El Paso Natural Gas Company

El Paso, Texas

October 24, 1956

Oil Conservation Commission
of the State of New Mexico
Capitol Annex Building
Santa Fe, New Mexico

Re: Bonds Pool Unit #1 Well
W/2 Sec. 13, 32-N, 10-W

Gentlemen:

We transmit herewith two (2) copies of an Operating Agreement and two (2) copies of a Communitization Agreement for the captioned well, which have been executed by Pacific Northwest Pipeline Corporation and El Paso Natural Gas Company.

The W/2 of Section 13, Township 32 North, Range 10 West was pooled pursuant to Order No. R-795 of the Oil Conservation Commission of the State of New Mexico. Pacific Northwest Pipeline Corporation elected to be governed by sub-paragraph 8(a) of said order, the Yager group elected to be governed by sub-paragraph 8(b) of said order, and Dave Clark made no election pursuant to said order. The Operating Agreement reflects the allocation of costs, the allocation of proceeds prior to El Paso's recovering 125% of the costs attributable to the Yager group and Dave Clark, and the allocation of production subsequent to El Paso's recovering said costs.

We respectfully request that you furnish us with an approved copy of each of these agreements, or with whatever evidence you deem necessary to indicate that the instruments have been filed with the Oil Conservation Commission of the State of New Mexico. The Communitization Agreement has been filed for record in San Juan County, New Mexico, and filed for approval with the United States Geological Survey.

Very truly yours,

Joe M. Cherry
Area Landman
Lease Department

JMC:pb
Encls.

NM 4440
NM 4441
NM 4445

Contract No._____

COMMUNITIZATION AGREEMENT
Bonds Pool Unit #1 Well

THIS AGREEMENT entered into as of the 16th day of July, 1956, by and between the parties subscribing, ratifying or consenting hereto, such parties being hereinafter referred to as "parties hereto";

W I T N E S S E T H:

WHEREAS, the Act of February 25, 1920, 41 Stat. 437, as amended by the Act of August 8, 1946, 60 Stat. 950, 30 U.S.C., Secs. 181, et seq., authorizes communitization or drilling agreements communitizing or pooling a federal oil and gas lease, or any portion thereof, with other lands, whether or not owned by the United States, when separate tracts under such federal lease cannot be independently developed and operated in conformity with an established well-spacing program for the field or area and such communitization or pooling is determined to be in the public interest; and

WHEREAS, the parties hereto own working, royalty or other leasehold interests, or operating rights under the oil and gas leases and lands subject to this agreement which cannot be independently developed and operated in conformity with the well-spacing program established for the field or area in which said lands are located; and

WHEREAS, the parties hereto desire to communitize and pool their respective mineral interests in lands subject to this agreement for the purpose of developing and producing dry gas and associated liquid hydrocarbons in accordance with the terms and conditions of this agreement:

NOW, THEREFORE, in consideration of the premises and the mutual advantages to the parties hereto, it is mutually covenanted and agreed by and between the parties hereto as follows:

1. The lands covered by this agreement (hereinafter referred to as "communitized area") are described, as follows:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: W/2
containing 320.00 acres,

more or less, and this agreement shall extend to and include only the Mesaverde formation underlying said lands and the dry gas and associated liquid hydrocarbons

NM 4440
NM 4441
NM 4445
(JWC)

(hereinafter referred to as "communitized substances") producible from such formation.

2. Attached hereto, and made a part of this agreement for all purposes, is Exhibit A designating the operator of the communitized area and showing the acreage, and the ownership of oil and gas interests in all lands within the communitized area, and the authorization, if any, for communitizing or pooling any patented or fee lands within the communitized area.

3. All matters of operation shall be governed by the operator under and pursuant to the terms and provisions of this agreement. A successor operator may be designated by the owners of the working interest in the communitized area and four (4) executed copies of a Designation of Successor Operator shall be filed with the Oil and Gas Supervisor.

4. Operator shall furnish the Secretary of the Interior, or his authorized representative, with a log and history of any well drilled on the communitized area, monthly reports of operations, statements of gas sales and royalties and such other reports as are deemed necessary to compute monthly the royalty due the United States, as specified in the applicable oil and gas operating regulations. Operator, in operations hereunder, shall not discriminate against any employee or applicant for employment, because of race, creed, color or national origin and an identical provision shall be incorporated in all sub-contracts.

5. The communitized area shall be developed and operated as an entirety with the understanding and agreement between the parties hereto that all communitized substances produced therefrom shall be allocated among the leaseholds comprising said area in the proportion that the acreage interest of each leasehold bears to the entire acreage interest committed to this agreement.

6. The royalties payable on communitized substances allocated to the individual leases comprising the communitized area and the rentals provided for in said leases shall be determined and paid on the basis prescribed in each of the individual leases. Payment of rentals under the terms of leases subject to this agreement shall not be affected by this agreement except as provided for under the terms and provisions of said leases or as may herein be otherwise provided. Except as herein modified and changed, the oil and gas leases subject to this agreement shall remain in full force and effect as originally made and issued.

7. There shall be no obligation on the lessees to offset any dry gas well or wells completed in the same formation covered by this agreement on separate component tracts into which the communitized area is now or may hereafter be divided, nor

shall any lessee be required to measure separately communitized substances by reason of the diverse ownership thereof, but the lessees hereto shall not be released from their obligation to protect said communitized area from drainage of communitized substances by a well or wells which may be drilled offsetting said area.

8. The commencement, completion, continued operation or production of a well or wells for communitized substances on the communitized area shall be construed and considered as the commencement, completion, continued operation or production on each and all of the lands within and comprising said communitized area, and operations or production pursuant to this agreement shall be deemed to be operations or production as to each lease committed hereto.

9. Production of communitized substances and disposal thereof shall be in conformity with allocation, allotments and quotas made or fixed by any duly authorized person or regulatory body under applicable Federal or State statutes. This agreement shall be subject to all applicable Federal and State laws or executive orders, rules and regulations, and no party hereto shall suffer a forfeiture or be liable in damages for failure to comply with any of the provisions of this agreement if such compliance is prevented by, or if such failure results from, compliance with any such laws, orders, rules or regulations.

10. This agreement shall be effective as of the date hereof upon execution by the necessary parties, notwithstanding the date of execution, and upon approval by the Secretary of the Interior, or his duly authorized representative, and shall remain in force and effect for a period of two (2) years and so long thereafter as communitized substances are produced from the communitized area in paying quantities; provided, that prior to production in paying quantities from the communitized area and upon fulfillment of all requirements of the Secretary of the Interior, or his duly authorized representatives, with respect to any dry hole or abandoned well, this agreement may be terminated at any time by mutual agreement of the parties hereto.

11. It is agreed between the parties hereto that the Secretary of the Interior, or his duly authorized representative, shall have the right of supervision over all operations within the communitized area to the same extent and degree as provided in the oil and gas leases under which the United States of America is Lessor, and in the applicable oil and gas regulations of the Department of the Interior.

12. In connection with the performance of work under this agreement, the operator agrees not to discriminate against any employee or applicant for employment because of race, religion, color, or national origin. The aforesaid provision shall

include, but not be limited to, the following: employment, upgrading, demotion, or transfer; recruitment or recruitment advertising, layoff, or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. The operator agrees to post hereafter in conspicuous places, available for employees and applicants for employment, notices to be provided by the contracting officer setting forth the provisions of the nondiscrimination clause.

The operator agrees to insert the foregoing provision in all subcontracts hereunder, except subcontracts for standard commercial supplies or raw materials.

13. The covenants herein shall be construed to be covenants running with the land with respect to the communitized interests of the parties hereto and their successors in interest until this agreement terminates, and any grant, transfer or conveyance of any such land or interest subject hereto, whether voluntary or not, shall be and hereby is conditioned upon the assumption of all obligations hereunder by the grantee, transferee or other successor in interest, and as to Federal land shall be subject to the approval of the Secretary of the Interior.

14. This agreement shall be binding upon the parties hereto and shall extend to and be binding upon their respective heirs, executors, administrators, successors and assigns.

15. This agreement may be executed in any number of counterparts, no one of which needs to be executed by all parties, or may be ratified or consented to by separate instrument, in writing, specifically referring hereto, and shall be binding upon all parties who have executed such counterpart, ratification or consent hereto with the same force and effect as if all parties had signed the same document.

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

ATTEST:

A. C. Martich
Assistant Secretary

EL PASO NATURAL GAS COMPANY

By _____
Vice President

RAH
BRH

ATTEST:

Assistant Secretary

FORM APPROVED
Simms & Modrall
by

PACIFIC NORTHWEST PIPELINE CORPORATION

By _____ Vice President

Saul A. Yager

Marian Yager

M. E. Gimp

Morris Mizel

Flora Mizel

Sam Mizel

STATE OF TEXAS)
)
COUNTY OF EL PASO)

On this 22 day of October, 1956, before me appeared H. F. Steen, to me personally known, who, being by me duly sworn did say that he is the Vice President of EL PASO NATURAL GAS COMPANY, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation and that said instrument was signed and sealed in behalf of said corporation by authority of its board of directors, and said H. F. Steen acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

My commission expires:

MARTHA B. IVEY,
Notary Public, in and for El Paso County, Texas
My commission expires June 1, 1957

Martha B. Ivey
Notary Public

STATE OF)
)
COUNTY OF)

On this ___ day of _____, 1956, before me appeared _____, to me personally known, who, being by me duly sworn did say that he is the Vice President of PACIFIC NORTHWEST PIPELINE CORPORATION, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation and that said instrument was signed and sealed in behalf of said corporation by authority of its board of directors, and said _____ acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

My commission expires:

_____

Notary Public

EXHIBIT A

To a Communitization Agreement dated July 16, 1956, embracing the following described land in San Juan County, New Mexico, to-wit:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: W/2

Operator of Communitized Area: El Paso Natural Gas Company

Well Name: Bonds Pool Unit #1

Description of Leases Committed

Tract No. 1

Lease Committed by: El Paso Natural Gas Company

Lessor: Mary Catherine Heizer

Original Lessee: John F. Sullivan

Lessees of Record: El Paso Natural Gas Company and John F. Sullivan, et al

Recordation Data: Book 151, Page 446, Official Records of San Juan County, New Mexico

Lease Date: June 27, 1950

Description of Lands Committed:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: NE/4 NW/4, North 7.5 acres of SE/4 NW/4
containing 47.50 acres, more or less.

Pooling Clause on Lease:

"17. Lessee is hereby given the right at its option, at any time and from time to time, to pool or unitize all or any part or parts of the above described land with other land, lease, or leases in the immediate vicinity thereof, such pooling to be into units not exceeding the minimum size tract on which a well may be drilled under laws, rules, or regulations in force at the time of such pooling or unitization; provided, however, that such units may exceed such minimum by not more than ten acres if such excess is necessary in order to conform to ownership subdivisions or lease lines. Lessee shall exercise said option, as to each desired unit, by executing and recording an instrument identifying the unitized area. Any well drilled or operations conducted on any part of each such unit shall be considered a well drilled or operations conducted under this lease, and there shall be allocated to the portion of the above described land included in any such unit such proportion of the actual production from all wells on such unit as lessor's interest, if any, in such portion, computed on an acreage basis, bears to the entire acreage of such unit. And it is understood and agreed that the production so allocated shall be considered for all purposes, including the payment or delivery of royalty, to be the entire production from the portion of the above described land included in such unit of the same manner as though produced from the above described land under the terms of this lease."

Tract No. 2

Lease Committed by: El Paso Natural Gas Company

Lessor: Robert J. Doughtie and wife, Edna O. Doughtie

Original Lessee: John F. Sullivan

Lessees of Record: El Paso Natural Gas Company and John F. Sullivan

Recordation Data: Book 151, Page 444, Official Records of San Juan County, New Mexico

Lease Date: June 26, 1950

Description of Lands Committed:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: The South 32½ acres of the $SE\frac{1}{4}NW\frac{1}{4}$ and the North 47 acres of the $N\frac{1}{2}SW\frac{1}{4}$
containing 79.50 acres, more or less

Pooling Clause on Lease:

"17. Lessee is hereby given the right at its option, at any time and from time to time, to pool or unitize all or any part or parts of the above described land with other land, lease, or leases in the immediate vicinity thereof, such pooling to be into units not exceeding the minimum size tract on which a well may be drilled under laws, rules, or regulations in force at the time of such pooling or unitization; provided however, that such units may exceed such minimum by not more than ten acres if such excess is necessary in order to conform to ownership subdivisions or lease lines. Lessee shall exercise said option, as to each desired unit, by executing and recording an instrument identifying the unitized area. Any well drilled or operations conducted on any part of each such unit shall be considered a well drilled or operations conducted under this lease, and there shall be allocated to the portion of the above described land included in any such unit such proportion of the actual production from all wells on such unit as lessor's interest, if any, in such portion, computed on an acreage basis, bears to the entire acreage of such unit. And it is understood and agreed that the production so allocated shall be considered for all purposes, including the payment or delivery of royalty, to be the entire production from the portion of the above described land included in such unit in the same manner as though produced from the above described land under the terms of this lease."

Tract No. 3

Lease Committed by: El Paso Natural Gas Company

Lessors: Robert L. Gaston and wife, Edith Gaston

Original Lessee: John F. Sullivan

Lessees of Record: El Paso Natural Gas Company and John F. Sullivan

Recordation Data: Book 151, Page 452, Official Records of San Juan County, New Mexico

Lease Date: September 16, 1950

Description of Lands Committed:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: $SE\frac{1}{4}SW\frac{1}{4}$, East 40 rods of the South 30 rods of the $NE\frac{1}{4}SW\frac{1}{4}$
containing 46.24 acres, more or less

Pooling Clause on Lease:

"17. Lessee is hereby given the right at its option, at any time and from time to time, to pool or unitize all or any part or parts of the above described land with other land, lease, or leases in the immediate vicinity thereof, such pooling to be into units not exceeding the minimum size tract on which a well may be drilled under laws, rules, or regulations in force at the time of such pooling or unitization: provided, however, that such units may exceed such minimum by not more than ten acres if such excess is necessary in order to conform to ownership subdivisions or lease lines. Lessee shall exercise said option, as to each desired unit, by executing and recording an instrument identifying the unitized area. Any well drilled or operations conducted on any part of each such unit shall be considered a well drilled or operations conducted under this lease, and there shall be allocated to the portion of the above described land included in any such unit such proportion of the actual production from all wells on such unit as lessor's interest, if any, in such portion, computed on an acreage basis, bears to the entire acreage of such unit. And it is understood and agreed that the production so allocated shall be considered for all purposes, including the payment or delivery of royalty, to be the entire production from the portion of the above described land included in such unit in the same manner as though produced from the above described land under the terms of this lease."

Tract No. 4

Lease Committed by: Pacific Northwest Pipeline Corporation

Lessor: United States of America

Original Lessee: Hazel L. Gentle

Lessee of Record: Pacific Northwest Pipeline Corporation

Serial Number of Lease: NM 012648

Lease Date: September 1, 1949

Description of Lands Committed:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: $SW\frac{1}{4}NW\frac{1}{4}$
containing 40.00 acres, more or less

Pacific's File No.: 77450

Tract No. 5

Lease Committed by: Pacific Northwest Pipeline Corporation

Lessors: Edward E. Miller and Lena A. Miller, his wife

Original Lessee: Phillips Petroleum Company

Lessee of Record: Pacific Northwest Pipeline Corporation

Recordation Data: Book 212, Page 62, Official Records of San Juan County, New Mexico

Lease Date: April 22, 1953

Description of Lands Committed:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: A strip of land thirty (30) rods wide off the South Side of the North Half of the Southwest Quarter ($N\frac{1}{2}SW\frac{1}{4}$), Section fifteen (S.15), Township thirty-two (T.32) of Range Ten West (R.10W), N.M.P.M. containing thirty acres, more or less.
Excepting However - the existing right-of-way of the Denver & Rio Grande Railroad Company and the right-of-way of State Highway 550, and
Excepting However - the East forty (40) rods in width off said thirty (30) acres, more or less, said east forty (40) rods being a part of the Northeast Quarter of the Southwest Quarter ($NE\frac{1}{4}SW\frac{1}{4}$) of said Section Fifteen (S.15), and
Excepting However - all that part of the above described thirty (30) acres more or less, lying west of the right-of-way of said State Highway 550, said tract containing three (3) acres, more or less.
containing 16.88 acres, more or less

Pooling Clause on Lease:

"Lessee shall have the right to unitize, pool, or combine all or any part of the above described lands with other lands in the same general area by entering into a cooperative or unit plan of development or operation approved by any governmental authority and, from time to time, with like approval, to modify, change or terminate any such plan or agreement and, in such event, the terms, conditions and provisions of this lease shall be deemed modified to conform to the terms, conditions, and provisions of such approved cooperative or unit plan of development or operation and, particularly, all drilling and development requirements of this lease, express or implied, shall be satisfied by compliance with the drilling and development requirements of such plan or agreement, and this lease shall not terminate or expire during the life of such plan or agreement. In the event that said above described lands or any part thereof, shall hereafter be operated under any such cooperative or unit plan of development or operation whereby the production therefrom is allocated to different portions of the land covered by said plan, then the production allocated to any particular tract of land shall, for the purpose of computing the royalties to be paid hereunder to lessor, be regarded as having been produced from the particular tract of land to which it is allocated and not to any other tract of land; and the royalty payments to be made hereunder to lessor shall be based upon production only as so allocated. Lessor shall formally express lessor's consent to any cooperative or unit plan of development or operation adopted by lessee and approved by any governmental agency by executing the same upon request of lessee."

Pacific's File No.: 77198

Tract No. 6

Lease Committed by: Pacific Northwest Pipeline Corporation

Lessors: Katherine Hendricks, a widow, Josephine Hendricks Bonds and Ed Bonds, her husband, Gladys Hendricks McCarville and J. E. McCarville, her husband, the said Katherine Hendricks, Josephine Hendricks Bonds and Gladys Hendricks McCarville being the sole heirs of E. B. Hendricks, deceased.

Original Lessee: H. C. Wynne

Lessee of Record: Pacific Northwest Pipeline Corporation

Recordation Data: Book 168, Page 31, Official Records of San Juan County, New Mexico

Lease Date: December 11, 1951

Description of Lands Committed:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: $SW\frac{1}{4}SW\frac{1}{4}$ (except 1.74 acres, more or less being the right-of-way of the Denver & Rio Grande Western Railroad Co.) containing 38.26 acres, more or less

Pooling Clause on Lease:

"9. As to the gas leasehold estate hereby granted (excluding casinghead gas produced from oil wells), lessee is expressly granted the right and privilege to consolidate said gas leasehold with any other adjacent or contiguous gas leasehold estates to form a consolidated gas leasehold estate and in the event lessee exercises the right and privilege of consolidation as herein granted, the consolidated gas leasehold estate shall be deemed, treated and operated in the same manner as though the entire consolidated leasehold estate were originally covered by and included in this lease, and all royalties which shall accrue on gas (excluding casinghead gas produced from oil wells), produced and marketed from the consolidated estate, including all royalties payable hereunder, shall be prorated and paid to the lessors of the various tracts included in the consolidated estate in the same proportion that the acreage of each said lessor bears to the total acreage of the consolidated estate, and a producing gas well on any portion of the consolidated estate shall operate to continue the oil and gas leasehold estate hereby granted so long as gas is produced therefrom.

17. Under Paragraph 9 hereof a drilling unit shall not exceed 160 acres in area for a Pictured Cliffs formation well, nor exceed 320 acres in area for a Mesaverde formation well."

Pacific's File No.: 73297

Tract No. 7

Lease Committed by: Pacific Northwest Pipeline Corporation

Lessor: Denver & Rio Grande Western Railroad Company

Original Lessee: Phillips Petroleum Company

Lessee of Record: Pacific Northwest Pipeline Corporation

Recordation Data: Book 208, Page 208, Official Records of San Juan County, New Mexico

Lease Date: December 24, 1952

Description of Lands Committed:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: All of the right of way of the Denver and Rio Grande Western Railroad Company for the main tract of its Farmington Branch near Cedar Hill, San Juan County, New Mexico, within the southwest quarter of the southwest quarter of Section 15, Township 32 North, Range 10 West, New Mexico Principal Meridian, said right of way being 50 feet wide on each side of the center line of said main tract
containing 1.74 acres, more or less

Pooling Clause on Lease:

"..... with the right and permission granted the Lessee to pool or combine all or any portion of the Railroad Lands with adjacent lands into drilling units in order to properly develop and operate the premises for the sole and only purpose of obtaining the oil and gas therefrom. Lessee shall execute in writing an instrument identifying and describing any drilling unit or units created hereunder and shall mail same, together with map showing such drilling unit or units, to the Railroad Company; provided, however, that no drilling unit so created shall exceed three hundred twenty (320) acre units on gas production from Mesa Verde formation or lower, one hundred sixty (160) acre units on gas production from formation shallower than said Mesa Verde formation, and forty (40) acre units on oil production but provided further that if the spacing regulations of the Oil Conservation Commission of the State of New Mexico or any governmental agency, state of federal, shall prescribe a spacing pattern or shall allocate a producing allowable based in whole or in part on acreage per well, then the unit or units herein contemplated may have the maximum surface acreage content so prescribed or allocated."

Pacific's File No.: 73297-A

Tract No. 8

Lease Committed by: Pacific Northwest Pipeline Corporation

Lessor: Denver & Rio Grande Western Railroad Company

Original Lessee: Phillips Petroleum Company

Lessee of Record: Pacific Northwest Pipeline Corporation

Recordation Data: Book 220, Page 45, Official Records of San Juan County, New Mexico

Lease Date: June 1, 1953

Description of Lands Committed:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: All of the 100-foot wide right of way of The Denver and Rio Grande Western Railroad Company for the main tract of its Farmington Branch near Cedar Hill, San Juan County, New Mexico,

Description of Lands Committed: (Continued)

lying within the southeast quarter of the northwest quarter, the northeast quarter of the southwest quarter, and the southeast quarter of the southwest quarter of Section 15, Township 32 North, Range 10 West, New Mexico Principal Meridian
containing 6.88 acres, more or less

Pooling Clause on Lease:

"..... with the right and permission granted the Lessee to pool or combine all or any portion of the Railroad Lands with adjacent lands into drilling units in order to properly develop and operate the premises for the sole and only purpose of obtaining the oil and gas therefrom. Lessee shall execute in writing an instrument identifying and describing any drilling unit or units created hereunder and shall mail same, together with map showing such drilling unit or units, to the Railroad Company; provided, however, that no drilling unit so created shall exceed three hundred twenty (320) acre units on gas production from Mesa Verde formation or lower, one hundred sixty (160) acre units on gas production from formation shallower than said Mesa Verde formation, and forty (40) acre units on oil production but provided further that if the spacing regulations of the Oil Conservation Commission of the State of New Mexico or any governmental agency, state or federal, shall prescribe a spacing pattern or shall allocate a producing allowable based in whole or in part on acreage per well, then the unit or units herein contemplated may have the maximum surface acreage content so prescribed or allocated."

Pacific's File No.: 78705

Description of Mineral Interests Committed

Tract No. 9

Mineral Interest Committed by: Saul A. Yager, et al

Description of Lands Committed:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: $NW\frac{1}{4}NW\frac{1}{4}$
containing 40.00 acres, more or less

Tract No. 10

Mineral Interest Committed by: Dave Clark

Description of Lands Committed:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: A tract of land situated in the South 30 rods of $N\frac{1}{2}SW\frac{1}{4}$ Section 15, Township 32 North, Range 10 West, N.M.P.M., lying west of the right-of-way of State Highway 550
containing 3.00 acres, more or less

OPERATING AGREEMENT
Bonds Pool Unit #1 Well

THIS AGREEMENT, made and entered into this 16th day of July, 1956, by and between EL PASO NATURAL GAS COMPANY, a Delaware corporation, whose address is P. O. Box 1492, El Paso, Texas, hereinafter sometimes referred to as "Operator"; and PACIFIC NORTHWEST PIPELINE CORPORATION, a corporation, whose address is P. O. Box 1526, Salt Lake City, Utah, hereinafter sometimes referred to as "Non-Operator";

W I T N E S S E T H:

WHEREAS, the parties hereto are the owners of certain Oil and Gas Leases, which leases cover, among other lands, the following described land in San Juan County, New Mexico, to-wit:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: W/2
containing 320.00 acres, more or less; and

WHEREAS, Saul A. Yager, et al, of Tulsa, Oklahoma, are the owners of all the oil, gas and other minerals underlying the following described lands located in San Juan County, New Mexico, to-wit:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: NW/4 NW/4
containing 40.00 acres, more or less; and

WHEREAS, Dave Clark, of Aztec, New Mexico, is the owner of all the oil, gas and other minerals underlying the following described lands located in San Juan County, New Mexico, to-wit:

Township 32 North, Range 10 West, N.M.P.M.
Section 15: A tract of land situated in the South 30 rods of N/2 SW/4 Section 15, Township 32 North, Range 10 West, N.M.P.M., lying west of the right-of-way of State Highway 550
containing 3.00 acres, more or less; and

WHEREAS, Saul A. Yager, et al, were willing to communitize their acreage with that of Operator, El Paso Natural Gas Company, and Non-Operator, Pacific Northwest Pipeline Corporation, to form a drilling and proration unit consisting of the W/2 of Section 15, Township 32 North, Range 10 West, N.M.P.M., but were unwilling to pay their share of the drilling costs in cash, proposing instead that their proportionate share of the drilling costs be taken out of the production attributable to the 7/8 working interest of the heretofore described 40 acre tract owned by Saul A. Yager, et al; and

WHEREAS, Dave Clark was unwilling to communitize his heretofore described three (3) acre tract with other acreage in the W/2 of Section 15, Township 32 North, Range 10 West, N.M.P.M.; and

WHEREAS, on April 27, 1956, by Order No. R-795 in Cases No. 1000 and No. 1001 (consolidated), the Oil Conservation Commission for the State of New Mexico ordered as follows:

"1. That all of the interests of all parties in the W/2 of Section 15, Township 32 North, Range 10 West, NMPM, San Juan County, New Mexico be, and the same are, hereby pooled and communitized by this order, and the said W/2 of Section 15 is hereby recognized as a pooled and communitized tract in the Blanco-Mesaverde Pool in San Juan County, New Mexico.

"2. That the applicant El Paso be, and is hereby, permitted and authorized to drill a well in the SW/4 of said Section 15, by complying with the terms and provisions of Order R-110.

"3. That, for the purposes of this order, the sum of $65,000 is fixed as the cost of drilling, completing, and equipping a well to said common source of supply, said figure including reasonable costs of supervision.

"4. That upon completion of said well the applicant El Paso shall submit to the Commission a verified statement of actual costs incurred, the Commission reserving jurisdiction to redetermine the cost of such well in the case of any dispute.

"5. That the basic proportions of the cost of drilling, completion and equipping the said well to be drilled by El Paso shall be borne as follows: El Paso Natural Gas Company - $\frac{174}{320}$, Pacific Northwest Pipeline Corporation - $\frac{103}{320}$, the Yager Group - $\frac{40}{320}$ and Dave Clark - $\frac{3}{320}$.

"6. That Pacific Northwest, the Yager Group, and Dave Clark shall pay their share of costs of El Paso by either one of the two following methods:

"(a) They shall each pay their basic proportionate share of costs, or furnish a sufficient guarantee of said payment, to El Paso within fifteen days from the date of this order, said payment insuring to each said party its same proportionate share of the working interest in said well.

"(b) That the said parties shall be permitted to wait the outcome of the drilling, and if production is found in the Mesaverde Formation, El Paso shall be permitted to withhold the proceeds (1) from the proportionate share of the working interest production of Pacific Northwest from said well, and (2) from the proportionate share of 8/8 production of the Yager Group and Dave Clark from said well, until such time as the applicant is reimbursed in the amount of 125 percent of such parties' basic proportionate share of the well costs, after which time the said parties shall receive their proportionate share in the working interest in said well.

"7. That Pacific Northwest, the Yager Group, and Dave Clark are hereby required to make an election within 15 days of the date of this order as to which method they desire to pursue in the payment of their share of costs, said election to be in writing, addressed to the main office of El Paso Natural Gas Company in El Paso, Texas, with a copy to the offices of this Commission in Santa Fe, New Mexico."; and

WHEREAS, pursuant to Paragraph 7 of said Order No. R-795, the Yager Group has elected to be governed by the provisions of Sub-paragraph 6 (b) of said Order No. R-795; and

WHEREAS, said Dave Clark has not made known his election to Operator in accordance with Paragraph 7 of said Order No. R-795; and

WHEREAS, it is the desire of Operator, El Paso Natural Gas Company, and Non-Operator, Pacific Northwest Pipeline Corporation, to enter into an Operating Agreement covering the development and operation of the W/2 of Section 15, Township 32 North, Range 10 West, N.M.P.M., as hereinafter set out:

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements hereinafter contained to be kept and performed by the parties hereto, said parties do hereby agree as follows:

1. FORMATION OF THE UNIT

For the purposes hereof, it is agreed that the aforementioned leases, insofar as they apply to the above described lands, have been pooled and communitized to form a unit covering only the Mesaverde Formation in and under the land described above. It being the intention of the parties hereto in forming said unit to pool and communitize all leases which they may now own or which they may hereafter acquire covering any interest in the communitized unit. Such unit is created by the Communitization Agreement bearing the same date as this Operating Agreement, executed by the owners of mineral interests in the land above described.

2. OPERATOR

El Paso Natural Gas Company is hereby designated and shall act as Operator of such unit in accordance with the terms and provisions of this Agreement. Operator shall have full and complete management of the development and operation of the said unit for dry gas and associated liquid hydrocarbons producible from the Mesaverde Formation as an entirety, but Operator agrees that no well shall be commenced upon the said unit, except the well hereinafter provided for, without the consent of Non-Operator.

El Paso Natural Gas Company may resign as Operator at any time by giving notice to Non-Operator in writing sixty (60) days in advance of the effective date of such resignation and, in such event, the working interest owners of said unit shall immediately select a successor. In the event El Paso Natural Gas Company shall sell or otherwise dispose of all its interest in said unit, the right of operation herein conferred shall not run with the transfer or assignment of such interest or inure to the benefit of El Paso Natural Gas Company's Assignee, but Non-Operator and El Paso Natural Gas Company's Assignee shall immediately select a new Operator.

3. WELL

Operator shall commence or cause to be commenced drilling operations for the joint account of the parties hereto and shall thereafter drill said well to a depth sufficient to test the Mesaverde Formation, unless salt, caprock, cavities, heaving shale, abnormal water flow, or impenetrable substances are encountered in said well at a lesser depth. The parties hereto may also mutually agree to discontinue drilling operations at a lesser depth. Upon completion of said well, if it is a commercial well, Operator shall notify Non-Operator of the date said well is connected to a gas gathering system, if it is so connected.

In the event a well capable of producing gas in paying quantities is shut-in, Operator shall immediately notify Non-Operator thereof; except that Operator shall not be

required to notify the Non-Operator if the well should be shut-in for limited periods of time in order to balance production during peak load periods or for reasons of making mechanical repairs. All production obtained from the unit area and all material and equipment acquired hereunder for the joint account of the parties hereto shall be owned by the parties hereto in the proportions hereinafter specified in Article 4 of this Agreement.

4. COSTS AND EXPENSES

The entire costs and expenses involved in drilling and completing said well shall be borne as follows:

El Paso Natural Gas Company	54.1375%
Pacific Northwest Pipeline Corporation . .	32.4250%
Saul A. Yager, et al	12.5000%
Dave Clark	.9375%

However, inasmuch as said Saul A. Yager, et al, are unwilling to pay their share of such costs in cash and have instead elected to be governed by the provisions of Sub-paragraph 6 (b) of said Order No. R-795 pertaining to such costs, and inasmuch as said Dave Clark has failed to make an election pursuant to said Order No. R-795, Operator will advance said Saul A. Yager, et al, and Dave Clark's share of such costs involved in drilling said well, and if production is found in the Mesaverde Formation, Operator shall be permitted to withhold the proceeds from said Saul A. Yager, et al, and Dave Clark's proportionate share of production from said well until such time as Operator is reimbursed in the amount of 125% of such parties' proportionate share of the costs involved in drilling said well which is pursuant to Paragraph 6 (b) of said Order No. R-795. Unless Operator elects to require Non-Operator to advance its share of the costs and expenses, as hereinafter provided, Operator shall initially advance and pay all costs and expenses for the drilling of the well provided for in Article 3 hereof, as well as operation expenses of said unit, and shall charge Non-Operator with its pro rata part thereof on the basis of its proportionate interest in the unit as set out above.

Pursuant to Order No. R-795 of the Oil Conservation Commission for the State of New Mexico, the entire costs and expenses involved in operating said well, if said well is a commercial well, will be borne as follows:

El Paso Natural Gas Company	54.1375%
Pacific Northwest Pipeline Corporation . .	32.4250%
Saul A. Yager, et al	12.5000%
Dave Clark	.9375%

Non-Operator, Pacific Northwest Pipeline Corporation, in accordance with Paragraph 6 (a) of said Order No. R-795, will pay their proportionate share of all costs and expenses involved in operating said well and will be governed by the terms and provisions of this paragraph as heretofore and hereinafter set out.

After Operator, pursuant to Order No. R-795, has been reimbursed in the amount of 125 percent of Saul A. Yager, et al and Dave Clark's proportionate share of the costs in-

volved in drilling said well, Operator will pay said Saul A. Yager, et al and Dave Clark their proportionate share of the proceeds of production of all gas and associated liquid hydrocarbons produced and saved from the acreage covered hereby, less however, all operating costs attributable to said Saul A. Yager, et al and Dave Clark's interest in said well.

All such costs, expenses, credits and related matter, and the method of handling the accounting with respect thereto, shall be in accordance with the provisions of the Accounting Procedure, attached hereto as Exhibit "A" and made a part hereof for all purposes; provided, however, that the Operator shall not apportion any part of the salaries and expenses of its District Superintendent, or other general district employees or of the district office expenses to the joint account as provided in Paragraph 11 of Section II of said Exhibit "A", as attached hereto; and the monthly per well overhead rates set forth under Paragraph 12 of Section II of said Exhibit "A", as attached hereto, shall be in lieu of any charges for any part of the compensation or salaries paid to Operator's District Superintendent and to other general district employees and shall be in lieu of any charges for district office expenses as well as Operator's division office and principal business office expenses and of any charge for field office and camp expenses, but shall not be in lieu of any charge for any part of the compensation, salaries, and related expenses of any of Operator's field crew and direct supervision of such crew directly engaged in the operation of Operator's wells in the area.

In the event of any conflict between the provisions contained in the body of this Agreement, and those contained in said Exhibit "A", the provisions of this Agreement shall govern to the extent of such conflict.

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

The well to be drilled on the communitized unit shall be drilled on a competitive contract basis at the usual rates prevailing in the field. However, Operator, if it so desires, may employ its own tools and equipment; in such event the cost of drilling shall include, but shall not be limited to, the following charges: (a) all direct material and

labor costs (b) a proportionate amount of applicable departmental overheads and undistributed field costs (c) rental charge on company equipment employed; all such charges to be determined in accordance with Operator's accounting practice, provided that, in no event shall the total of such charges exceed the prevailing rate in the field, and such work shall be performed by Operator under the same terms and conditions as shall be customary and usual in the field in contracts of independent contractors who are doing work of a similar nature.

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

5. RENTALS

Each party hereto agrees to pay all rentals, minimum royalties and/or shut-in royalty which may become due under the lease or leases which such party is contributing to such unit hereunder, and Operator shall not have any obligation to pay any such rentals, minimum royalties and/or shut-in royalty except as to the lease contributed by Operator. Each party further agrees to use its best efforts to keep and maintain in full force and effect the oil and gas lease(s) contributed by such party to said unit.

6. INSURANCE

Operator shall at all times while conducting operations hereunder, carry and require its contractors and their sub-contractors to carry insurance to protect and save the parties hereto harmless, as follows:

A. Workmen's Compensation and Employer's Liability Insurance sufficient to comply with the Workmen's Compensation Law for the State of New Mexico.

B. Comprehensive General Public Liability Insurance with limits of not less than $50,000 per person and $100,000 per accident, and General Public Liability Property Damage with limits of not less than $50,000 per accident.

C. Automobile Public Liability Insurance including non-owned and hired automobile endorsement with limits of not less than $50,000 per person and $100,000 per accident, and Automobile Property Damage Insurance with a limit of not less than $50,000 per accident.

All costs and actual expenditures incurred and paid by Operator in settlement of any or all losses, claims, damages and judgments which are not covered by such insurance and other expenses, including legal services connected therewith, shall be charged to the joint account. Provided that prior to settlement of any claims, damages, occurrences and/or judgments which are not covered by the above insurance and which are to be charged to the joint account, Operator shall have the concurrence of Non-Operator before any settlement is made.

7. DISPOSAL OF PRODUCTION

Each of the parties hereto shall own and have the right, at its own expense to

take in kind or separately dispose of its proportionate part of all gas and associated liquid hydrocarbons produced and saved from the acreage covered hereby, exclusive of the production which may be used by Operator in developing and continuing operations on the said tract under the Communitization Agreement referred to in Paragraph 1 above, and of the production unavoidably lost, provided that each of the parties hereto shall pay or secure the payment of the royalty interests, overriding royalty interests, payments out of production and other similar interests, if any, from its proportionate part of said production. If at any time or times Non-Operator shall fail or refuse to take in kind or separately dispose of its proportionate part of said production, Operator shall have the right, revocable by Non-Operator at will, to sell such part of such production at the same price which Operator received for its own portion of the production, or to take such gas for its own use for resale; should gas be delivered by either party during any period that such other party or parties have failed or refused to take or sell its or their gas, then the party receiving or taking delivery of the gas agrees to account to the other party or parties for its or their proportionate part of the gas so delivered, (1) if sold by the receiving party, at the market price at the wellhead for said gas, or at the price received at wellhead by such party, whichever is greater or, (2) if taken for its own use or transported for resale by the receiving party, at the highest price it is paying others in the area at the wellhead for gas of similar quality and pressure or, (3) if no such purchases are being made by the receiving party, then at the market price at the wellhead. Any sales by Operator of Non-Operator's production shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the circumstances, but in no event shall any such sale be for a period in excess of one (1) year.

8. DURATION OF AGREEMENT

This Agreement shall become effective as of the date hereof upon execution by the parties hereto, notwithstanding the date of execution, and shall remain in full force and effect for a period of two (2) years and so long thereafter as dry gas and associated liquid hydrocarbons are produced from any part of said communitized unit in paying quantities, provided that prior to production in paying quantities from said communitized unit and upon fulfillment of all the requirements of the Oil Conservation Commission of the State of New Mexico, with respect to any dry hole or abandoned well, this Agreement may be terminated at any time by the mutual agreement of all the parties hereto.

9. ROYALTY INTERESTS

It is agreed and understood that the burden of any royalty, overriding royalties, payments out of production, carried working interests, net profit obligations or other similar payments, shall be borne and paid by the party owning the lease to which such interests apply.

10. TAXES

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

11. RELATION OF PARTIES

The rights, duties, obligations and liabilities of the parties hereto shall be several and not joint or collective, it being the express purpose and intention of the parties hereto that their ownership in said unit shall be as tenants in common; and nothing herein contained shall ever be construed as creating a partnership of any kind, joint venture, an association or trust or as imposing upon any one or more of the parties hereto any partnership duty, obligation or liability. Each party hereto shall be individually responsible only for his or its obligations, as set out in this Agreement. Pursuant to the provisions of Section 761(a) of the Internal Revenue Code of 1954, and the regulations promulgated thereunder, election is hereby made to exclude this agreement and all operations thereunder from the application of all of the provisions of subchapter K of the Internal Revenue Code of 1954.

12. ACCESS TO PREMISES, LOGS AND REPORTS

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

13. SURRENDER, EXPIRATION, ABANDONMENT OR RELEASE OF LEASE

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

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

14. LOSS OR FAILURE OF TITLE

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

15. ABANDONMENT OF WELL

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

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

16. LAWS AND REGULATIONS

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

17. FORCE MAJEURE

No party to this Agreement shall be liable to any other party for any delay or default in performance under this Agreement due to any cause beyond its control and without its fault or negligence, including but not restricted to acts of God or the public enemy, acts or requests of the Federal or State Government or of any Federal or State officer purporting to act under duly constituted authority, floods, fires, wars, storms, strikes, interruption of transportation, freight embargoes or failures, exhaustion or unavailability or delays in delivery of any material, equipment or service necessary to the performance of any provisions hereof, or the loss of holes, blow-outs or happening of any unforeseen accident, misfortune or casualty whereby performance hereunder is delayed or prevented.

18. OPERATOR'S LIEN

Operator shall have an express contract lien, which is hereby granted, upon the interest of Non-Operator in said unit, in the gas or other minerals produced from such unit and in the materials and equipment located thereon, to secure the payment by said Non-Operator of its proportionate part of the costs and expenses incurred or paid by Operator here-

under, and interest, if any, accrued on such part. Such lien may be enforced and foreclosed as any other contract lien. Moreover, Operator may to the full extent of any indebtedness owed by it to Non-Operator, offset such debt against sums owing to Operator hereunder by Non-Operator.

19. NOTICES

All notices, reports and other correspondence required or made necessary by the terms of this Agreement shall be deemed to have been properly served and addressed if sent by mail or telegram, as follows:

El Paso Natural Gas Company
Post Office Box 1492
El Paso, Texas

Pacific Northwest Pipeline Corporation
Post Office Box 1526
Salt Lake City, Utah

20. HEIRS, SUCCESSORS AND ASSIGNS

All of the provisions of this Agreement shall extend to and be binding upon the parties hereto, their heirs, successors and assigns, and such provisions shall be deemed to be covenants running with the land covered hereby.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement in several counterpart originals as of the day and year first above written.

ATTEST:

Assistant Secretary

EL PASO NATURAL GAS COMPANY

By _____ Vice President

RAM
BRA

ATTEST:

Assistant Secretary

PACIFIC NORTHWEST PIPELINE CORPORATION

By _____ Vice President

FORM APPROVED
Simms & Modrall
by

STATE OF TEXAS)
)
COUNTY OF EL PASO)

On this 22 day of October, 1956, before me appeared H. F. Steen, to me personally known, who, being by me duly sworn, did say that he is the Vice President of EL PASO NATURAL GAS COMPANY, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said H. F. Steen acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

My commission expires:

MARTHA B. IVEY,
Notary Public, In and for El Paso County, Texas
My commission expires June 1, 1957

Notary Public

STATE OF New Mexico

COUNTY OF Bernalillo

On this 28th day of August, 1956, before me appeared J. M. Clark, to me personally known, who, being by me duly sworn, did say that he is the Vice President of PACIFIC NORTHWEST PIPELINE CORPORATION, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said J. M. Clark acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

My commission expires:

July 15, 1959

Eugene Leatherwood
Notary Public

OFFICE OF COMMISSIONER OF PUBLIC LANDS
Santa Fe, New Mexico

I HEREBY CERTIFY that the foregoing Communitization Agreement was filed in my office on the_____day of_____, 1956 and CONSENTED TO and APPROVED by me on_____, 1956.

_____
Commissioner of Public Lands

EXHIBIT "A"

PASO-T-1955-2

Attached to and made a part of an Operating Agreement dated July 16, 1956, covering Bonds Pool Unit #1 Well, W½ 15, 32-10, by and between El Paso Natural Gas Company and Pacific Northwest Pipeline Corporation.

ACCOUNTING PROCEDURE

(UNIT AND JOINT LEASE OPERATIONS)

I. GENERAL PROVISIONS

1. Definitions

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

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

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

2. Statements and Billings

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

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

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

C. Statements as follows:

(1) Detailed statement of material ordinarily considered controllable by operators of oil and gas properties;

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

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

3. Payments by Non-Operator

Each party shall pay its proportion of all such bills within fifteen (15) days after receipt thereof. If payment is not made within such time, the unpaid balance shall bear interest at the rate of six per cent (6%) per annum until paid.

4. Adjustments

Payment of any such bills shall not prejudice the right of Non-Operator to protest or question the correctness thereof. Subject to the exception noted in Paragraph 5 of this section I, all statements rendered to Non-Operator by Operator during any calendar year shall conclusively be presumed to be true and correct after twenty-four (24) months following the end of any such calendar year, unless within the said twenty-four (24) month period Non-Operator takes written exception thereto and makes claim on Operator for adjustment. Failure on the part of Non-Operator to make claim on Operator for adjustment within such period shall establish the correctness thereof and preclude the filing of exceptions thereto or making of claims for adjustment thereon. The provisions of this paragraph shall not prevent adjustments resulting from physical inventory of property as provided for in Section VI, Inventories, hereof.

5. Audits

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

II. DEVELOPMENT AND OPERATING CHARGES

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

1. Rentals and Royalties

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

2. Labor

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

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

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

3. Employee Benefits

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

4. Material

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

5. Transportation

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

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

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

6. Service

A. Outside Services:
The cost of contract services and utilities procured from outside sources.

B. Use of Operator's Equipment and Facilities:
Use of and service by Operator's exclusively owned equipment and facilities as provided in Paragraph 5 of Section III entitled "Operator's Exclusively Owned Facilities."

7. Damages and Losses to Joint Property and Equipment

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

8. Litigation Expense

All costs and expenses of litigation, or legal services otherwise necessary or expedient for the protection of the joint interests, including attorneys' fees and expenses as hereinafter provided, together with all judgments obtained against the parties or any of them on account of the joint operations under this agreement, and actual expenses incurred by any party or parties hereto in securing evidence for the purpose of defending against any action or claim prosecuted or urged against the joint account or the subject matter of this agreement.

A. If a majority of the interests hereunder shall so agree, actions or claims affecting the joint interests hereunder may be handled by the legal staff of one or more of the parties hereto; and a charge commensurate with cost of providing and furnishing such services rendered may be made against the joint account; but no such charge shall be made until approved by the legal departments of or attorneys for the respective parties hereto.

B. Fees and expenses of outside attorneys shall not be charged to the joint account unless authorized by the majority of the interests hereunder.

9. Taxes

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

10. Insurance and Claims

A. Premiums paid for insurance required to be carried for the benefit of the joint account, together with all expenditures incurred and paid in settlement of any and all losses, claims, damages, judgments, and other expenses, including legal services, not recovered from insurance carrier.

B. If no insurance is required to be carried, all actual expenditures incurred and paid by Operator in settlement of any and all losses, claims, damages, judgments, and any other expenses, including legal services, shall be charged to the joint account.

11. ~~District and Camp Expense (Field Supervision and Camp Expense)~~ See Par. 2 Art. 4 of this Agreement

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

12. Administrative Overhead

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

WELL BASIS (Rate Per Well Per Month)

Well Depth	DRILLING WELL RATE	PRODUCING WELL RATE (Use Completion Depth)		
	Each Well	First Five	Next Five	All Wells Over Ten
Mesaverde	$250.00	$45.00 per well per month		

A. Overhead charges for drilling wells shall begin on the date each well is spudded and terminate when it is on production or is plugged, as the case may be, except that no charge shall be made during the suspension of drilling operations for fifteen (15) or more consecutive days.

B. In connection with overhead charges, the status of wells shall be as follows:
(1) Injection wells for recovery operations, such as for repressure or water flood, shall be included in the overhead schedule the same as producing oil wells.
(2) Water supply wells utilized for water flooding operations shall be included in the overhead schedule the same as producing oil wells.
(3) Producing gas wells shall be included in the overhead schedule the same as producing oil wells.

(4) Wells permanently shut down but on which plugging operations are deferred shall be dropped from the overhead schedule at the time the shutdown is effected. When such wells are plugged, overhead shall be charged at the producing well rate during the time required for the plugging operation.

(5) Wells being plugged back, drilled deeper, or converted to a source or input well shall be included in the overhead schedule the same as drilling wells.

(6) Temporarily shut-down wells (other than by governmental regulatory body) which are not produced or worked upon for a period of a full calendar month shall not be included in the overhead schedule; however, wells shut in by governmental regulatory body shall be included in the overhead schedule only in the event the allowable production is transferred to other wells on the same property. In the event of a unit allowable, all wells capable of producing will be counted in determining the overhead charge.

(7) Wells completed in dual or multiple horizons shall be considered as two wells in the producing overhead schedule.

(8) Lease salt water disposal wells shall not be included in the overhead schedule unless such wells are used in a secondary recovery program on the joint property.

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

D. It is specifically understood that the above overhead rates apply only to drilling and producing operations and are not intended to cover the construction or operation of additional facilities such as, but not limited to, gasoline plants, compressor plants, repressuring projects, salt water disposal facilities, and similar installations. If at any time any or all of these become necessary to the operation, a separate agreement will be reached relative to an overhead charge and allocation of district expense.

E. The above specific overhead rates may be amended from time to time by agreement between Operator and Non-Operator if, in practice, they are found to be insufficient or excessive.

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

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

NONE

14. Other Expenditures

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

III. BASIS OF CHARGES TO JOINT ACCOUNT

1. Purchases

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

2. Material Furnished by Operator

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

A. New Material (Condition "A")

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

(2) Other material shall be priced on basis of a reputable supply company's preferential price list effective at date of transfer and f.o.b. the store or railway receiving point nearest the joint account operation where such material is available.

(3) Cash discount shall not be allowed.

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

(1) Material which is in sound and serviceable condition and is suitable for reuse without reconditioning shall be classed as Condition "B" and priced at seventy-five per cent (75%) of new price.

(2) Material which cannot be classified as Condition "B" but which,

(a) After reconditioning will be further serviceable for original function as good secondhand material (Condition "B"), or

(b) Is serviceable for original function but substantially not suitable for reconditioning,

shall be classed as Condition "C" and priced at fifty per cent (50%) of new price.

(3) Material which cannot be classified as Condition "B" or Condition "C" shall be priced at a value commensurate with its use.

(4) Tanks, buildings, and other equipment involving erection costs shall be charged at applicable percentage of knocked-down new price.

3. Premium Prices

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

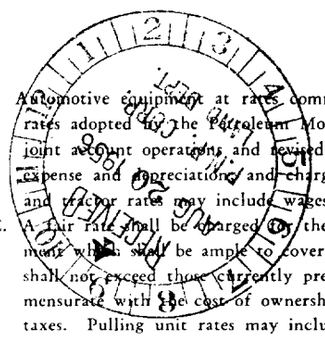
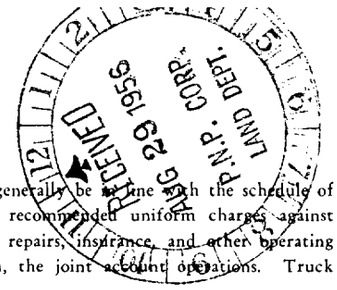
4. Warranty of Material Furnished by Operator

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

5. Operator's Exclusively Owned Facilities

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

A. Water, fuel, power, compressor and other auxiliary services at rates commensurate with cost of providing and furnishing such service to the joint account but not exceeding rates currently prevailing in the field where the joint property is located.

B. Automotive equipment at rates commensurate with cost of ownership and operation. Such rates should generally be in line with the schedule of rates adopted by the Petroleum Motor Transport Association, or some other recognized organization, as recommended uniform charges against joint account operations and revised from time to time. Automotive rates shall include cost of oil, gas, repairs, insurance, and other operating expense and depreciation, and charges shall be based on use in actual service on, or in connection with, the joint account operations. Truck and tractor rates may include wages and expenses of driver.

C. A fair rate shall be charged for the use of drilling and cleaning-out tools and any other items of Operator's fully owned machinery or equipment which shall be ample to cover maintenance, repairs, depreciation, and the service furnished the joint property; provided that such charges shall not exceed those currently prevailing in the field where the joint property is located. Pulling units shall be charged at hourly rates commensurate with the cost of ownership and operation, which shall include repairs and maintenance, operating supplies, insurance, depreciation, and taxes. Pulling unit rates may include wages and expenses of the operator.

D. A fair rate shall be charged for laboratory services performed by Operator for the benefit of the joint account, such as gas, water, core, and any other analyses and tests; provided such charges shall not exceed those currently prevailing if performed by outside service laboratories.

E. Whenever requested, Operator shall inform Non-Operator in advance of the rates it proposes to charge.

F. Rates shall be revised and adjusted from time to time when found to be either excessive or insufficient.

IV. DISPOSAL OF LEASE EQUIPMENT AND MATERIAL

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

1. Material Purchased by the Operator or Non-Operator

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

2. Division in Kind

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

3. Sales to Outsiders

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

V. BASIS OF PRICING MATERIAL TRANSFERRED FROM JOINT ACCOUNT

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

1. New Price Defined

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

2. New Material

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

3. Good Used Material

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

A. At seventy-five per cent (75%) of current new price if material was charged to joint account as new, or

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

4. Other Used Material

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

A. After reconditioning will be further serviceable for original function as good secondhand material (Condition "B"), or

B. Is serviceable for original function but substantially not suitable for reconditioning.

5. Bad-Order Material

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

6. Junk

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

7. Temporarily Used Material

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

VI. INVENTORIES

1. Periodic Inventories, Notice and Representation

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

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

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

2. Reconciliation and Adjustment of Inventories

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

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

3. Special Inventories

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

NM 236

OPERATING AGREEMENT

THIS AGREEMENT, made and entered into this 9 day of ~~July~~ August, 1954, by and between GREAT WESTERN DRILLING COMPANY, a Texas corporation whose address is Post Office Box 1659, Midland Texas, hereinafter sometimes referred to as "Operator"; EL PASO NATURAL GAS COMPANY, a Delaware corporation whose address is Post Office Box 1492, El Paso, Texas, and PUBCO DEVELOPMENT, INC. (No Stockholders Liability), a New Mexico corporation whose address is Post Office Box 1360, Albuquerque, New Mexico, the two latter corporations being hereinafter referred to as "Non-Operator":

W I T N E S S E T H :

WHEREAS, the parties hereto are the owners of certain Oil and Gas Leases, which leases cover, among other lands, the following described land in San Juan County, New Mexico, to-wit:

Township 31 North, Range 11 West, N.M.P.M.
Section 36: S½
containing 320.0 acres, more or less; and

WHEREAS, it is the desire of the parties hereto to enter into an Operating Agreement covering the development and operation of the above described tract as hereinafter set out:

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements hereinafter contained to be kept and performed by the parties hereto, said parties do hereby agree as follows:

1. FORMATION OF THE UNIT:

For the purposes hereof, it is agreed that the aforementioned leases, insofar as they apply to the above described lands, are hereby pooled and communitized to form a unit covering only the Mesaverde formation in and under the land described above. It is the intention of the parties hereto in forming said unit to pool and communitize all leases which they may now own or which they may hereafter acquire covering any interest in the communitized unit. Such unit is created by the Communitization Agreement bearing the same date as this Operating Agreement, executed by the owners of leasehold interests in the land above described.

2. OPERATOR:

Great Western Drilling Company is hereby designated and shall act as Operator of such unit in accordance with the terms and provisions of this Agreement. Operator shall have full and complete management of the development and operation of the said unit for dry gas and associated liquid hydrocarbons producible from the Mesaverde formation as an entirety, but Operator agrees that no well shall be commenced upon the said unit except the well hereinafter provided for, without the consent of

Non-Operator.

Operator may resign at any time by giving notice to Non-Operator in writing sixty (60) days in advance of the effective date of such resignation and, in such event, the working interest owners of said unit shall immediately select a successor. In the event Operator shall sell or otherwise dispose of all its interest in said unit, the right of operation herein conferred shall not run with the transfer or assignment of such interest or inure to the benefit of Operator's assignee, but Non-Operator and Operator's assignee shall immediately select a new Operator.

Notwithstanding anything to the contrary contained in this Paragraph, the parties to this Agreement hereby agree that if and when said initial test well is completed by Operator as a producing well, Pubco Development, Inc. (No Stockholders Liability), a New Mexico corporation, the address of which is Post Office Box 1360, Albuquerque, New Mexico, shall act as Operator of said well, and shall have full authority to act in behalf of the parties hereto in the same manner and to the same extent as Operator hereinabove designated.

3. WELL:

Operator shall, on or before one year from the date of this Agreement, and after giving Non-Operator at least ten (10) days advance notice in writing, commence or cause to be commenced drilling operations on an initial test well and shall thereafter drill said well to a depth sufficient to test the Mesaverde formation, unless salt, caprock, cavities, heaving shale, abnormal water flow, or impenetrable substances are encountered in said well at a lesser depth. The parties hereto may also mutually agree to discontinue drilling operations at a lesser depth. Upon completion of said well, if it is a commercial well, Operator shall notify Non-Operator of the date said well is tied-in to a gas gathering system.

In the event a well capable of producing gas in paying quantities is shut-in, other than on a temporary basis, Operator shall immediately notify Non-Operator thereof. All production obtained from the communitized area and all material and equipment acquired hereunder shall be owned by the parties hereto in the proportions hereinafter specified in Article 4 of this Agreement.

4. COSTS AND EXPENSES:

The entire costs and expenses involved in drilling and completing said well, if said well is a commercial well, or in plugging and abandoning if said well is a dry hole or non-commercial well, shall be borne by the parties hereto, as follows:

Great Western Drilling Company:	87.500%
El Paso Natural Gas Company:	12.500%

Unless Operator elects to require Non-Operator to advance its share of the costs and expenses, as hereinafter provided, Operator shall initially advance and pay all costs and expenses for the drilling of the well provided for in Article 3 hereof, as well as operation expenses of said unit, and shall charge Non-Operator with its pro rata part thereof on the basis of its proportionate interest in the unit as set out above.

All such costs, expenses, credits and related matter, and the method of handling the accounting with respect thereto, shall be in accordance with the provisions of the Accounting Procedure, attached hereto as Exhibit "A" and made a part hereof for all purposes; provided, however, that the Operator shall not apportion any part of the salaries and expenses of its District Superintendent, or other general district employees or of the district office expenses to the joint account as provided in paragraph 11 of Section II of said Exhibit "A", as attached hereto; and the monthly per well overhead rates set forth under paragraph 12 of Section II of said Exhibit "A", as attached hereto, shall be in lieu of any charges for any part of the compensation or salaries paid to Operator's District Superintendent and to other general district employees and shall be in lieu of any charges for district office expenses as well as Operator's division office and principal business office expenses and of any charge for field office and camp expenses, but shall not be in lieu of any charges on a fair and proportionate basis for any part of the compensation, salaries, and related expenses of any of Operator's field crew and direct supervision of such crew directly engaged in the operation of Operator's wells in the area.

In the event of any conflict between the provisions contained in the body of this Agreement, and those contained in said Exhibit "A", the provisions of this Agreement shall govern to the extent of such conflict.

In the event that Operator elects to require Non-Operator to advance its proportionate share of the above mentioned costs and expenses, Operator shall submit an itemized estimate of such costs and expenses for the succeeding calendar month to Non-Operator, showing therein the proportionate part of the estimated costs and expenses chargeable to Non-Operator. Within fifteen (15) days after receipt of said estimate, Non-Operator shall pay to the Operator its proportionate share of the estimated costs and expenses. If payment of the estimated costs and expenses is not made when due, the unpaid balance thereof shall bear interest at the rate of six per cent

(6%) per annum from the due date until paid. Adjustments between estimated and actual costs and expenses shall be made by Operator at the close of each calendar month and the account of the respective parties adjusted accordingly.

The well to be drilled on the communitized unit shall be drilled on a competitive contract basis at the usual rates prevailing in the field. However, Operator, if it so desires, may employ its own tools and equipment; in such event the cost of drilling shall include, but shall not be limited to, the following charges: (a) all direct material and labor costs; (b) a proportionate amount of applicable departmental overheads and undistributed field costs; (c) rental charge on company equipment employed; all such charges to be determined in accordance with Operator's accounting practice, provided, that in no event shall the total of such charges exceed the prevailing rate in the field, and such work shall be performed by Operator under the same terms and conditions as shall be customary and usual in the field in contracts of independent contractors who are doing work of a similar nature.

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

5. RENTALS:

Each party hereto agrees to pay all rentals and/or shut-in royalty which may become due under the lease or leases which such party is contributing to such unit hereunder, and Operator shall not have any obligation to pay any such rentals and/or shut-in royalty except as to the lease contributed by Operator. Each party further agrees to use its best efforts to keep and maintain in full force and effect the oil and gas lease(s) contributed by such party to said unit.

6. INSURANCE:

Operator shall at all times while conducting operations hereunder, at its cost, carry and require its contractors and their sub-contractors to carry insurance to protect and save the parties hereto harmless, as follows:

A. Workmen's Compensation Insurance sufficient to comply with the Workmen's Compensation Law for the State of New Mexico.

B. Comprehensive General Public Liability Insurance with limits of not less than $50,000 per person and $100,000 per accident, and General Public Liability Property Damage with limits of not less than $50,000 per accident.

C. Automobile Public Liability Insurance with limits of not less than $50,000 per person and $100,000 per accident, and Automobile Property Damage Insurance with a limit of not less than $50,000 per accident.

All costs and actual expenditures incurred and paid by Operator in settlement of any or all losses, claims, damages and judgments which are not covered by such insurance and other expenses, including legal services connected therewith, shall be charged to the joint account.

7. DISPOSAL OF PRODUCTION:

Each of the parties hereto shall own and have the right, at its own expense, to take in kind or separately dispose of its proportionate part of all dry gas and associated liquid hydrocarbons produced and saved from the acreage covered hereby, exclusive of the production which may be used by Operator in developing and continuing operations on the said tract and of production unavoidably lost, provided that each of the parties hereto shall pay or secure the payment of the royalty interests, overriding royalty interests, payments out of production or other similar interests, if any, from its proportionate part of said production. If at any time or times Non-Operator shall fail or refuse to take in kind or separately dispose of its proportionate part of said production, Operator shall have the right, revocable by Non-Operator at will, to sell such part of such production at the same price which Operator receives for its own portion of the production. All such sales by Operator of Non-Operator's production shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the circumstances, but in no event shall any such sale be for a period in excess of one (1) year.

8. DURATION OF AGREEMENT:

This Agreement shall become effective as of the date hereof upon execution by the parties hereto, notwithstanding the date of execution, and shall remain in full force and effect for a period of two (2) years and so long thereafter as dry gas and associated liquid hydrocarbons are produced from any part of said communitized unit in paying quantities, provided that prior to production in paying quantities from said communitized unit and upon fulfillment of all the requirements of the Oil Conservation Commission of the State of New Mexico, with respect to any dry hole or abandoned well, this Agreement may be terminated at any time by the mutual agreement of all the parties hereto.

9. ROYALTY INTERESTS:

It is agreed and understood that the burden of any royalty, overriding royalties, payments out of production, carried working interests, net profit obligations, or other similar payments, shall be borne and paid by the party owning the lease to which such interests apply.

10. TAXES:

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

11. RELATION OF PARTIES:

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

12. ACCESS TO PREMISES, LOGS AND REPORTS:

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

13. SURRENDER, EXPIRATION, ABANDONMENT OR RELEASE OF LEASE:

No lease or leases subject to this Agreement shall be voluntarily surrendered, let to expire, abandoned or released, in whole or in part, unless the parties mutually consent thereto in writing. In the event that less than all parties hereto should elect to surrender, let expire, abandon or release all or any part of a lease or leases subject to this Agreement and the other party does not consent or agree, the party so electing shall notify the other party not less than sixty (60) days in advance of such surrender, expiration, abandonment or release, and, if requested so to do by the party not so electing, immediately shall assign without warranty to the latter party all of its rights, title and interest in and to said lease or leases, covering only the formation to be developed under the terms of this Agreement, the well or wells located thereon, and the casing and other physical equipment in or on said well or wells. If the party not so electing fails to request assignment within such sixty (60) day period, the party so electing shall have the right to surrender, let expire, abandon or release said lease or leases, or any part thereof. In the event such assignment is so requested, the party to whom such assignment is made, upon the delivery thereof, shall pay to the assigning party the salvage value of its interest in all the salvable casing and other physical equipment in or on the unit, such value to be determined in accordance with the provisions of the attached Exhibit "A", designated as Accounting Procedure. After the delivery of any such assignment, the party making the assignment shall be released from and discharged of all the duties and obligations thereafter accruing or arising hereunder, in connection with the operation and development of the unit, with respect to the interest assigned in said lease or leases.

14. LOSS OR FAILURE OF TITLE:

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

obtained hereunder or the payment of proceeds derived from the sale of any production, prior to the date loss or failure of title is finally determined.

15. ABANDONMENT OF WELL:

No well on the unit which is capable of producing dry gas and associated liquid hydrocarbons from the formation covered by this Agreement shall be abandoned without the mutual consent of the parties hereto. If either of the parties desire to abandon such well, such party shall so notify the other party in writing and the latter shall have ten (10) days after receipt of such notice in which to elect whether to agree to such abandonment. If all parties hereto agree to such abandonment, such well shall be abandoned and plugged by the Operator at the expense of the joint account, and as much as possible of the casing and other physical equipment in and on said well shall be salvaged for the benefit of the joint account. If either party does not agree to said abandonment, such party shall purchase the interest of the party desiring to abandon said well in the physical equipment therein and thereof; and, within twenty-five (25) days after receipt of notice by the party not electing to abandon, the party desiring to abandon, shall execute and deliver to the other party an assignment, without warranty of title, of all its interest in said well and physical equipment, and in the working interest and gas leasehold estate, insofar as it covers the formation covered by this Agreement in said unit. In exchange for said assignment, the purchasing party shall pay to the assigning party the salvage value of the latter's interest in the salvable casing and other physical equipment in and on said well, such value to be determined in accordance with the provisions of the Accounting Procedure attached hereto as Exhibit "A".

16. LAWS AND REGULATIONS:

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

17. FORCE MAJEURE:

No party to this Agreement shall be liable to the other party for any delay or default in performance under this Agreement due to any cause beyond its control

and without its fault or negligence, including but not restricted to acts of God or the public enemy, act or requests of the Federal or State Government or of any Federal or State officer purporting to act under duly constituted authority, floods, fires, wars, storms, strikes, interruption of transportation, freight embargoes or failures, exhaustion or unavailability or delays in delivery of any material, equipment or service necessary to the performance of any provisions hereof, or the loss of holes, blow-outs or happening of any unforeseen accident, misfortune or casualty whereby performance hereunder is delayed or prevented.

18. OPERATOR'S LIEN:

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

19. NOTICES:

All notices, reports and other correspondence required or made necessary by the terms of this Agreement shall be deemed to have been properly served and addressed if sent by mail or telegram as follows:

El Paso Natural Gas Company
Post Office Box 1492
El Paso, Texas

Pubco Development, Inc.
Post Office Box 1360
Albuquerque, New Mexico

Great Western Drilling Company
Post Office Box 1659
Midland, Texas

20. ELECTION AS TO JOINDER:

Notwithstanding anything to the contrary hereinabove stated, and upon receipt of the notice to the effect that Operator intends to commence drilling operations hereunder as set out in Article 3 herein, Non-Operator may, by responsive notice given to the Operator in writing within ten (10) days of receipt of the aforesaid notice, elect as to whether Non-Operator desires to join in the drilling of such well. Failure to respond within said ten (10) days shall be deemed an election not to join in the drilling of said well. In the event Non-Operator elects not to join in the drilling of said well, Operator shall nevertheless proceed with due diligence

to drill such well at the sole cost and risk of the Operator. In the event said well is a dry hole, it shall be plugged and abandoned at the sole cost of the Operator. In the event said well is a producer, it shall be tested, completed and equipped to produce at the sole cost of the Operator, and the Operator shall be entitled to receive from the proportionate share of production attributable to the lease or leases owned by such non-joining Non-Operator (after deducting therefrom all royalties, overriding royalties, and one hundred per cent. (100%) of the operating expenses attributable thereto) a sum equal to one hundred and fifty per cent. (150%) of that portion of the total cost of drilling, testing, completing, and equipping said well which is chargeable to the lease or leases owned by said non-joining Non-Operator. For the purposes of this paragraph, where a party takes its share of production in kind, the proceeds of production from such well shall be computed upon the same price basis as that employed for payment of royalties to the State of New Mexico on comparable production from the communitized area. When Operator shall have been reimbursed for one hundred and fifty per cent. (150%) of said costs as hereinabove provided, proceeds from said well shall thereafter be shared by the parties hereto as provided in Article 7 hereof. Any amounts which may be realized from sale or disposition of the well or equipment thereon, or required in connection with the drilling, testing, completing, equipping and operating thereof, shall be paid to the Operator and credited against the total unreturned portion of said one hundred and fifty per cent. (150%), with the balance thereof, if any, to be divided between the parties hereto in the same proportion as the production is shared according to Article 7.

21. HEIRS, SUCCESSORS AND ASSIGNS:

All of the provisions of this Agreement shall extend to and be binding upon the parties hereto, their heirs, successors and assigns, and such provisions shall be deemed to be covenants running with land covered hereby.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement in several counterpart originals as of the day and year first above written.

GREAT WESTERN DRILLING COMPANY

By: R. C. Linker.
President

ATTEST:

R. W. Pearman
Asst - Secretary

PUBCO DEVELOPMENT, INC. (No Stockholders Liability)

By: Frank Grisham
Vice President

ATTEST:

Jack Z. Shaw
Assistant Secretary

EL PASO NATURAL GAS COMPANY

By _____
President

ATTEST:

_____
ASST. Secretary

ACCTG.
INS.
LEASE

STATE OF TEXAS)
) ss
COUNTY OF Midland)

On this 9 day of August, 1954, before me appeared _____ R. C. Tucker, to me personally known, who, being by me duly sworn, did say that he is the _____ President of GREAT WESTERN DRILLING COMPANY, a Texas corporation, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said _____ R. C. Tucker acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

_____
Notary Public, County of Midland
State of Texas

My commission expires:

6-1-55

STATE OF TEXAS)
(ss
COUNTY OF EL PASO)

On this 27 day of August, 1954, before me appeared _____ H. F. STEEN to me personally known, who being by me duly sworn, did say that he is the VICE President of EL PASO NATURAL GAS COMPANY, a Delaware corporation, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said H. F. STEEN acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

_____
Notary Public, County of El Paso,
State of Texas

My commission expires:

ELSE M. WIELAND
Notary Public, in and for El Paso County Texas
My Commission expires June 1, 1955

STATE OF NEW MEXICO)
(ss
COUNTY OF BERNALILLO)

On this 31st day of August, 1954, before me appeared _____

Frank D. Gorham Jr., to me personally known, who, being by me duly sworn, did say that he is the Vice President of PUBCO DEVELOPMENT, INC. (No Stockholders Liability), a New Mexico corporation, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said

Frank D. Gorham Jr. acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

Mary Beth Harkness
Notary Public, County of Bernalillo,
State of New Mexico

My commission expires:

My Commission Expires June 24, 1957

601 ROSS-MARTIN CO. TULSA 1, OKLAHOMA

EXHIBIT " A "

Model Form-PASO-1949-1

Attached to and made a part of Operating Agreement dated _____ day of July, 1954, between Great Western Drilling Company, El Paso Natural Gas Company and Pubco Development, Inc., covering the S/2 Section 36, T-31-N, R-11-W

ACCOUNTING PROCEDURE

(UNIT AND JOINT LEASE OPERATIONS)

I. GENERAL PROVISIONS

1. **Definitions**
The term "joint property" as herein used shall be construed to mean the subject area covered by the agreement to which this "Accounting Procedure" is attached.
The term "Operator" as herein used shall be construed to mean the party designated to conduct the development and operation of the leased premises for the joint account.
The term "Non-Operator" as herein used shall be construed to mean any one or more of the non-operating parties.

2. **Statements and Billings**
Operator shall bill Non-Operator on or before the last day of each month for its proportionate share of costs and expenditures during the preceding month. Such bills will be accompanied by statements, reflecting the total costs and charges as set forth under Sub-Paragraph A below:
A. Statement in detail of all charges and credits to the joint account.
B. Statement of all charges and credits to the joint account, summarized by appropriate classifications indicative of the nature thereof.
C. Statements, as follows:
(1) Detailed statement of material ordinarily considered controllable by Operators of oil and gas properties;
(2) Statement of all other charges and credits to the joint account summarized by appropriate classifications indicative of the nature thereof; and
(3) Statement of any other receipts and credits.

3. **Payments by Non-Operator**
Each party shall pay its proportion of all such bills within fifteen (15) days after receipt thereof. If payment is not made within such time, the unpaid balance shall bear interest at the rate of six per cent (6%) per annum until paid.

4. **Audits**
Payment of any such bills shall not prejudice the right of Non-Operator to protest or question the correctness thereof. All statements rendered to Non-Operator by Operator during any calendar year shall be conclusively presumed to be true and correct after eighteen months following the close of any such calendar year, unless within said eighteen months period Non-Operator takes written exception thereto and makes claim on Operator for adjustment. Failure on the part of Non-Operator to make claim on Operator for adjustment within such period shall establish the correctness thereof and preclude the filing of exceptions thereto or the making of claims for adjustment thereon. A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the accounting hereunder, within eighteen months next following the close of any calendar year. Non-Operator shall have six months next following the examination of the Operator's records within which to take written exception to and make any and all claims on Operator. The provisions of this paragraph shall not prevent adjustments resulting from the physical inventory of property as provided for in Section VI, Inventories, hereof.

II. DEVELOPMENT AND OPERATING CHARGES

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

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

2. **Labor, Transportation, and Services**
Labor, transportation, and other services necessary for the development, maintenance, and operation of the joint property. Labor shall include (A) Operator's cost of vacation, sickness and disability benefits of employees, and expenditures or contributions imposed or assessed by governmental authority applicable to such labor, and (B) Operator's current cost of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of like nature, applicable to Operator's field payroll; provided that the charges under Part (B) of this paragraph shall not exceed five per cent (5%) of the total of such labor charged to the joint account.

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

4. **Moving Material to Joint Property**
Moving material to the joint property from Vendor's or from Operator's warehouse in the district or from the other properties of Operator, but in either of the last two events no charge shall be made to the joint account for a distance greater than the distance from the nearest reliable supply store or railway receiving point where such material is available, except by special agreement with Non-Operator.

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

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

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

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

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

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

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

12. **Overhead**
Overhead charges, which shall be in lieu of any charges for any part of the compensation or salaries paid to managing officers and employees of Operator, including the division superintendent, the entire staff and expenses of the division office located at Farmington, New Mexico, and any portion of the office expense of the principal business office located at Midland, Texas, but which are not in lieu of district or field office expenses incurred in operating any such properties, or any other expenses of Operator incurred in the development and operation of said properties; and Operator shall have the right to assess against the joint property covered hereby the following overhead charges:
A. $ 250.00 per month for each drilling well, beginning on the date the well is spudded and terminating when it is on production or is plugged, as the case may be, except that no charge shall be made during the suspension of drilling operations for fifteen (15) or more consecutive days.
B. $ 45.00 per well per month for the first five (5) producing wells.
C. [illegible]
D. [illegible]
E. In connection with overhead charges, the status of wells shall be as follows:
   (1) In-put or key wells shall be included in overhead schedule the same as producing oil wells.
   (2) Producing gas wells shall be included in overhead schedule the same as producing oil wells.
   (3) Wells permanently shut down but on which plugging operations are deferred, shall be dropped from overhead schedule at the time the shutdown is effected. When such wells are plugged, overhead shall be charged at the producing well rate during the time required for the plugging operation.
   (4) Wells being plugged back or drilled deeper shall be included in overhead schedule the same as drilling wells.
   (5) Various wells may be shut down temporarily and later replaced on production. If and when a well is shut down (other than for proration) and not produced or worked upon for a period of a full calendar month, it shall not be included in the overhead schedule for such month.
   (6) Salt water disposal wells shall not be included in overhead schedule.

F. The above overhead schedule on producing wells shall be applied to individual leases; provided that, whenever leases covered by this agreement are operated as a unitized project in the interest of economic development, the schedule shall be applied to the total number of wells, irrespective of individual leases.

G. The above specific overhead rates may be amended from time to time by agreement between Operator and Non-Operator if, in practice, they are found to be insufficient or excessive.

13. **Warehouse Handling Charges**

NONE

14. **Other Expenditures**

Any other expenditure incurred by Operator for the necessary and proper development, maintenance, and operation of the joint property.

III. BASIS OF CHARGES TO JOINT ACCOUNT

1. **Purchases**

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

2. **Material Furnished by Operator**

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

A. New Material (Condition "A")
   (1) New material transferred from Operator's warehouse or other properties shall be priced f. o. b. the nearest reputable supply store or railway receiving point, where such material is available, at current replacement cost of the same kind of material. This will include material such as tanks, rigs, pumps, sucker rods, boilers, and engines. Tubular goods (2" and over), shall be priced on carload basis effective at date of transfer and f. o. b. railway receiving point nearest the joint account operation, regardless of quantity transferred.
   (2) Other material shall be priced on basis of a reputable supply company's Preferential Price List effective at date of transfer and f. o. b. the store or railway receiving point nearest the joint account operation where such material is available.
   (3) Cash discount shall not be allowed.

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

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

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

4. **Operator's Exclusively Owned Facilities**

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

A. Water service, fuel gas, power, and compressor service: At rates commensurate with cost of providing and furnishing such service to the joint account but not exceeding rates currently prevailing in the field where the joint property is located.

B. Automotive Equipment: Rates commensurate with cost of ownership and operation. Such rates should generally be in line with schedule of rates adopted by the Petroleum Motor Transport Association, or some other recognized organization, as recommended uniform charges against joint account operations and revised from time to time. Automotive rates shall include cost of oil, gas, repairs, insurance, and other operating expense and depreciation; and charges shall be based on use in actual service on, or in connection with, the joint account operations. Truck, tractor, and pulling unit rates shall include wages and expenses of driver.

C. A fair rate shall be charged for the use of drilling and cleaning-out tools and any other items of Operator's fully owned machinery or equipment which shall be ample to cover maintenance, repairs, depreciation, and the service furnished the joint property; provided that such charges shall not exceed those currently prevailing in the field where the joint property is located.

D. Whenever requested, Operator shall inform Non-Operator in advance of the rates it proposes to charge.

E. Rates shall be revised and adjusted from time to time when found to be either excessive or insufficient.

IV. DISPOSAL OF LEASE EQUIPMENT AND MATERIAL

The Operator shall be under no obligation to purchase interest of Non-Operator in surplus new or secondhand material. Derricks, tanks, buildings, and other major items shall not be removed by Operator from the joint property without the approval of Non-Operator. Operator shall not sell major items of material to an outside party without giving Non-Operator an opportunity either to purchase same at the price offered or to take Non-Operator's share in kind.

1. **Material Purchased by Operator**
Material purchased by Operator shall be credited to the joint account and included in the monthly statement of operations for the month in which the material is removed from the joint property.

2. **Material Purchased by Non-Operator**
Material purchased by Non-Operator shall be invoiced by Operator and paid for by Non-Operator to Operator immediately following receipt of invoice. The Operator shall pass credit to the joint account and include the same in the monthly statement of operations.

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

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

V. BASIS OF PRICING MATERIAL TRANSFERRED FROM JOINT ACCOUNT

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

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

2. **New Material**
New material (Condition "A"), being new material procured for the joint account but never used thereon, at 100% of current new price.

3. **Good Used Material**
Good used material (Condition "B"), being used material in sound and serviceable condition, suitable for reuse without reconditioning,
   A. At 75% of current new price if material was charged to joint account as new, or
   B. At 75% of current new price less depreciation consistent with their usage on and service to the joint property, if material was originally charged to the joint property as secondhand at 75% of new price.

4. **Other Used Material**
Used Material (Condition "C"), being used material which
   A. After reconditioning will be further serviceable for original function as good secondhand material (Condition "B"), or
   B. Is serviceable for original function but substantially not suitable for reconditioning,
   at 50% of current new price.

5. **Bad-Order Material**
Used material (Condition "D"), being material which cannot be classified as Condition "B" or Condition "C", shall be priced at a value commensurate with its use.

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

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

VI. INVENTORIES

1. **Periodic Inventories**
Periodic inventories shall be taken by Operator of the joint account material, which shall include all such material as is ordinarily considered controllable by operators of oil and gas properties.

2. **Notice**
Notice of intention to take inventory shall be given by Operator at least ten days before any inventory is to begin, so that Non-Operator may be represented when any inventory is taken.

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

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

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

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