

UNIT OPERATING AGREEMENT  
FOR THE  
BLUE QUAIL UNIT AREA  
LEA COUNTY, NEW MEXICO

BEFORE THE  
OIL CONSERVATION COMMISSION  
SANTA FE, NEW MEXICO  
EXHIBIT No. \_\_\_\_\_  
CASE \_\_\_\_\_

THIS AGREEMENT, made and entered into as of the 15th day of March, 1957, by and among SKELLY OIL COMPANY, a Delaware corporation with offices in Tulsa, Oklahoma, hereinafter referred to as either "Skelly" or "Unit Operator", and TIDEWATER OIL COMPANY, a Delaware corporation with offices in \_\_\_\_\_, \_\_\_\_\_, SINCLAIR OIL AND GAS COMPANY, a Maine corporation with offices in \_\_\_\_\_, THE ATLANTIC REFINING COMPANY, a \_\_\_\_\_ corporation with offices in \_\_\_\_\_, GULF OIL CORPORATION, a Pennsylvania corporation with offices in \_\_\_\_\_, \_\_\_\_\_, SUNRAY MID-CONTINENT OIL COMPANY, a \_\_\_\_\_ corporation with offices in \_\_\_\_\_, \_\_\_\_\_, and SEABOARD OIL COMPANY, a Delaware corporation with offices in \_\_\_\_\_, hereinafter referred to as "Tidewater", "Sinclair", "Atlantic", "Gulf", "Sunray Mid-Continent", and "Seaboard", respectively, and hereinafter referred to collectively as "Working Interest Owners";

WHEREAS, concurrently herewith the parties hereto have made and entered into a Unit Agreement for the development and operation of the Blue Quail Unit Area, which said agreement is hereinafter referred to as "Unit Agreement", embracing the following described land in Lea County, New Mexico:

NEW MEXICO PRINCIPAL MERIDIAN, NEW MEXICO

Township 10 South, Range 33 East:

Section 24: SE/4  
Section 25: NE/4

Township 10 South, Range 34 East:

Section 19: All  
Section 30: N/2

situated in Lea County, New Mexico, containing 1,278.04 acres, more or less;

Exhibit "A" attached hereto is a map showing the unit area and the boundaries and identity of the tracts and leases in said area to the extent known to the Unit Operator; and,

WHEREAS, Skelly has been designated the Unit Operator under the terms of said Unit Agreement and is a Working Interest Owner under said Unit Agreement and enters into this agreement in both capacities; and,

WHEREAS, the other parties hereto have committed certain oil and gas leasehold interests to said Unit Agreement which are subject to the terms and conditions thereof; and,

WHEREAS, Articles 6 and 9 of said Unit Agreement provide for the apportionment of all costs and expenses incurred in conducting the unit operations under the terms of said Unit Agreement and for the allocation of production of unitized substances among the Working Interest Owners, in accordance with a Unit Operating Agreement to be made and entered into by and between the Unit Operator and the Working Interest Owners having interests committed to said Unit Agreement.

NOW, THEREFORE, it is mutually agreed between the parties hereto as follows:

1. TITLES: Each of the parties hereto represents that it is the owner, respectively, of the oil and gas leasehold interests shown by the schedule attached hereto, made a part hereof and for purposes of identification marked Exhibit "B".

In case of loss or failure of title or of a dispute involving the interest of any of the parties hereto, the same shall be handled as provided in Article 20 of the Unit Agreement; provided, however, that each of the parties hereto shall be responsible for its proportionate part, on the basis hereinafter provided, of the cost of drilling and completing the initial test well required by the Unit Agreement, regardless of the status of title of the leasehold interests of any of

the parties hereto. It is agreed that any loss or failure of title to any interest or lease shall be borne by the party or parties committing such interest or lease to the Unit Agreement and the participating interest in the unit area of the parties hereto shall be revised accordingly; provided, however, that there shall be no retroactive adjustment among the parties hereto of costs incurred and benefits received prior to the final determination of the loss of title. Unit Operator is hereby relieved of any and all liability for any failure or loss of title.

2. UNIT OPERATOR APPOINTED - DUTIES: Skelly is hereby appointed Unit Operator hereunder to serve until its successor is appointed in the manner provided in the Unit Agreement. Subject to the terms of the Unit Agreement and this agreement, Unit Operator shall have full management and control of the unit area and all leasehold interests committed to the Unit Agreement. Unit Operator will use reasonable diligence in all operations and work to be performed shall be conducted in a prudent manner.

3. INITIAL TEST WELL: By their joinder herein, the parties hereto and each of them agree that, within sixty (60) days after the effective date hereof, Unit Operator shall commence operations for the drilling of a test well for oil and gas at a location described as being 660 feet from the South line and 660 feet from the East line of the Southwest Quarter (SW/4) of Section 19, Township 10 South, Range 34 East, Lea County, New Mexico, and shall drill said well with due diligence to an approximate depth of 14,000 feet or to a depth sufficient, in the opinion of Unit Operator, to test the Devonian Formation, whichever is the lesser depth, or to such lesser depth as un-  
tized substances shall be discovered in paying quantities or

until, in the opinion of Unit Operator, it shall be determined that the further drilling of said well shall be unwarranted or impracticable.

4. COST OF INITIAL TEST WELL: It is understood and agreed by and among the parties hereto that the risk, cost and expense of drilling, completing and equipping said initial test well for production (including by way of illustration but not limitation, all necessary lines, separators and lease tankage) shall be borne by Skelly, Tidewater, Sinclair, Gulf, Sunray Mid-Continent and Seaboard, and same shall be paid by such Working Interest Owners in the following proportions:

Skelly	49.923320%
Tidewater	12.519170%
Sinclair	12.519170%
Gulf	12.519170%
Sunray Mid-Continent	6.259585%
Seaboard	6.259585%

All risk, cost and expense of operating said well shall be borne and paid by each of the parties hereto in the proportion set out opposite its name in Paragraph 6 below.

5. ACREAGE CONTRIBUTION BY ATLANTIC: It is understood and agreed that Atlantic is contributing to Gulf, Sunray Mid-Continent and Seaboard an undivided one-half (1/2) interest in its lease committed to the Unit Agreement in consideration of Gulf, Sunray Mid-Continent and Seaboard bearing all of Atlantic's proportionate share of the risk, cost and expense incurred in drilling, completing and equipping said initial test well for production, all as is provided in Paragraph 4 above. By its joinder herein, Atlantic hereby agrees that as soon as practicable after the drilling and completion of the initial test well

provided for herein, it will transfer, assign and convey unto Gulf, Sunray Mid-Continent and Seaboard an undivided one-half (1/2) interest in its lease committed to said Unit Agreement, and described in Exhibit "B" attached hereto; said interest assigned shall be owned and held in the following proportions:

Gulf	50%
Sunray Mid-Continent	25%
Seaboard	25%

Said assignment shall be effective as among the parties thereto without regard to whether or not same shall be approved by the Commissioner of Public Lands of the State of New Mexico, and the working interest in the unit area shall be owned as provided in Paragraph 6 below, without regard to the record ownership of the leases committed to the Unit Agreement. Atlantic further agrees to execute any other and further instruments necessary and requisite to vest effectively such interest in Gulf, Sunray Mid-Continent and Seaboard.

6. PARTICIPATING INTEREST OF THE PARTIES. For the purpose of this agreement and as between the parties hereto, the royalty interest is and shall be treated as one-eighth (1/8) and the working interest shall be treated as seven-eighths (7/8). Except as otherwise specifically provided herein, all of the production from the unit area attributable to the working interest hereunder, and all equipment and material acquired pursuant hereto, shall be owned and shared by the parties hereto in the following proportions:

Skelly	49.92332
Tidewater	12.51917
Sinclair	12.51917
Atlantic	6.25958
Gulf	9.38938
Sunray Mid-Continent	4.69469
Seaboard	4.69469

and, except for the cost attributable to the drilling, completion and equipping of said initial test well for production, specifically provided for in Paragraph 4, all costs, expenses and liabilities accruing or resulting from the development and operation of the unit area shall be borne by the parties hereto in the same proportion.

7. OVERRIDING ROYALTIES, PRODUCTION PAYMENTS, ETC: If any lease committed to the Unit Agreement is burdened with an overriding royalty, payment out of production or other charge in addition to the usual one-eighth (1/8) royalty, the owner of each such lease shall bear and assume the same out of the production allocated to it herein.

8. ADDITIONAL DRILLING: The parties hereto shall mutually agree upon the drilling of additional wells, their location, depth, deepening, plugging back, reconditioning and abandonment, and upon any of these operations applicable to any wells which may have been previously drilled hereunder. Unit Operator shall secure the written approval of Working Interest Owners before incurring any item of expense in excess of Five Thousand Dollars (\$5,000.00) in connection with the operation of the unit area, except in connection with the drilling of any authorized well. Unit Operator shall upon request furnish Working Interest Owners with a copy of Unit Operator's authority for expenditures for any project costing in excess of Two Thousand Five Hundred Dollars (\$2,500.00). The consent and approval of the drilling of any well shall include all expenditures regardless of amount for the drilling, testing, completing and equipping of same, including all necessary lines, separators and lease tankage.

9. NONCONSENT OPERATIONS: If at any time the parties cannot mutually agree upon the drilling of a particular well or the deepening, plugging back or reworking of any non-commercial well

previously drilled hereunder, the party or parties desiring to conduct such operations shall give the other parties written notice thereof, specifying the location, proposed depth, and estimated cost. The parties receiving such notice shall have fifteen (15) days after receipt thereof within which to notify the party or parties desiring to conduct such operations whether or not such parties shall elect to participate in the cost thereof. The failure of any party to give such notice within said period of fifteen (15) days shall be construed that such party does not elect to participate in the cost of the proposed drilling operations. If such parties shall elect not to participate in the cost of the proposed drilling operations, then within sixty (60) days after the expiration of said period of fifteen (15) days the party or parties desiring to conduct such operations, in order to be entitled to the benefits under this paragraph, shall authorize Unit Operator to commence the same for the account of such party or parties and thereafter prosecute the same with due diligence until said operations are completed. Any well drilled under the provisions of this paragraph shall conform to the then existing well spacing program. Any drilling operations under the provisions of this paragraph shall be conducted at the sole cost, risk and expense of the party or parties electing to conduct such operations. The parties deepening, plugging back or reworking any noncommercial well under the provisions of this paragraph shall pay to the other party or parties a sum equal to the proportionate share of such non-participating party or parties in the salvage value (determined in accordance with Exhibit "C" and after deducting cost of recovery) of the equipment and reclaimable casing or tubing on and in any well in which such deepening, plugging back and reworking operations are conducted, and the amount so paid shall form part of the cost of deepening, plugging back or reworking

such well for which the participating parties shall be entitled to reimbursement out of production on the basis hereinafter set out. If such operations when completed upon a particular well should result in commercial production, the participating party or parties shall own such well and be entitled to receive all the proceeds from the sale of each nonparticipating party's net share of the working interest production from such well until said participating party or parties shall have received from the proceeds of the sale of each nonparticipating party's net share of the production an amount equal to Two Hundred Percent (200%) of what each nonparticipating party's share of the cost of such operations (including equipment acquired or installed in such operations) would have been had each such party participated, and One Hundred Percent (100%) of each such nonparticipating party's share of the cost of the operation of said well during the time such reimbursement is being made. Upon reimbursement to participating party or parties of the share of the cost of each nonparticipating party, each such nonparticipating party shall be entitled to receive its proportionate share of such production as if such operations upon said well had been conducted by mutual agreement of all parties, and upon full reimbursement of such cost, such well shall be then owned as other wells and be operated by Unit Operator for the joint account of all parties hereto, the same as any other well drilled upon the unit area in accordance with the provisions hereof. In the event the participating party or parties fail to obtain from each nonparticipating party's share of such production a sufficient amount to repay such party's share of the cost of such drilling operations, plus such party's share of the cost of operating any such well, as set forth above, the participating party or parties shall have and own all such material, equipment and supplies placed or installed by it or them in or on the unit

area in connection with the operations conducted under the provisions of this paragraph; provided that if such material, equipment and supplies have a salvage value in excess of such remaining reimbursement figure hereinabove provided, such excess shall be owned by the parties hereto in proportion to their then participating interest in the unit area. If the drilling of any such well should result in a dry hole or non-commercial production, Unit Operator shall plug and abandon the same at participating party or parties' sole cost and expense. The participating party or parties shall hold the non-participating party or parties free and clear of all cost, expense and liability in connection with the drilling of any such well.

10. ACCOUNTING PROCEDURE AND COST OF OPERATION: All expenses and charges of every kind and character arising from or growing out of operations hereunder shall be paid by the Unit Operator and charged to the parties hereto in proportion to their respective interests hereunder. Except as herein otherwise provided, all costs, income, charges and credits for materials and other items in connection with all operations under said Unit Agreement and accounting with respect thereto shall be in accordance with the "Accounting Procedure" attached hereto and made a part hereof and marked Exhibit "C". The term "Non-Operators" as used in said Exhibit "C" shall be deemed to refer to the Working Interest Owners herein.

11. LIEN OF UNIT OPERATOR: Unit Operator shall have a lien on the interest or interests of each of the other parties hereto which are subjected to this agreement, the proceeds from the sale of oil and gas produced therefrom, and such party's interest in the material and equipment thereon and therein, to secure Unit Operator in the payment of any sum due to Unit Operator hereunder from each such party. The lien herein provided

for shall not extend to any royalty interests in or under the premises subject hereto or the production therefrom. And it is agreed that in event any amount due and owing to Unit Operator by any other party hereto is not paid as herein elsewhere provided within fifteen (15) days from the due date thereof, Unit Operator may serve a written order on the purchaser or purchasers of such other party's share of such oil and gas, and the service of such written order shall authorize and require such purchaser or purchasers to pay to Unit Operator the proceeds thereafter becoming due and owing for such share until Unit Operator shall have been fully reimbursed to date for and on account of such other party's delinquent part of such amounts so due and owing under this agreement, together with interest thereon at the rate of six percent (6%) per annum, but it is agreed that this remedy shall not be exclusive; provided, however, that all parties hereto shall have the right to sell and dispose of their respective interests in the oil and gas produced from the premises subject hereto free and clear of such lien and the purchaser or purchasers thereof need not take notice of said lien until default in payment and service of such written order as above provided, in which events each party hereto agrees that at any time when it may be in arrears in payments hereunder, but only in such event, it will execute upon request, such additional instrument as may be necessary or desired to further evidence such lien and to provide for the prompt discharge thereof.

12. LEASE RENTALS: Each Working Interest Owner shall pay any and all rentals which become due and payable under any oil and gas lease of such Working Interest Owner committed to said Unit Agreement and shall, at least ten (10) days prior to the time any such rental becomes due and payable, furnish to Unit Operator satisfactory evidence that said rental has been paid.

The burden of paying such rental shall fall entirely upon the Working Interest Owner committing the oil and gas lease to the Unit Agreement and Unit Operator as such is hereby relieved of any and all liability for any loss of title resulting from the failure to pay any rental due under the terms of any such oil and gas lease.

All rentals which may become due and payable under the lease committed to the unit area by Atlantic shall be paid by Atlantic; and Gulf, Sunray Mid-Continent and Seaboard shall reimburse Atlantic for their proportionate part of one-half (1/2) of all rentals so paid.

13. DRILLING CONTRACTS: All wells drilled on the premises shall be drilled on a competitive contract basis at the usual rates prevailing in the area. Unit Operator, if it so desires, may employ its own tools and equipment in the drilling of wells, but in such event the charge therefor shall not exceed the prevailing rate in the field, and such work shall be performed by Unit Operator under the same terms and conditions as shall be customary and usual in the field in the contracts of independent contractors who are doing work of a similar nature.

14. ABANDONMENT OF WELLS: Except as provided in numerical Paragraph 9 hereof, no well which is producing or has produced shall be abandoned without the mutual consent of the parties hereto; provided, however, if the parties are unable to agree as to the abandonment of any well, then the party or parties not desiring to abandon the well shall tender to the party or parties desiring to abandon same such abandoning party's proportionate share of the salvage value of the material and equipment in and on said well, such value to be determined in accordance with the attached Exhibit "C" -- Accounting Procedure. Upon receipt of said sum, the party or parties desiring to abandon

such well shall, without express or implied warranty of title, assign to the party or parties tendering said sum the abandoning party's or parties' rights in all working interest production which may be produced from said well from the formation or formations for which abandonment is contemplated, together with all material and equipment used in or on said well. If there is more than one non-abandoning party such assignment shall run in favor of the non-abandoning parties in proportion to their then participating interest in the unit area. Upon the delivery of said assignment, the assigning party or parties shall be relieved from all obligations thereafter (but not theretofore) accruing hereunder with respect to such well.

15. TRANSFER OF INTERESTS: In the event any party desires to sell or otherwise dispose of all or any part of its leasehold interest committed to said Unit Agreement, the other parties hereto shall have a preferential right to purchase or acquire the same. In such event, the selling or disposing party shall promptly communicate to the other parties hereto the offer received by it from a prospective transferee ready, willing and able to purchase or acquire the same, together with the name and address of such prospective transferee, and said parties shall thereupon have an option for a period of ten (10) days after the receipt of said notice to purchase or acquire such undivided interest under the same terms offered by such prospective transferee; provided, further, that the limitations of this paragraph shall not apply where any party hereto desires to mortgage its interest or to dispose of its interest by merger, reorganization, consolidation, sale or transfer of all its assets or a sale or transfer of its interest hereunder to a subsidiary or parent company, or to any company in which such party hereto owns a majority of the stock, or sale or other disposition by an individual to a member of his immediate family. Any interests so acquired

by more than one party hereto shall be shared by the parties purchasing the same upon the basis of their then participating interest in the unit area. The sale or other disposition of such interest subjected hereto shall be made expressly subject to this agreement and the Unit Agreement, and in the event of a sale or other disposition which is not made expressly subject to this agreement and the Unit Agreement, the selling or disposing party shall continue to be primarily liable and agrees to pay any costs or expenses attributable to the interest so sold or disposed of should the transferee of such interest fail or refuse to make such payment when due.

16. LIABILITY OF PARTIES: The liability of the parties hereunder shall be several and not joint or collective. Each party shall be responsible only for its obligations as herein set out and shall be liable only for its proportionate share of the cost of developing and operating the unit area. It is expressly agreed that it is not the purpose or intention of this agreement to create, nor shall the same be construed as creating, any mining partnership, commercial partnership or other partnership relations, nor shall the operations of the parties hereunder be construed or considered as a joint venture.

17. EMPLOYEES: The number of employees, the selection thereof, and hours of labor and the compensation for services to be paid them, shall be determined by Unit Operator. Such employees shall be the employees of Unit Operator.

18. RIGHT OF PARTIES TO INSPECT PROPERTY AND RECORDS: The following specific rights, privileges and obligations of the parties hereto are hereby expressly provided, but not by way of limitation or exclusion of any other rights, privileges and obligations of the respective parties:

- (a) Any party hereto shall have access to the entire unit area at all reasonable times to inspect and observe operations of every kind and character upon the property.
- (b) Any party hereto shall have access, at all reasonable times, to any and all information pertaining to wells drilled, production secured and marketed, and to the books, records and vouchers relating to the operation of the unit area.
- (c) Unit Operator shall, upon request, furnish the other parties hereto with daily drilling reports, true and complete copies of well logs, tank tables, daily gauge and run tickets, and reports of stock on hand at the first of each month, and shall also, upon request, make available samples and cuttings from any and all wells drilled on the unit area.

19. SURPLUS MATERIAL: Surplus material and equipment from the unit area, which in the judgment of Unit Operator is not necessary for the development and operation thereof, may be sold by Unit Operator to the other parties hereto or to others for the benefit of the joint account, or may be divided in kind between the parties hereto; provided that any party furnishing such material or equipment in kind shall have the prior right to take back such material or equipment in kind. Proper charges and credits shall be made by Unit Operator as provided in the Accounting Procedure, marked Exhibit "C", attached hereto.

20. RIGHT TO TAKE PRODUCTION IN KIND: Each of the parties hereto shall take in kind or separately dispose of its proportionate share of the production from the unit area, exclusive of production which may be used in development and producing operations on said unit area and in preparing and treating oil for marketing purposes and production unavoidably lost, and shall pay or deliver or cause to be paid or delivered all applicable royalties thereon and each party shall execute any and all contracts of sale pertaining to its interest in such production. Any extra expenditures incurred by the taking in kind or

separate disposition by any party hereto of its proportionate share of the production shall be borne by such party. In the event any party hereto shall fail or refuse to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the production from said unit area, Unit Operator shall have the right for the time being and subject to revocation at will by the other party owning same, to either purchase or to market such production at not less than the prevailing market price in the area for production of like grade, gravity and quality, but in no event less than the price which Unit Operator receives for its own portion of such production determined at the mouth of the well or wells; PROVIDED that all contracts of sale by Unit Operator of any Working Interest Owner'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 contract be for a period in excess of one year. Nothing herein contained shall ever be construed, however, as requiring Unit Operator to purchase or supply a market for the production of Working Interest Owners. Subject to provision of numerical Paragraph 11, each party hereto shall be entitled to receive directly payment for its proportionate share of the proceeds from the sale of production, saved and sold from said premises.

21. INSURANCE: Unit Operator shall carry such Workmen's Compensation and Employers' Liability Insurance as may be required by the laws of the State of New Mexico, provided that Unit Operator may be a self-insurer as to either or both of such risks, if permissible, under the laws of said state. No other insurance shall be carried by Unit Operator for the benefit of the parties hereto except by mutual consent of the parties.

22. SURRENDER OR TERMINATION OF INTERESTS: No lease committed to the Unit Agreement, insofar as it covers lands within the Unit Area, shall be surrendered in whole or in part unless all of the parties hereto mutually consent thereto. Any Working Interest Owner shall have the right at any time while not in default of any of the provisions hereof or indebted to the joint account to be relieved of all further obligations, except the obligation to pay such party's proportionate part of the cost of any well then drilling under this Agreement by assigning, subject to the approval of the Commissioner of Public Lands of the State of New Mexico, to the other parties hereto, in proportion to the interest then severally held by them in the Unit Area, all of the committed working interest in the Unit Area of the Working Interest Owner desiring to be relieved of such further obligations. Such interest shall be assigned free and clear of all liens and encumbrances, except those existing on the effective date of this agreement. In such event the Unit Operator shall pay to the Working Interest Owner desiring to be relieved of such further obligation, at fair secondhand value, less the cost of salvaging the same, all such party's proportionate interest in all casing, material, equipment, fixtures, and personal property belonging to the joint account.

23. REGULATIONS: This agreement and the respective rights and obligations of the parties hereunder shall be subject to all valid and applicable state and federal laws, rules, regulations and orders, and in the event this agreement or any provision thereof is, or the operations contemplated thereby are, found to be inconsistent with or contrary to any such law, rules, regulation or order, the latter shall be deemed to control and this agreement shall be regarded as modified accordingly, and as so modified, to continue in full force and effect.

Unit Operator shall prepare and furnish to any such duly constituted authority, through its proper agency or department

any and all reports, statements and information as may be requested when such reports are required to be furnished by Unit Operator.

24. FORCE MAJEURE: Obligations other than the obligation to make payments of amounts due hereunder shall be suspended while the parties hereto are prevented from complying therewith by acts of God, riots, war, acts of federal or state agencies, inability to secure materials, strikes, lockouts, or other matters beyond their control, whether similar or dissimilar; provided, that the settlement of strikes or lockouts shall be entirely within the discretion of the party having the difficulty.

25. CONTRIBUTIONS FROM OTHERS: In the event the parties hereto or any one of them receive a contribution toward the drilling of any well located on any lands within the unit area, said contribution shall be owned by the parties hereto in the proportion of their participation in the cost of said well.

26. NOTICES: All notices that are required or authorized to be given hereunder except as otherwise specifically provided herein shall be given by United States mail or Western Union telegram, postage or charges prepaid, and addressed to the party or parties to whom such notice is given at their respective addresses set forth under the signatures hereto or to such other address as any such party may have furnished in writing to the party sending the notice. The originating notice to be given under any provision hereof shall be deemed given when received by the party to whom such notice is directed and the time for such party to give response thereto shall run from the date the originating notice is received. The second or subsequent notice shall be deemed given when deposited in the United States Post Office or with Western Union Telegraph Company, with postage or charges prepaid.

27. FURTHER INSTRUMENTS: Each party hereto agrees that it will execute such contracts, surrenders, assignments, or other instruments necessary or required to carry out and make effectual all or any of the provisions of this agreement.

In the event that any of the leases which are now a part of the unit covered hereby, or which may hereafter become a part of such unit, cover lands owned by the State of New Mexico and it becomes necessary to apply the provisions of numerical Paragraphs 14, 15 or 22 of this agreement and in the application of the provisions of such paragraph, or paragraphs, any law, rule, regulation or order of the State of New Mexico or any governmental agency having jurisdiction hereof will be violated as to a matter of substance as distinguished from a matter of form, the parties hereto agree that such lands or leases shall be exempt from the application of such Paragraphs 14, 15 or 22, and separate agreements entered into at such time. Any assignment of a lease covering lands owned by the State of New Mexico which under the provisions of Paragraphs 14, 15 or 22 would otherwise run to two or more assignors, shall be made to the Unit Operator alone, who shall hold the interest conveyed thereby for the benefit of those entitled thereto under the provisions of the applicable paragraph or paragraphs.

28. PARTNERSHIP EXCLUSION: Each party hereto hereby elects that it and the operations covered by this agreement be excluded from the application of all of Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code of 1954, and amendments thereto, insofar as said Subchapter may be applicable in respect of the operations covered by this agreement. Operator is authorized and directed to make this election effective by complying with the requirements of the income tax regulations issued under said Subchapter. Each party agrees

not to notify the Commissioner of Internal Revenue that it desires Subchapter K to apply to the operations hereunder.

29. TAXES: Unit Operator shall render, for ad valorem tax purposes, the premises covered hereby, together with all tangible property, however classified, appurtenant thereto if, and to the extent that Unit Operator deems such property then to be subject to ad valorem taxation and shall pay, for the benefit of the parties hereto, such ad valorem taxes which Unit Operator deems to be assessed validly against such property. When paid, such ad valorem taxes shall be charged to the joint account as provided in the attached Exhibit "B".

30. UNIT AGREEMENT: The parties hereto having entered into that certain agreement, captioned "Unit Agreement For The Development and Operation of the Blue Quail Unit Area, Lea County, New Mexico" (hereinafter referred to as the "Unit Agreement"), of even date herewith, all of the terms, provisions and conditions of said agreement are incorporated herein by reference and made a part hereof with the same effect as if set out in full herein.

31. HEADINGS FOR CONVENIENCE: The headings used in this agreement are inserted for convenience only and shall be disregarded in construing this agreement.

32. EFFECTIVE DATE AND TERM: This Unit Operating Agreement shall become effective as of the effective date of the Unit Agreement for the development and operation of the Blue Quail Unit Area and shall remain in full force and effect during the life of such Unit Agreement, and the provisions hereof shall be considered as covenants running with the ownership of the respective oil and gas leases committed by the parties hereto to said Unit Agreement, and shall be binding upon the heirs, personal

representatives, successor and assigns of the parties hereto.

33. COUNTERPARTS: This agreement may be executed in any number of counterparts with the same force and effect as if all parties had signed the same document or this agreement may be ratified with like force and effect by a separate instrument in writing specifically referring hereto.

IN WITNESS WHEREOF, this agreement is executed as of the day and year first hereinabove written.

Approved as to Form: [Signature]

SKELLY OIL COMPANY

*Emo.*

By [Signature] Vice-President

ATTEST:

[Signature]  
asst Secretary

UNIT OPERATOR

TIDEWATER OIL COMPANY

ATTEST:

\_\_\_\_\_  
Secretary

By \_\_\_\_\_  
President

SINCLAIR OIL AND GAS COMPANY

ATTEST:

\_\_\_\_\_  
Secretary

By \_\_\_\_\_  
President

THE ATLANTIC REFINING COMPANY

ATTEST:

\_\_\_\_\_  
Secretary

By \_\_\_\_\_  
President

GULF OIL CORPORATION

ATTEST:

\_\_\_\_\_  
Secretary

By \_\_\_\_\_  
President

SUNRAY MID-CONTINENT  
OIL COMPANY

ATTEST:

\_\_\_\_\_  
Secretary

By \_\_\_\_\_  
President

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

SEABOARD OIL COMPANY

ATTEST:

\_\_\_\_\_  
Secretary

By \_\_\_\_\_  
President

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

WORKING INTEREST OWNERS

STATE OF OKLAHOMA |  
                          | SS  
COUNTY OF TULSA |

On this 27<sup>th</sup> day of August, 1957, before me appeared

[Signature], to me personally known, who, being by me duly sworn, did say that he is the Vice-President of SKELLY OIL COMPANY, a corporation, and that the seal affixed to said instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said SKELLY OIL COMPANY by authority of its Board of Directors, and that said [Signature] acknowledged said instrument to be the free act and deed of said corporation.

[Signature]  
Notary Public

My commission expires:  
My Commission Expires Mar. 18, 1958

STATE OF \_\_\_\_\_ |  
                          | SS  
COUNTY OF \_\_\_\_\_ |

On this \_\_\_\_\_ day of \_\_\_\_\_, 1957, before me appeared

[Signature], to me personally known, who, being by me duly sworn, did say that he is the \_\_\_\_\_ President of TIDEWATER OIL COMPANY, a corporation, and that the seal affixed to said 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 that said [Signature] acknowledged said instrument to be the free act and deed of said corporation.

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

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

STATE OF \_\_\_\_\_ |  
                          | SS  
COUNTY OF \_\_\_\_\_ |

On this \_\_\_\_\_ day of \_\_\_\_\_, 1957, before me appeared

[Signature], to me personally known, who, being by me duly sworn, did say that he is the \_\_\_\_\_ President of SINCLAIR OIL AND GAS COMPANY, a corporation, and that the seal affixed to said 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 that said [Signature] acknowledged said instrument to be the free act and deed of said corporation.

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

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

STATE OF \_\_\_\_\_ |  
COUNTY OF \_\_\_\_\_ | SS

On this \_\_\_\_\_ day of \_\_\_\_\_, 1957, before me appeared

\_\_\_\_\_, to me personally known, who, being by me duly sworn, did say that he is the \_\_\_\_\_ President of THE ATLANTIC REFINING COMPANY, a corporation, and that the seal affixed to said 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 that said \_\_\_\_\_ acknowledged said instrument to be the free act and deed of said corporation.

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

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

STATE OF \_\_\_\_\_ |  
COUNTY OF \_\_\_\_\_ | SS

On this \_\_\_\_\_ day of \_\_\_\_\_, 1957, before me appeared

\_\_\_\_\_, to me personally known, who, being by me duly sworn, did say that he is the \_\_\_\_\_ President of GULF OIL CORPORATION, a corporation, and that the seal affixed to said 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 that said \_\_\_\_\_ acknowledged said instrument to be the free act and deed of said corporation.

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

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

STATE OF \_\_\_\_\_ |  
COUNTY OF \_\_\_\_\_ | SS

On this \_\_\_\_\_ day of \_\_\_\_\_, 1957, before me ap-

peared \_\_\_\_\_, to me personally known, who, being by me duly sworn, did say that he is the \_\_\_\_\_ President of SUNRAY MID-CONTINENT OIL COMPANY, a corporation, and that the seal affixed to said 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 that said \_\_\_\_\_ acknowledged said instrument to be the free act and deed of said corporation.

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

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

STATE OF \_\_\_\_\_ |  
COUNTY OF \_\_\_\_\_ | SS

On this \_\_\_\_\_ day of \_\_\_\_\_, 1957, before me ap-  
peared \_\_\_\_\_, to me personally known, who, being  
by me duly sworn, did say that he is the \_\_\_\_\_ President of SEA-  
BOARD OIL COMPANY, a corporation, and that the seal affixed to  
said 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 that  
said \_\_\_\_\_ acknowledged said instrument to  
be the free act and deed of said corporation.

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

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

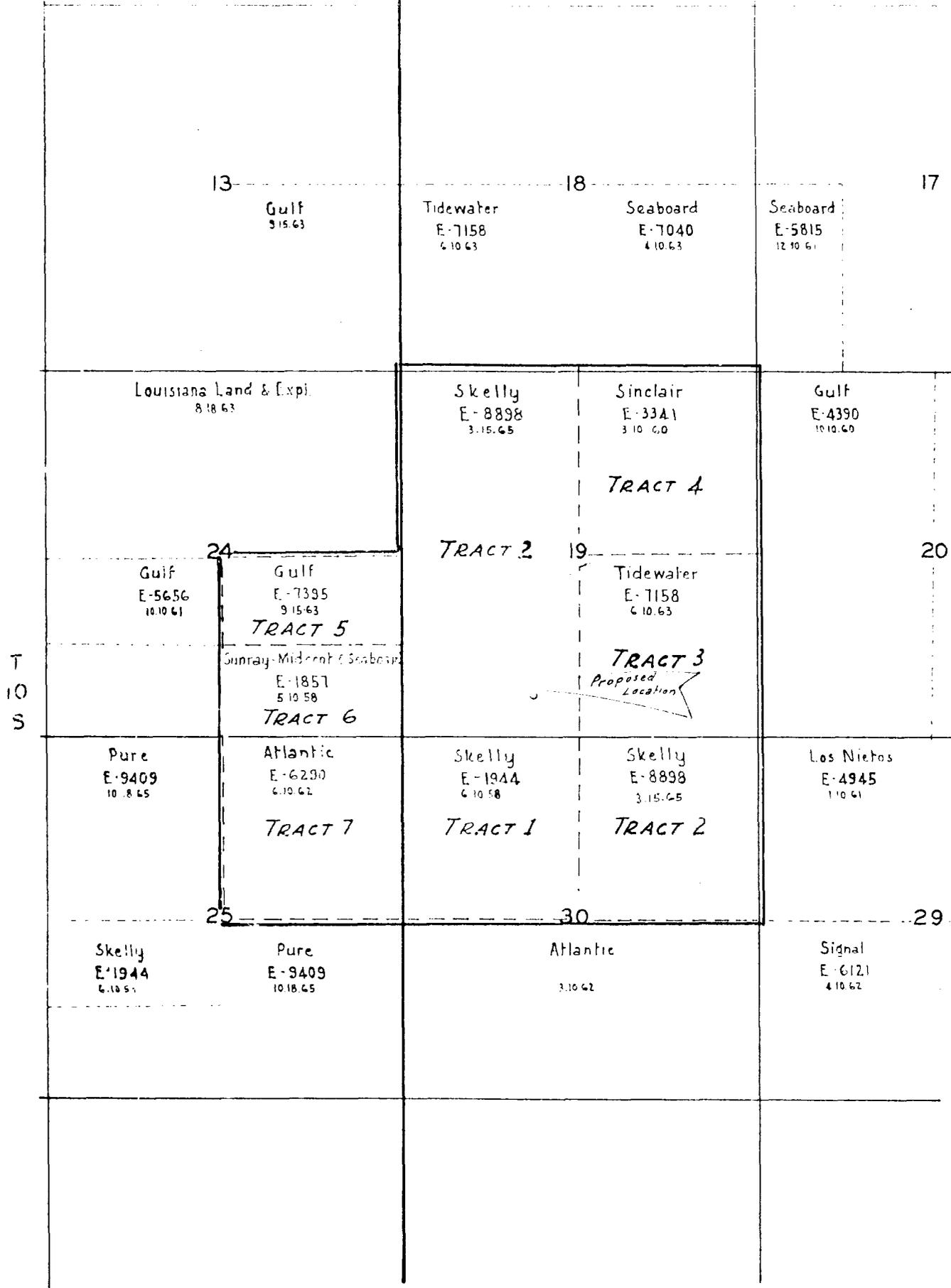


EXHIBIT "A"  
 SKELLY OIL COMPANY-OPERATOR  
 BLUE QUAIL UNIT  
 T-10-S R-33 & 34-E  
 A COUNTY, NEW MEXICO

EXHIBIT "B"  
 BLUE QUAIL UNIT  
 SKELLY OIL COMPANY - OPERATOR  
 SCHEDULE OF PERCENTAGE AND OWNERSHIP OF  
 OIL AND GAS INTERESTS IN ALL LANDS

Description & Tract No.	No. of Acres	New Mexico State Lease and Date	*Landowner & Percentage of Royalty	Record Owner of Lease Application	Over-riding Royalty	Working Interest Owner and Percentage of Interest Under Option Agreement, Operating Agreement or Assignment
Tract No. 1 Lot No. 1 (39.73 ac) Lot No. 2 (39.75 ac) & E2 NW4 Sec. 30 T10S-R34E	159.48	E-1944 (6-10-48)	State of New Mexico 12 $\frac{1}{2}$ %	Skelly Oil Company	None	Skelly Oil Company 87.50%
Tract No. 2 Lot No. 1 (39.58 ac) Lot No. 2 (39.62 ac) Lot No. 3 (39.65 ac) Lot No. 4 (39.70 ac) E2 W2 Sec. 19 NE4 Sec. 30 T10S-R34E	478.56	E-8898 (3-15-55)	State of New Mexico 12 $\frac{1}{2}$ %	Skelly Oil Company	None	Skelly Oil Company 87.50%
Tract No. 3 NE4 Sec. 19 T10S-R34E	160.00	E-7158 (6-10-53)	State of New Mexico 12 $\frac{1}{2}$ %	Tidewater Oil Co.	None	Tidewater Oil Company 87.50%
Tract No. 4 NE4 Sec. 19 T10S-R34E	160.00	E-3341 (3-10-50)	State of New Mexico 12 $\frac{1}{2}$ %	Sinclair Oil and Gas Co.	None	Sinclair Oil & Gas Company 87.50%
Tract No. 5 NE2 SE4 Sec. 24 T10S-R33E	80.00	E-7395 (9-15-53)	State of New Mexico 12 $\frac{1}{2}$ %	Gulf Oil Corporation	None	Gulf Oil Corporation 87.50%

EXHIBIT "B"  
 BLUE QUAIL UNIT  
 SKELLY OIL COMPANY - Operator  
 SCHEDULE OF PERCENTAGE & OWNERSHIP OIL & GAS  
 INTERESTS IN ALL LANDS

Tract No. & Description	No. of Acres	New Mexico State Lease & Date	*Landowner & Percentage of Royalty	Record Owner of Lease Application	Over-riding Royalty	Working Interest Owner & Percentage of Interest Under Option Agreement, Operating Agreement or Assignment	
Tract No. 6 S2 S24 Sec. 24 T10S-R33E	80.00	E-1857 (5-10-48)	State of New Mexico 12 1/2%	Sunray-Mid-Continent Oil Company & Seaboard Oil Company, jointly	None	Sunray-Mid-Continent Oil Company & Seaboard Oil Company, jointly	87.50%
Tract No. 7 S24 Sec. 25 T10S-R33E	160.00	E-6290 (6-10-52)	State of New Mexico 12 1/2%	The Atlantic Refining Company	None	The Atlantic Refining Company  Sunray-Mid-Continent Oil Company & Seaboard Oil Company, jointly  Gulf Oil Corporation	43.75% 21.875% <u>21.875%</u> 87.50%

\* All New Mexico State Lands

## EXHIBIT " C "

PASO-T-1555-2

Attached to and made a part of Blue Quail Unit Operating  
Agreement, Lea County, New Mexico

### ACCOUNTING PROCEDURE

#### (UNIT AND JOINT LEASE OPERATIONS)

#### I. GENERAL PROVISIONS

##### 1. Definitions

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

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

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

##### 2. Statements and Billings

Operator shall bill Non-Operator on or before the last day of each month for its proportionate share of costs and expenditures during the preceding month. Such bills will be accompanied by statements, reflecting the total costs and charges as set forth under Subparagraph 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 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 warehouses or other properties, no charge shall be made to the joint account for a distance greater than the distance from the nearest reliable supply source 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)**

A pro rata portion of the salaries and expenses of Operator's production superintendent and other employees serving the joint property and other properties of the Operator in the same operating area, whose time is not allocated directly to the properties, and a pro rata portion of the cost of maintaining and operating a production office known as Operator's New Mexico District office located at or near Hobbs, New Mexico (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 ~~the same basis; one drilling well equals four producing wells.~~

a well basis; one drilling well equals four producing wells.

**12. Administrative Overhead**

Operator shall have the right to assess against the joint property covered hereby the following management and administrative overhead charges, which shall be in lieu of all expenses of all offices of the Operator not covered by Section II, Paragraph 11, above, 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
all depths	\$200.00	\$50.00	\$35.00	\$25.00

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