-McGee farmout agreement.

Please do not hesitate to contact me at (918) 491-4176 to discuss this matter.

Very truly yours,

*Rock A. Quinn*

Rock A. Quinn  
Senior Landman

RAQ:rkw

mm121296

---

# Facsimile Cover Sheet

**To:** Mecca Mauritsen  
**Company:** Yates Petroleum Corporation  
**Phone:** 505/748-1471  
**Fax:** 505/748-4572

**From:** Rock Quinn  
**Company:** InterCoast Oil and Gas Company  
(formerly named Medallion  
Production Company)  
**Phone:** 918+488-8283  
**Fax:** 918+488-8182

**Date:** 12/13/96  
**Pages including this  
cover page:** 3

**Comments:**

MARTIN YATES, III  
1912 - 1985  
FRANK W. YATES  
1936 - 1986



105 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

CHAIRMAN OF THE BOARD  
JOHN A. YATES  
PRESIDENT  
PEYTON YATES  
EXECUTIVE VICE PRESIDENT  
RANDY G. PATTERSON  
SECRETARY  
DENNIS G. KINSEY  
TREASURER

December 13, 1996

InterCoast Oil and Gas  
7130 South Lewis Avenue - Suite 700  
Tulsa, Oklahoma 74136  
Attention: Rock Quinn

RE: Stonewall Area  
Township 20 South, Range 28 East  
Section 20: All  
Eddy County, New Mexico

Dear Rock:

I have received your letter of December 12, 1996 and upon review, it appears there are some misconceptions and inaccuracies regarding our dealings with you and our intentions regarding Section 20-20S-28E. These inaccuracies will be addressed at the hearing next week.

The one issue which can be settled is your statement that you have not received a well proposal from us on the E/2 of Section 20. You, along with all the other owners in this acreage, were sent a letter dated November 22, 1996, proposing the drilling of the Stonewall AQK St. Com. #1 along with an AFE to drill this well. We have a certified receipt which indicates InterCoast received this proposal on November 25, 1996.

If InterCoast will dismiss both their pooling cases and join with Yates in our proposal, we will commence the drilling of this well before January 17, 1997 and protect your rights under your farmout from Kerr-McGee. Please contact me at your earliest convenience if you wish to discuss this matter.

Thank you.

Very truly yours,

YATES PETROLEUM CORPORATION

Mecca Mauritsen  
Landman

MM:bn

MARTIN YATES, III  
1912 - 1985  
FRANK W. YATES  
1936 - 1986



105 SOUTH FOURTH STREET  
ARTESIA, NEW MEXICO 88210  
TELEPHONE (505) 748-1471

S. P. YATES  
CHAIRMAN OF THE BOARD  
JOHN A. YATES  
PRESIDENT  
PEYTON YATES  
EXECUTIVE VICE PRESIDENT  
RANDY G. PATTERSON  
SECRETARY  
DENNIS G. KINSEY  
TREASURER

---

# Fax Cover Sheet

**To:** Rock Quinn  
**Company:** InterCoast  
**Phone:**  
**Fax:** (918) 488-8182

**From:** Mecca Mauritsen  
**Company:** Yates Petroleum Corporation  
**Phone:** 505-748-1471  
**Fax:** 505-748-4572

**Date:** 12-13-96  
**Pages including this cover page:** 2

**Comments:**

Stonewall Area - Eddy County, New Mexico

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[ TRANSMIT ]

NO.	DATE	TIME	DESTINATION STATION	PG.	DURATION	MODE	RESULT
4399	12-13	14:01	918 488 8182	2	0'01'13"	NORM.E	OK
				2	0'01'13"		