Mobil Oil Corporation

NINE GREENWAY PLAZA-SUITE 2700
HOUSTON, TEXAS 77046

June 11, 1979

BEFORE EXAMINER STAMETS
OIL CONSERVATION DIVISION
CASE NO. 4
CASE NO. 6574
Submitted by: TXO
Hearing Date 7-11-79

Texas Oil & Gas Corporation
900 Wilco Building
Midland, TX 79701

Attention: Mr. Doyle John Snow

~~PROPOSED FARMOUT~~
NM-567 (STATE)
LEA COUNTY, NEW MEXICO
PROP. NO. 10-546-79 (REVISED)

Gentlemen:

Mobil Oil Corporation is the owner of the following described Oil, Gas and Mineral lease:

B-1527 (MOC NM-567) - Oil and Gas Lease dated December 21, 1932, by and between the State of New Mexico, Lessor, and Magnolia Petroleum Company, Lessee, insofar as said lease covers the South Half of the Northeast Quarter (S/2 NE/4) of Section 6, T-17-S, R-35-E, Lea County, New Mexico.

Reference is hereby made to said lease and the record thereof for this and for all other purposes.

If you (a) commence on or before ninety (90) days from the date hereof the drilling of a well at a location on the SE/4 SE/4 said Section 6, (b) prosecute the drilling of said well with due diligence to a depth sufficient to test to this company's complete satisfaction the Morrow formation, at an estimated depth of 12,200 feet, (c) complete said well as a producer of gas in paying quantities within a reasonable time not later than 180 days from the date of commencement, and (d) have fully complied with all other provisions hereof, we agree to assign to you, without warranty in law or in equity, all of our oil and gas operating rights in the above-described lease, insofar and only insofar as said lease covers the S/2 NE/4 Section 6, T-17-S, R-35-E, Lea County, New Mexico, 80 acres, more or less, down to the depth of 100 feet below total depth drilled, subject however, to the further conditions, obligations and reservations hereinafter set out. Said well is sometimes hereinafter referred to as the "earning well".

In any assignment which we make to you pursuant to the terms of this agreement, we shall reserve and retain the following:

A. All oil, gas and related hydrocarbons under the assigned premises covered by the above-described lease below the depth of 100' below the total depth drilled in said well.

B. Subject to the "back-in" provisions of this agreement which follow, we shall reserve a free overriding royalty of 1/8 of 8/8 of all the oil, gas and other liquid hydrocarbons which may be produced and saved from the earning well. If Mobil's interest in said lease, insofar as it covers the assigned premises, is less than a full interest or if said lease, insofar as it covers the assigned premises, covers less than a full interest, said overriding royalty interest in such lease shall be proportionately reduced. The overriding royalty hereby reserved shall be in addition to any and all existing overriding royalties, production payments and other burdens, if any, affecting or payable out of the oil and gas leasehold estate in the assigned premises, or any part thereof. Said overriding royalty oil (including liquid hydrocarbons saved at the well) shall, at Mobil's option, be delivered free of cost to Mobil, either into its storage tanks or to its credit in the pipeline to which the earning well or wells may be connected. Said overriding royalty on gas (including gas-well gas, casinghead gas, and all other gaseous hydrocarbons) shall be measured on the basis of the market value at the well(s) from which produced. You shall furnish Mobil complete statements, at such intervals and on such forms as Mobil may request, covering production from the earning well, measurement thereof, amounts stored, used, delivered to pipelines and sold. Fuel oil and gas may be deducted before computing said overriding royalty.

C. The right and option to convert the above-described overriding royalty to a leasehold estate in the assigned premises equal to an undivided 33-1/3% of the leasehold interest owned by Mobil therein immediately prior to execution of said assignment, such leasehold estate to be free and clear of any overriding royalty, production payment or other burden not now existing. The following provisions shall govern the time and manner of exercising such right and option:

(i) Promptly after "payout (as the term "payout" is hereinafter defined) of the earning well drilled under the terms of this agreement, you shall notify Mobil in writing of such fact.

Within 30 days after receipt by Mobil of any such notice of payout, Mobil shall notify you in writing whether or not Mobil elects to exercise its above-stated right and option. If Mobil so notifies you of its election to exercise such right and option, you shall promptly assign to Mobil the above-specified interest in the assigned premises, the well or wells thereon and personal property appurtenant thereto, and Mobil shall release the above-described overriding royalty interest, both effective as of 7:00 a.m. on the day following the date of payout. Concurrently with delivery of said assignment, the owners thereof shall execute an operating agreement to be the same in form as Exhibit "II" hereto and to be completed in the manner specified therein.

(ii) "Payout" of the earning well shall mean the date on which you shall have recovered out of the total proceeds of production from the pooled or communitized gas unit as hereinafter provided (after deducting the lease royalty, any and all overriding royalties and production payments existing at the time of the original assignment from Mobil to you and affecting the assigned premises, the overriding royalty reserved by Mobil herein and applicable gross production taxes) 100% of the cost of drilling, completing, testing and equipping said well to produce through the tanks, in the case of an oil well, or into the pipeline to which the well may be connected, in the case of a gas well, together with 100% of the operating costs thereof up to such time. The Accounting Procedure made a part of the Operating Agreement form attached hereto as Exhibit "II" shall govern the extent to which expenses may be charged to such well (as well as the basis of all such charges and credits thereto) for the purpose of determining payout.

(iii) You shall keep an accurate record of all costs of drilling, completing, testing equipping and operating said well, which record shall be available at all reasonable times for inspection by Mobil and its duly authorized representatives. You shall furnish Mobil a monthly statement showing the total proceeds from production (and the amount of the above-described authorized deductions therefrom) from the earning well for the previous month and the well costs for such month (such costs to be detailed to the same extent as required by Provision I 2 of said Accounting Procedure). Such statement shall also show the cumulative well-cost and production proceeds so that the then current payout status of the well can be readily ascertained. Mobil's representatives shall have the right to audit your books to the same extent a non-operator is given the right to audit the books of operator under the terms of said Accounting Procedure.

Mobil

Upon completion of the earning well as a gas well capable of producing gas in paying quantities, you shall pool or communitize the above-described lease insofar as it covers the land and depths subject to this agreement with other oil and gas operating rights or leasehold estates to form a unit for the production of gas, said unit to be comprised of the E/2 of Section 6, Township 17 South, Range 35 East, Lea County, New Mexico. The overriding royalty, or the oil and gas operating rights and working interests to which said overriding royalty may be converted, as herein provided, shall be reduced proportionately to the amount that the assigned premises placed in the unit bears to the total acreage so pooled or communitized in said unit. We agree to join with you in execution of such instrument(s) as may be required for formation of such unit.

This agreement and any assignment made pursuant hereto is subject to the Casinghead Gas Sales Contract between Mobil Oil Corporation, Seller, and Phillips Petroleum Company, Purchaser, dated August 1, 1962, covering gas produced from the above-described property. You shall, as to any interest assigned to you hereunder, be bound by said contract as fully as if you had executed the same.

Exhibit "I" attached hereto is a part of this agreement as if copied in full herein. If there be any conflict between Exhibit "I" and the foregoing provisions of this agreement, said foregoing provisions shall prevail.

This letter is in triplicate and is not binding upon us unless accepted by you as evidenced by your signature and two signed copies are returned to this company within fifteen (15) days from your receipt hereof, at which time this letter shall constitute a valid and binding contract between you and Mobil Oil Corporation.

Yours very truly,

MOBIL OIL CORPORATION

By _____
S. T. Alexander
Division Land Manager

MJM/gs

AGREED TO AND ACCEPTED THIS
_____DAY OF _____, 1979:

TEXAS OIL & GAS CORPORATION

BY_____

EXHIBIT "I"

'ACHED TO AND MADE A PART OF FARMOUT LETTER AGREEMENT BETWEEN MOBIL OIL CORPORATION AND

Texas Oil & Gas Corporation

'ED June 11, 1979

Additional Covenants, Agreements, Terms and Conditions

A. With respect to each well provided for in this Farmout Letter Agreement:

1. Mobil, and its authorized employees and representatives, shall at any and all times have free access to (i) the well, including freedom of the derrick floor, and (ii) all information and records pertaining to the well and the production therefrom.

2. You shall test to Mobil's complete satisfaction all formations covered by this Agreement which reasonably appear capable of producing oil or gas; and at Mobil's request you shall core and/or test by drillstem or other method specified by Mobil any and all formations covered by this Agreement which Mobil believes may be oil-bearing or gas-bearing formations.

3. Before any testing, coring or logging operations are begun, you shall notify one of the following persons (in the order listed) in sufficient time for Mobil representatives to be present to witness the same:

Name	Office Phone	Home Phone
D. E. Dewey	713 - 871-5112	713 - 688-0895
H. J. Holmquest	713 - 871-5089	713 - 467-9307
C. K. Petter	713 - 871-5090	713 - 461-8664

4. You shall, at your own expense, furnish to the Mobil representative(s) designated hereinbelow the following:

(a) Daily progress reports by telephone each morning (except Saturdays, Sundays and Mobil employee holidays) before 9:00 a.m. from the time the well is spudded until it is finally completed (such reports covering Saturday, Sunday and holiday operations to be furnished by 9:00 a.m. of the next succeeding day which is neither a Saturday, Sunday nor holiday). Such daily progress reports shall be telephoned to Geological Secretary

713 - 871-5087 at Nine Greenway Plaza, Suite 2700, Houston, TX 77046

(b) All data and information from the well, including but not limited to the following (same to be furnished to Mobil at Nine Greenway Plaza, Suite 2700, Houston, Texas 77046,

Attention: David E. Dewey:

(1) Two copies of each form and report filed with any governmental authority; and one copy to S. W. Akers at the above address.

(2) Two copies of all logs and surveys, core and fluid analyses, drillstem, wireline or other test charts, evaluation reports, logging reports and daily-drilling-time reports;

(3) Representative chips from all cores, taken at one-foot intervals; samples of cuttings taken at _____-foot intervals from _____ feet to _____ feet; and (if requested by Mobil) two quarts of fluid from each drillstem test;

(4) Two complete sets (including both field prints and final copies) of each of the following: (i) an induction-electrical log, from bottom of the surface casing to total depth; (ii) a sonic log through the zones of interest in the well or, at Mobil's request, from the bottom of the surface casing to total depth (which induction-electrical log and sonic log you agree to run before completion or abandonment of the well); and (iii) if requested by Mobil, a dipmeter survey from the bottom of the surface casing to total depth;

(5) Daily production reports (if the well be completed as a producer) from the time the initial potential test is completed until 30 days after the date on which production from the well is first marketed; and

(6) _____

_____

_____.

5. In the event the well is not capable of producing oil or gas in paying quantities, you shall promptly plug and abandon the same; before plugging and abandoning the well, however, you shall obtain Mobil's authority therefor.

6. Mobil shall have the right and option to conduct a velocity survey in the well if you do not conduct such survey. You shall give Mobil adequate advance notice (a minimum of 48 hours before plugging or running any production casing in the well) of your intention not to run a velocity survey so that Mobil will have ample time to get the necessary personnel and equipment on the rig location and exercise its option to run a velocity survey. Any velocity survey conducted by Mobil hereunder shall be run at its own expense, and Mobil agrees to pay for all standby rig time attributable to the running of its velocity survey. Mobil shall retain all trading and sales rights to any velocity survey run at its expense hereunder and shall not be obligated to furnish you the results of, or any information or data concerning, said velocity survey.

B. You shall notify Mobil before shutting in any gas well drilled on lands covered by this Agreement, whether such shut-in occurs before or after initial production from said well; and you shall take all necessary action to insure that any and all payments required by reason of the shut-in under the terms of any lease(s) affected by this Agreement are timely and properly made. Unless and until otherwise specifically provided by mutual agreement of the parties in writing, you shall make all such shut-in payments and shall bear 100% of the amount thereof.

C. Unless and until otherwise specifically provided by mutual agreement of the parties in writing, Mobil shall pay or tender (or cause to be paid or tendered) all rentals and minimum royalties, if any, which may hereafter become due under the terms of any lease(s) covered by this Agreement, but shall have no liability to you for failure to make any such payment or tender or to make same timely or properly; and you shall, within fifteen (15) days after receipt of invoice therefor, reimburse Mobil for 100% of all of such rentals or minimum royalties so paid or tendered and attributable to lands then covered by this Agreement.

D. All operations by reason of this Agreement other than those, if any, which Mobil actually conducts under a specific right or obligation to do so, as herein provided, or which are actually conducted under terms of an Operating Agreement between Mobil and you specially provided for herein (all such operations being hereinafter called "operations hereunder") shall be at your own risk and expense and under your exclusive control.

E. All operations hereunder shall be conducted with due diligence and in a good and workmanlike manner. Time is of the essence in the conduct of all operations hereunder and in the performance of all your obligations under this Agreement

F. You shall indemnify and save Mobil harmless from and against any and all claims, demands, causes of action and judgments of whatsoever nature (and all costs and fees in connection with the same) arising in favor of any party (including you, your employees, Mobil's employees and any other party whomsoever) for or on account of personal injury, death, property damage or for any other reason whatever, incident to or arising, directly or indirectly, from operations hereunder. You shall also pay Mobil for all damages to its property and shall indemnify and save Mobil harmless from and against any and all liens, claims and encumbrances against Mobil's property (and from and against the payment or satisfaction of same) arising, directly or indirectly from, or incident to, operations hereunder.

G. You shall obtain and pay for all permits and licenses, if any, required for conducting operations hereunder and shall strictly comply with all applicable laws and ordinances and all applicable governmental rules, regulations and orders in connection with qualifying for and conducting operations hereunder, including, without limitation, the Fair Labor Standards Act, the Occupational Safety and Health Act, all applicable pollution control laws, ordinances, rules, regulations and orders and those pertaining to ecology and the environment (as all of same have been or may hereafter be amended). You shall also, unless exempt, comply with Executive Order 11246 (Equal Employment Opportunity) effective October 24, 1965, as same may hereafter be amended or superseded, together with all relevant governmental rules, regulations and orders promulgated pursuant thereto. You agree that all provisions of said laws, ordinances, rules, regulations and orders shall be deemed incorporated herein by reference and shall be binding upon you to the same extent as if copied in full herein.

H. You shall restore the surface of the land affected by operations hereunder to the condition and at the time(s) required by (1) the express or implied covenants of the lease(s) and other instruments, if any, pertaining to lands covered by this Agreement and (2) applicable laws and ordinances and applicable governmental rules, regulations and orders

I. Any assignment or lease given by Mobil pursuant to the terms of this Agreement shall be executed by Mobil without warranty of title, either express or implied. In addition, any such assignment or lease may, at Mobil's election, include such of the provisions of this Agreement as Mobil deems appropriate to include.

J. Unless Mobil receives from you a written request for any assignment or lease to which you would become entitled hereunder, except for the provisions of this Paragraph J, within sixty (60) days after completion of the well which is the particular assignment-earning or lease-earning well hereunder, you shall have no right to receive any such assignment or lease from Mobil, notwithstanding anything in this Agreement to the contrary.

K. If you (i) fail timely and properly to commence, drill and complete any well(s) provided for herein in accordance with the provisions hereof for such well(s) or (ii) fail to perform any of your contractual duties, obligations or agreements hereunder, Mobil may terminate your further rights, if any, under this Agreement. Any termination for non-performance of a contractual duty, obligation or agreement shall, however, be evidenced by written notice to you, specifying the particular act(s) or omission(s) constituting such non-performance; and your further rights under this Agreement shall terminate upon your receipt of any such notice. The rights given Mobil under this Paragraph K shall be in addition to any and all other rights or remedies afforded Mobil by this Agreement or otherwise available to Mobil, either at law or in equity.

L. Mobil, its successors and assigns, shall have, and in any assignment or lease issued by Mobil pursuant to this Agreement (the land included therein, as to the formations or depths covered thereby, being hereinafter sometimes called the "Assigned Premises"), Mobil shall except therefrom and reserve (in addition to any and all other rights and interests herein provided to be reserved to Mobil) to itself, its successors and assigns, the following rights and options with respect to all oil, other liquid hydrocarbons and gas produced and saved from the Assigned Premises (after deducting any used for your ordinary lease operations thereon):

1. The continuing right and option, at any time(s), to purchase all or any of (a) the oil and/or (b) other liquid hydrocarbons (including condensate, distillate and other liquids recovered from the well stream by normal lease-separation methods) produced and saved from the Assigned Premises. The price to be paid therefor shall be Mobil's posted price applicable thereto for the particular field or the average price paid for such oil and/or liquid hydrocarbons of the same grade and gravity by other purchasers in the field, whichever is the greater.

2. The preferential right and option to purchase the gas (the term "gas" to include natural gas, casinghead gas and all other gaseous substances and all constituents thereof in the well stream, whether produced from gas wells or oil wells) produced and saved from the Assigned Premises on the same terms (or on terms the monetary equivalent thereof) as those under which you propose to sell or otherwise dispose of same. You shall notify Mobil in writing of each proposed sale or other disposition of the gas as much in advance as reasonably possible; and Mobil shall have thirty (30) days after receiving written notice of all terms of each bona fide offer by a prospective purchaser ready, willing and able to purchase the gas, or part thereof (or of all terms of any other proposed disposition of the gas, or part thereof) in which to notify you of its election either to exercise or waive its preferential right and option. No contract for the sale or other disposition of the gas, or any part thereof, shall ever be made by you until Mobil shall have first either exercised or waived in writing its herein-described preferential right and option with respect to the gas (and no claimed act or expression of waiver shall bind Mobil unless and until specifically expressed in writing). Mobil shall have a continuing separate right and option with respect to each and every proposed sale or other disposition of the gas, or part thereof.

In the event (a) Mobil waives in writing its above-stated preferential right and option with respect to a particular proposed sale or other disposition of the gas, or part thereof, (b) you enter into a contract with the other prospective purchaser for the sale or other disposition of the gas, or part thereof, and (c) Mobil herein reserves a right to receive a leasehold estate and/or working interest, either by conversion of a reserved overriding royalty interest thereto or otherwise upon payout or other specified time, then each such contract you so enter into shall contain the following provision:

"This contract shall cover only the interest of Seller in the properties affected hereby and nothing herein shall ever be construed as committing to the terms or conditions of this contract any leasehold estate or working interest in such properties, or part(s) thereof, to which Mobil Oil Corporation ("Mobil"), its successors or assigns, may be or hereafter become entitled by reason of the provisions of that certain Farmout Letter Agreement between Mobil and Texas Oil & Gas Corporation, dated June 11, 1979; and there is excepted from any gas or gas reserves hereby committed, and is reserved to Mobil, its successors and assigns, for its exclusive disposition, that share of gas to which Mobil, its successors and assigns, is or may become entitled by reason of said Farmout Letter Agreement."

or other similar provision satisfactory to and approved by Mobil in writing prior to your execution of the contract (unless Mobil agrees in writing to waive inclusion of such provision). In addition, if Mobil so requests, you shall furnish to Mobil a written statement by the gas purchaser, acknowledging and agreeing that such purchaser is buying

and taking only gas attributable to the interest of Seller under such contract and that any working interest share of the gas to which Mobil, or its successors or assigns, may be or become entitled by reason of said Farmout Letter Agreement is not covered by or committed to such contract, nor is to be taken by the purchaser thereunder.

If any part(s), or all, of the Assigned Premises be included with other land(s) to form any unit, pool or joint-operating area with respect to oil, other liquid hydrocarbons and/or gas and a portion of the total production from such unit, pool or joint-operating area (the "unit production") is allocated or attributed to the part(s) of the Assigned Premises included therein under the instrument(s) creating or covering the same, then Mobil's preferential-purchase rights and options stated hereinabove in this Paragraph L (and the subparagraphs thereunder) shall, with respect to such unit production, apply to the portion(s) of total unit production so allocated or attributed to the part(s) of the Assigned Premises included in such unit, pool or joint-operating area, absent specific agreement between the parties to the contrary.

The rights and options of Mobil provided for in this Paragraph L (and the sub-paragraphs thereunder) may be sold, transferred or assigned in whole or in part, and the provisions thereof shall extend to and inure to the benefit of such successors and assigns of Mobil.

M. All gas, including casinghead gas, produced and saved by you from the Assigned Premises shall -- at your own risk d cost and before sold or otherwise disposed of or used for any purpose by you -- be run through properly functioning eld-type separating equipment (unless the liquid hydrocarbon content thereof is so small as to make installation and eration of such equipment not profitable or unless the gas pressure is such that running the same through such equipnt would substantially diminish your ability to sell and deliver the gas against gathering system or pipeline pressure) r the purpose of separating, extracting and saving the liquid and liquifiable hydrocarbons recoverable from the gas by ch means before the gas is sold, disposed of, or used for any purpose by you.

N. Mobil does not covenant, warrant or represent to you, either expressly or impliedly, the present or continuing lidity or status of any oil, gas and/or mineral lease(s) or other instrument(s) described or mentioned in this Agreent or the right of Mobil to commit any such lease(s) or instrument(s) to this Agreement.

O. Should you at any time(s) intend to release, surrender, abandon or allow to terminate (whether by nonpayment of ntals or otherwise), in whole or in part, any lease(s) covered by an assignment from Mobil hereunder, you shall give itten notice thereof to Mobil at least thirty (30) days prior to the date of any such intended release, surrender or andonment, or the date on which same would terminate. Mobil shall, within fifteen (15) days after receipt of any such tice, notify you whether or not it desires to receive a reassignment of the interest(s) which you intend to release, rrender, abandon or allow to terminate. If Mobil so notifies you of its desire to receive such reassignment, you all execute and deliver to Mobil -- on or before five (5) days prior to the date on which you intend to release, surrenr, abandon or allow said interest(s) to terminate -- such reassignment, in form and substance satisfactory to Mobil. such reassignment shall, however, relieve you (1) of the obligation to plug and abandon -- at your sole risk and cost d in strict accordance with all applicable laws and all applicable rules, regulations and orders of governmental thorities -- any well or wells on the premises covered by such reassignment, or (2) of any other obligation imposed on you by this Agreement, unless (and then only to the extent that) Mobil specifically agrees in writing to assume such ligation(s).

P. In the event you earn any assignment of an interest in a lease(s) affecting the Assigned Premises pursuant to the erms of this Agreement, and production of oil or gas therefrom shall cease for any period of ninety (90) consecutive ays during which period of time no operations are conducted on the Assigned Premises in a good-faith effort to restablish production of oil or gas therefrom, and said lease(s) is then being maintained in force and effect by some eans other than production from or operations on the Assigned Premises, you shall promptly tender a reassignment of such nterest to Mobil. If Mobil accepts such reassignment, you shall nevertheless be bound by the provisions of the last entence of Paragraph O of this Exhibit "I".

Q. Except as may be otherwise specifically set forth in this Agreement, you hereby assume, and agree to comply with, l express and implied covenants and obligations of all leases and assignments thereof, deeds, agreements and other inruments pertaining to lands and depths covered by this Agreement, insofar as such covenants and obligations relate to ch lands and depths. Without limiting the generality of the immediately preceding sentence hereof, it is agreed that the event any part or parts of the lands affected by this Agreement are subject to any Unit Agreement, Unit Operating reement or other contracts of a similar nature providing for the furnishing of notice or information to the Operator ereof or prescribing any requirements in connection with non-unit operations on such lands, you shall timely and operly furnish any and all such required notices and information and comply with any and all such requirements in conction with your operations hereunder, all at your own risk and expense.

R. All rights of Mobil under this Agreement shall apply not only to, and during the life of, any lease(s) described an assignment delivered by Mobil hereunder, but to any renewal or extension thereof and to any lease you may acquire thin one year from expiration of the prior lease(s), to the extent such renewal, extension or lease covers the signed Premises.

S. Except as may be otherwise specifically provided for herein, all notices, requests and information authorized or required to be given or made to Mobil hereunder (including requests for Mobil's authority to plug and abandon wells) shall be given or made to the representative of Mobil executing this Agreement or to his designated representatives at the same address.

All such notices, requests and information to be given or made to you hereunder shall be given or made at your address as shown on the first page of the Letter to which this Exhibit "I" is attached. Each party shall have the right, from time to time, to change its address or addresses herein specified by giving written notice thereof to the other party.

T. Neither this Agreement nor your rights or obligations hereunder may be transferred or assigned, in whole or in part, without Mobil's advance written consent. In the event Mobil should so consent to any such transfer or assignment, you shall nevertheless remain bound by all of the provisions hereof unless Mobil shall specifically release you therefrom in writing.

EXHIBIT "II"

ATTACHED TO AND MADE PART OF FARMOUT LETTER AGREEMENT DATED JUNE 11, 1979 BY AND BETWEEN MOBIL OIL CORPORATION AND _____

A.A.P.L. FORM 610

MODEL FORM OPERATING AGREEMENT – 1956

Non-Federal Lands

OPERATING AGREEMENT

DATED

_____, 19___,

FOR UNIT AREA IN TOWNSHIP 17-S, RANGE 35-E,

LEA COUNTY, STATE OF NEW MEXICO.

AMERICAN ASSOCIATION OF PETROLEUM LANDMEN
APPROVED FORM. A.A.P.L. NO. 610
MAY BE ORDERED DIRECTLY FROM THE PUBLISHER
ROSS-MARTIN COMPANY, BOX 300, TULSA 74101

A.A.P.L. FORM 610

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A.A.P.L. FORM 610

OPERATING AGREEMENT

THIS AGREEMENT, entered into this_____ day of_____, 19____, between Texas Oil & Gas Corporation hereafter designated as "Operator", and the signatory parties other than Operator.

WITNESSETH, THAT:

WHEREAS, the parties to this agreement are owners of oil and gas leases covering and, if so indicated, unleased mineral interests in the tracts of land described in Exhibit "A", and all parties have reached an agreement to explore and develop these leases and interests for oil and gas to the extent and as hereinafter provided;

NOW, THEREFORE, it is agreed as follows:

1. DEFINITIONS

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

(1) The words "party" and "parties" shall always mean a party, or parties, to this agreement.

(2) The parties to this agreement shall always be referred to as "it" or "they", whether the parties be corporate bodies, partnerships, associations, or persons real.

(3) The term "oil and gas" shall include oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons, unless an intent to limit the inclusiveness of this term is specifically stated.

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

(5) The term "Unit Area" shall refer to and include all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".

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

(7) All exhibits attached to this agreement are made a part of the contract as fully as though copied in full in the contract.

(8) The words "equipment" and "materials" as used here are synonymous and shall mean and include all oil field supplies and personal property acquired for use in the Unit Area.

2. TITLE EXAMINATION, LOSS OF LEASES AND OIL AND GAS INTERESTS

~~A. Title Examination:~~

Each party other than Operator shall promptly submit to Operator abstracts certified from beginning to recent date, together with all title papers in its possession covering leases and oil and gas interests which it is subjecting to this contract. All of these abstracts and title records shall be examined for the benefit of all parties by Operator's attorneys.

Operator shall promptly submit abstracts certified from beginning to recent date, together with all title papers in its possession covering leases and oil and gas interests which it is subjecting to this agreement, to _____ for examination by the latter's attorney for the benefit of all parties.

All title examinations shall be made without charge. Each examining attorney shall prepare a complete title report on each separate tract based upon the abstract record and title papers submitted to him. Each title report shall contain a list of fee owners and their interests, shall state the attorney's opinion concerning validity of their interests, and shall contain an enumeration and description of title defects, if any, a report upon mortgages, taxes, pending suits, and judgments, and unreleased oil and gas leases, and a list of requirements, if any, upon which the examiner's approval of title to the lease or oil and gas interest is contingent. The title report shall also contain a specific description of the oil and gas lease being subjected to this contract, with a statement of its form, term (which will be satisfactory if it has a primary term expiring not sooner than _____), amount of royalty, status of delay rental payments, and unusual drilling,

"Joint Loss"

~~obligations and of excess royalty, oil payments, and other special burdens. A copy of each title opinion, and~~ of each supplemental opinion, and of all final opinions, shall be sent promptly to each party. The opinion of the examining attorney concerning the validity of the title to each oil and gas interest and each lease, and the amount of interest covered thereby shall be binding and conclusive on the parties, but the acceptability of leases as to primary term, royalty provisions, drilling obligations, and special burdens, shall be a matter for approval and acceptance by an authorized representative of each party.

All title examinations shall be made, and title reports submitted, within a period of _____ days after the submission of abstracts and title papers. Each party shall, in good faith, try to satisfy the requirements of the examining attorneys concerning its leases and interests, and each shall have a period of _____ days from receipt of title report for this purpose. If the title to any lease, or oil and gas interest, is finally rejected by the examining attorney, all parties shall then be asked to state in writing whether they will waive the title defects and accept the leases or interests, or whether they will stand on the attorney's opinion. If one or more parties refuse to waive title defects, this agreement shall, in that case, be terminated and abandoned, and all abstracts and title papers shall be returned to their senders. If all titles are approved by the examining attorneys, or are accepted by all parties, and if all leases are accepted as to primary terms, royalty provisions, drilling obligations and special burdens, all subsequent provisions of this agreement shall become operative immediately, and the parties shall proceed to their performance as they are hereinafter stated.

B. Failure of Title:

~~After all titles are approved or accepted,~~ Any defects of title that may develop shall be the joint responsibility of all parties and, if a title loss occurs, it shall be the loss of all parties, with each bearing its proportionate part of the loss and of any liabilities incurred in the loss. If such a loss occurs, there shall be no change in, or adjustment of, the interests of the parties in the remaining portion of the Unit Area.

C. Loss of Leases For Other Than Title Failure:

If any lease or interest subject to this agreement be lost through failure to develop or because express or implied covenants have not been performed, or if any lease be permitted to expire at the end of its primary term and not be renewed or extended, the loss shall not be considered a failure of title and all such losses shall be joint losses and shall be borne by all parties in proportion to their interests and there shall be no readjustment of interests in the remaining portion of the Unit Area.

3. UNLEASED OIL AND GAS INTERESTS

~~If any party owns an unleased oil and gas interest in the Unit Area, that interest shall be treated for~~ the purpose of this agreement as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B" and for the primary term therein stated. As to such interests, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the leased interest.

4. INTERESTS OF PARTIES

Exhibit "A" lists all of the parties, and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this contract shall be borne and paid, and all equipment and material acquired in operations on the Unit Area shall be owned, by the parties as their interests are given in Exhibit "A". All production of oil and gas from the Unit Area, subject to the payment of lessor's royalties, shall also be owned by the parties in the same manner.

If any oil and gas lease covered by this agreement is subject to an overriding royalty, production payment, or other charge over and above the usual one-eighth (⅛) royalty, the party contributing that lease shall assume and alone bear all such excess obligations and shall account for them to the owners thereof out of its share of the working interest production of the Unit Area.

5. OPERATOR OF UNIT

Texas Oil & Gas Corporation shall be the Operator of the Unit Area, and shall conduct and direct and have full control of all operations on the Unit Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained, or liabilities incurred, except such as may result from gross negligence or from breach of the provisions of this agreement.

6. EMPLOYEES

The number of employees and their selection, and the hours of labor and the compensation for services performed, shall be determined by Operator. All employees shall be the employees of Operator.

~~**7. TEST WELL**~~

On or before the_____ day of_____, 19____, Operator shall commence the drilling of a well for oil and gas in the following location:

and shall thereafter continue the drilling of the well with due diligence to

unless granite or other practically impenetrable substance is encountered at a lesser depth or unless all parties agree to complete the well at a lesser depth.

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

If in Operator's judgment the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the test as a dry hole, it shall first secure the consent of all parties to the plugging, and the ~~well shall then be plugged and abandoned as promptly as possible.~~

8. COSTS AND EXPENSES

Except as herein otherwise specifically provided, Operator shall promptly pay and discharge all costs and expenses incurred in the development and operation of the Unit Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the cost and expense basis provided in the Accounting Procedure attached hereto and marked Exhibit "C". If any provision of Exhibit "C" should be inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance of their respective shares of the estimated amount of the costs to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated costs, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated costs shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest at the rate ~~of six percent (6%) per annum until paid.~~ as specified in Exhibit "C" Proper adjustment shall be made monthly between advances and actual cost, to the end that each party shall bear and pay its proportionate share of actual costs incurred, and no more.

9. OPERATOR'S LIEN

Operator is given a first and preferred lien on the interest of each party covered by this contract, and in each party's interest in oil and gas produced and the proceeds thereof, and upon each party's interest in material and equipment, to secure the payment of all sums due from each such party to Operator.

In the event any party fails to pay any amount owing by it to Operator as its share of such costs and expense or such advance estimate within the time limited for payment thereof, Operator, without prejudice to other existing remedies, is authorized, at its election, to collect from the purchaser or purchasers of oil or gas, the proceeds accruing to the working interest or interests in the Unit Area of the delinquent party up to the amount owing by such party, and each purchaser of oil or gas is authorized to rely upon Operator's statement as to the amount owing by such party.

In the event of the neglect or failure of any non-operating party to promptly pay its proportionate part of the cost and expense of development and operation when due, the other non-operating parties and Operator, within thirty (30) days after the rendition of statements therefor by Operator, shall proportionately contribute to the payment of such delinquent indebtedness and the non-operating parties so contributing shall be entitled to the same lien rights as are granted to Operator in this section. Upon the payment by such delinquent or defaulting party to Operator of any amount or amounts on such delinquent indebtedness, or upon any recovery on behalf of the non-operating parties under the lien conferred above, the amount or amounts so paid or recovered shall be distributed and paid by Operator to the other non-operating parties and Operator proportionately in accordance with the contributions theretofore made by them.

10. TERM OF AGREEMENT

This agreement shall remain in full force and effect for as long as any of the oil and gas leases subjected to this agreement are jointly owned, insofar as they cover land within the Unit Area, by the parties hereto, their heirs, successors and assigns. It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

11. LIMITATION ON EXPENDITURES

Without the consent of all parties: (a) No well shall be drilled on the Unit Area except any well expressly provided for in this agreement and except any well drilled pursuant to the provisions of Section 12 of this agreement, it being understood that the consent to the drilling of a well shall include consent to all necessary expenditures in the drilling, testing, completing, and equipping of the well, including necessary tankage; (b) No well shall be reworked, plugged back or deepened except a well reworked, plugged back or deepened pursuant to the provisions of Section 12 of this agreement, it being understood that the consent to the reworking, plugging back or deepening of a well shall include consent to all necessary expenditures in conducting such operations and completing and equipping of said well to produce, including necessary tankage; (c) Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of FIFTEEN THOUSAND AND NO/100 ---------- Dollars ($15,000.00) except in connection with a well the drilling, reworking, deepening, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that in case of explosion, fire, flood, or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency and to safeguard life and property, but Operator shall, as promptly as possible, report the emergency to the other parties. Operator shall, upon request, furnish copies of its "Authority for Expenditures" for any single project costing in excess of $ 5,000.00

12. OPERATIONS BY LESS THAN ALL PARTIES

If all the parties cannot mutually agree upon the drilling of any well on the Unit Area ~~other than the test well provided for in Section 7,~~ or upon the reworking, deepening or plugging back of a dry hole drilled at the joint expense of all parties or a well jointly owned by all the parties and not then producing in paying quantities on the Unit Area, any party or parties wishing to drill, rework, deepen or plug back such a well may give the other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days (except as to reworking, plugging back or drilling deeper, where a drilling rig is on location, the period shall be limited to forty-eight (48) hours exclusive of Saturday or Sunday) after receipt of the notice within which to notify the parties wishing to do the work whether they elect to participate in the cost of the proposed operation. Failure of a party receiving such a notice to so reply to it within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation.

If any party receiving such a notice elects not to participate in the proposed operation (such party or parties being hereafter referred to as "Non-Consenting Party"), then in order to be entitled to the benefits of this section, the party or parties giving the notice and such other parties as shall elect to participate in the operation (all such parties being hereafter referred to as the "Consenting Parties") shall, within thirty (30) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the 48-hour period where the drilling rig is on location, as the case may be) actually commence work on the proposed operation and complete it with due diligence.

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions that their respective interests as shown in Exhibit "A" bear to the total interests of all Consenting Parties. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this section results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk, and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties in accordance with the provisions of this section, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's interest in the well, its leasehold operating rights, and share of production therefrom until the proceeds or market value thereof (after deducting production taxes, royalty, overriding royalty and other interests payable out of or measured by the production from such well accruing with respect to such interest until it reverts) shall equal the total of the following:

(A) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this section, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to each Non-Consenting Party had it participated in the well from the beginning of the operation; and

(B) 200% of that portion of the costs and expenses of drilling, reworking, deepening or plugging back, testing and completing, after deducting any cash contributions received under Section 24, and 200% of that portion of the cost of newly acquired equipment in the well (to and including the wellhead connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Unit Area, Operator shall have the right, subject to revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others for the time being, at not less than the market price prevailing in the area, which shall in no event be less than the price which Operator receives for its portion of the oil and gas produced from the Unit Area. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser. Notwithstanding the foregoing, Operator shall not make a sale into interstate commerce of any other party's share of gas production without first giving such other party sixty (60) days notice of such intended sale.

14. ACCESS TO UNIT AREA

Each party shall have access to the Unit Area at all reasonable times, at its sole risk, to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator shall, upon request, furnish each of the other parties with copies of all drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Unit Area.

15. DRILLING CONTRACTS

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

16. ABANDONMENT OF WELLS

No well, other than any well which has been drilled or reworked pursuant to Section 12 hereof for which the Consenting Parties have not been fully reimbursed as therein provided, which has been completed as a producer shall be plugged and abandoned without the consent of all parties; provided, however, if all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall then assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and its equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. The assignments so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments to, the assignees shall be in a ratio based upon the relationship of their respective percentages of participation in the Unit Area to the aggregate of the percentages of participation in the Unit Area of all assignees. There shall be no readjustment of interest in the remaining portion of the Unit Area.

After the assignment, the assignors shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open. Upon request of the assignees, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned well.

17. DELAY RENTALS AND SHUT-IN WELL PAYMENTS

Each party shall pay all delay rentals and shut-in well payments which may be required under the terms of its lease or leases and submit evidence of each payment to the other parties at least ten (10) days prior to the payment date. The paying party shall be reimbursed by Operator for 100% of any such delay rental payment and 100% of any such shut-in well payment. The amount of such reimbursement shall be charged by Operator to the joint account of the parties and treated in all respects the same as costs incurred in the development and operation of the Unit Area. Each party responsible for such payments shall diligently attempt to make proper payment, but shall not be held liable to the other parties in damages for the loss of any lease or interest therein if, through mistake or oversight, any rental or shut-in well payment is not paid or is erroneously paid. The loss of any lease or interest therein which results from a failure to pay or an erroneous payment of rental or shut-in well payment shall be a joint loss and there shall be no readjustment of interests in the remaining portion of the Unit Area. If any party secures a new lease covering the terminated interest, such acquisiton shall be subject to the provisions of Paragraph 22 of this agreement.

Operator shall promptly notify each other party hereto of the date on which any gas well located on the Unit Area is shut in and the reason therefor.

18. PREFERENTIAL RIGHT TO PURCHASE

Should any party desire to sell all or any part of its interests under this contract, or its rights and interests in the Unit Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all of its assets, or a sale or transfer of its interests to a subsidiary or parent company, or subsidiary of a parent company, or to any company in which any one party owns a majority of the stock.

19. SELECTION OF NEW OPERATOR

Should a sale be made by Operator of its rights and interests, the other parties shall have the right within sixty (60) days after the date of such sale, by majority vote in interest, to select a new Operator. If a new Operator is not so selected, the transferee of the present Operator shall assume the duties of and act as Operator. In either case, the retiring Operator shall continue to serve as Operator, and discharge its duties in that capacity under this agreement, until its successor Operator is selected and begins to function, but the present Operator shall not be obligated to continue the performance of its duties for more than 120 days after the sale of its rights and interests has been completed.

20. MAINTENANCE OF UNIT OWNERSHIP

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this contract, and notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Unit Area and in wells, equipment and production unless such disposition covers either:

(1) the entire interest of the party in all leases and equipment and production; or

(2) an equal undivided interest in all leases and equipment and production in the Unit Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the rights of the other parties.

If at any time the interest of any party is divided among and owned by four or more co-owners, Operator may, at its discretion, require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such party's interests within the scope of the operations embraced in this contract; however, all such co-owners shall enter into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Unit Area and they shall have the right to receive, separately, payment of the sale proceeds thereof.

21. RESIGNATION OF OPERATOR

Operator may resign from its duties and obligations as Operator at any time upon written notice of not less than ninety (90) days given to all other parties. In this case, all parties to this contract shall select by majority vote in interest, not in numbers, a new Operator who shall assume the responsibilities and duties, and have the rights, prescribed for Operator by this agreement. The retiring Operator shall deliver to its successor all records and information necessary to the discharge by the new Operator of its duties and obligations.

22. LIABILITY OF PARTIES

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Unit Area. Accordingly, the lien granted by each party to Operator in Section 9 is given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render them liable as partners.

23. RENEWAL OR EXTENSION OF LEASES

If any party secures a renewal of any oil and gas lease subject to this contract, each and all of the other parties shall be notified promptly, and shall have the right to participate in the ownership of the renewal lease by paying to the party who acquired it their several proper proportionate shares of the acquisition cost, which shall be in proportion to the interests held at that time by the parties in the Unit Area.

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the unit area to the aggregate of the percentages of participation in the unit area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all the parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this section shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this section.

The provisions in this section shall apply also and in like manner to extensions of oil and gas leases.
The provisions in this section shall not apply to portions of leases situated outside the Unit Area.

24. SURRENDER OF LEASES

The leases covered by this agreement, in so far as they embrace acreage in the Unit Area, shall not be surrendered in whole or in part unless all parties consent.

However, should any party desire to surrender its interest in any lease or in any portion thereof, and other parties not agree or consent, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not desiring to surrender it. Upon such assignment, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the acreage assigned and the operation of any well thereon, and the assigning party shall have no further interest in the lease assigned and its equipment and production. The parties assignee shall pay to the party assignor the reasonable salvage value of the latter's interest in any wells and equipment on the assigned acreage, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. If the assignment is in favor of more than one party, the assigned interest shall be shared by the parties assignee in the proportions that the interest of each bears to the interest of all parties assignee.

Any assignment or surrender made under this provision shall not reduce or change the assignors' or surrendering parties' interest, as it was immediately before the assignment, in the balance of the Unit Area; and the acreage assigned or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this agreement.

25. ACREAGE OR CASH CONTRIBUTIONS

If any party receives while this agreement is in force a contribution of cash toward the drilling of a well or any other operation on the Unit Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly execute an assignment of the acreage, without warranty of title, to all parties to this agreement in proportion to their interests in the Unit Area at that time, and such acreage shall become a part of the Unit Area and be governed by all the provisions of this contract. Each party shall promptly notify all other parties of all acreage or money contributions it may obtain in support of any well or any other operation on the Unit Area.

26. PROVISION CONCERNING TAXATION

Each of the parties hereto elects, under the authority of Section 761(a) of the Internal Revenue Code of 1954, to be excluded from the application of all of the provisions of Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code of 1954. If the income tax laws of the state or states in which the property covered hereby is located contain, or may hereafter contain, provisions similar to those contained in the Subchapter of the Internal Revenue Code of 1954 above referred to under which a similar election is permitted, each of the parties agrees that such election shall be exercised. Each party authorizes and directs the Operator to exercise such an election or elections on its behalf and to file the election with the proper governmental office or agency. If requested by the Operator so to do, each party agrees to execute and join in such an election.

Operator shall render for ad valorem taxation all property subject to this agreement which by law should be returned for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Operator shall bill all other parties for their proportionate share of all tax payments in the manner provided in Exhibit "C".

If any tax assessment is considered unreasonable by Operator, it may at its discretion protest such valuation within the time and manner prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final determination. When any such protested valuation shall have been finally determined, Operator shall pay the assessment for the joint account, together with interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as provided in Exhibit "C".

27. INSURANCE

At all times while operations are conducted hereunder, Operator shall comply with the Workmen's Compensation Law of the State where the operations are being conducted. Operator shall also carry or provide insurance for the benefit of the joint account of the parties as may be outlined in Exhibit "D" attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Unit Area to comply with the Workmen's Compensation Law of the State where the operations are being conducted and to maintain such other insurance as Operator may require.

In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for operator's fully owned automotive equipment.

28. CLAIMS AND LAWSUITS

If any party to this contract is sued on an alleged cause of action arising out of operations on the Unit Area, or on an alleged cause of action involving title to any lease or oil and gas interest subjected to this contract, it shall give prompt written notice of the suit to the Operator and all other parties.

The defense of lawsuits shall be under the general direction of a committee of lawyers representing the parties, with Operator's attorney as Chairman. Suits may be settled during litigation only with the joint consent of all parties. No charge shall be made for services performed by the staff attorneys for any of the parties, but otherwise all expenses incurred in the defense of suits, together with the amount paid to discharge any final judgment, shall be considered costs of operation and shall be charged to and paid by all parties in proportion to their then interests in the Unit Area. Attorneys, other than staff attorneys for the parties, shall be employed in lawsuits involving Unit Area operations only with the consent of all parties; if outside counsel is employed, their fees and expenses shall be considered Unit Area expense and shall be paid by Operator and charged to all of the parties in proportion to their then interests in the Unit Area. The provisions of this paragraph shall not be applied in any instance where the loss which may result from the suit is treated as an individual loss rather than a joint loss under prior provisions of this agreement, and all such suits shall be handled by and be the sole responsibility of the party or parties concerned.

Damage claims caused by and arising out of operations on the Unit Area, conducted for the joint account of all parties, shall be handled by Operator and its attorneys, the settlement of claims of this kind shall be within the discretion of Operator so long as the amount paid in settlement of any one claim does not exceed one thousand ($1000.00) dollars and, if settled, the sums paid in settlement shall be charged as expense to and be paid by all parties in proportion to their then interests in the Unit Area.

29. FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than the continuance of the force majeure. The affected party shall use all possible diligence to remove the force majeure as quickly as possible.

The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

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

30. NOTICES

All notices authorized or required between the parties, and required by any of the provisions of this agreement, shall, unless otherwise specifically provided, be given in writing by United States mail or Western Union Telegram, postage or charges prepaid, and addressed to the party to whom the notice is given at the

addresses listed on Exhibit "A". The originating notice to be given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid. Each party shall have the right to change its address at any time, and from time to time, by giving written notice thereof to all other parties.

31. OTHER CONDITIONS, IF ANY, ARE:

A. This agreement is made subject to all the provisions of that certain Farmout Letter Agreement dated June 11, 1979, from Mobil Oil Corporation to Texas Oil & Gas Corporation, and if there be any conflict between the provisions of this agreement and said Farmout Letter Agreement, the provisions of the latter shall prevail.

B. If, after the date of said Farmout Letter Agreement, any party hereto should create against its interest any overriding royalty, production payment or other burden, and if any other party or parties thereafter should conduct non-consent operations and, as a result, become entitled to receive the working interest of the non-participating party or parties, the party or parties entitled to receive the working interest of the non-participating party or parties shall be entitled to receive such production free and clear of all such overriding royalty, production payment or other burdens, other than the lessor's lease royalty, and the non-participating parties creating such burdens shall discharge such burdens out of its own funds and shall save the participating party or parties harmless with respect to receipt of such working interest production.

C. Operator shall give non-operator notice thereof each time any producing gas well is shut in, which notice shall include the date on which such well was shut in and the reason therefor. Each time a gas well which has been shut in is put back on production, Operator shall give non-operator notice thereof. Operator shall, in good faith, endeavor to promptly give non-operator the notices herein provided for but Operator shall not be liable to non-operator for inadvertently failing to give such notices.

D. In the performance of the contract, Operator shall not engage in any conduct or practice which violates any applicable law, order or regulation prohibiting discrimination against any person by reason of his race, religion, color, sex, national origin or age; and Operator further agrees to comply fully with the non-discrimination provisions of Section 202 of Executive Order No. 11246 (30 F.R. 12319) as amended by Executive Order #11375, which are hereby included in this Contract as Contract Supplements "A" and "B" and made part hereof. Operator shall also abide by the requirements of Executive Order #11598, Occupational Safety and Health Act, and by Executive Order #11640, Veterans Hire Regulations, which orders are inserted herein by reference.

E. Gas well production shall be governed by Exhibit "E", Gas Balancing Agreement, attached hereto.

This agreement may be signed in counterpart, and shall be binding upon the parties and upon their heirs, successors, representatives and assigns.

TEXAS OIL & GAS CORPORATION

ATTEST:

BY: _____

_____

OPERATOR

ATTEST:

_____

_____

ATTEST:

_____

_____

(ACKNOWLEDGMENTS)

EXHIBIT "A"

ATTACHED TO AND MADE A PART OF THAT CERTAIN OPERATING AGREEMENT BY AND BETWEEN TEXAS OIL & GAS CORPORATION, OPERATOR, AND MOBIL OIL CORPORATION, NON-OPERATOR, FOLLOWING THE FARMOUT LETTER AGREEMENT BETWEEN MOBIL OIL CORPORATION AND TEXAS OIL & GAS CORPORATION DATED JUNE 11, 1979.

(Prior to execution of this Operating Agreement by the appropriate parties, the provisions of this Exhibit "A" shall be completed in accordance with the terms and provisions of the said captioned Farmout Letter Agreement dated June 11, 1979, with the general guidelines set out below.)

UNIT AREA

East Half Section 6, T-17-S, R-35-E, Lea County, New Mexico

INTERESTS OF THE PARTIES

Ownership in the oil and gas interest and the oil and gas leasehold, personal property, equipment wells and production therefrom, shall be as set forth in said Farmout Letter Agreement, and any reversionary oil and gas interest, or oil and gas leasehold, shall become subject to this agreement when such interest becomes jointly owned by the parties pursuant to the terms of said Farmout Letter Agreement.

LEASES(S) OF THE PARTIES

Lease(s) described in said Farmout Letter Agreement which become(s) jointly owned by the parties pursuant to the terms of said Farmout Letter Agreement and such leases that may be pooled or communitized with said jointly owned lease pursuant to the terms of said Farmout Letter Agreement.

ADDRESSES OF THE PARTIES

Mobil Oil Corporation
Nine Greenway Plaza, Suite 2700
Houston, TX 77046
Attention: Joint Interest Administrator

Texas Oil & Gas Corporation
900 Wilco Building
Midland, TX 79701
Attention: Mr. Doyle John Snow

EXHIBIT "B"

There is no Exhibit "B"

EXHIBIT "C"

Attached to and made a part of that certain Operating Agreement dated _____ between _____, Operator, and _____, Non-Operator(s)

ACCOUNTING PROCEDURE JOINT OPERATIONS

I. GENERAL PROVISIONS

1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

2. Statement and Billings

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

3. Advances and Payments by Non-Operators

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

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

4. Adjustments

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

5. Audits

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

6. Approval by Non-Operators

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

COPAS

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. Rentals and Royalties

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

2. Labor

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

(2) [redacted]

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

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

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

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

3. Employee Benefits

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

4. Material

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

5. Transportation

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

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

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

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

6. Services

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

7. Equipment and Facilities Furnished by Operator

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

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

8. Damages and Losses to Joint Property

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

9. Legal Expense

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

COPAS

10. Taxes

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

11. Insurance

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

12. Other Expenditures

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

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

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

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

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

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

A. Overhead - Fixed Rate Basis

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

Drilling Well Rate $ 2,030
Producing Well Rate $ 203

(Note: Use rates shown where production is anticipated above 7500'. For deeper wells, use $2,708 and $270.)

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

(a) Drilling Well Rate

[1] Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.

[2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days

[3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

[1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.

[2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.

[3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.

[4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.

[5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

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

B. Overhead - Percentage Basis

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

(a) Development

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

(b) Operating

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

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

2. Overhead - Major Construction

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess of $ 25,000 :

A. 5 % of total costs if such costs ~~are not exceeded~~ up to $ 100,000 ; plus

B. 3 % of total costs in excess of $ 100,000 but less than $1,000,000; plus

C. 2 % of total costs in excess of $1,000,000.

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

3. Amendment of Rates

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

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

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

1. Purchases

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

2. Transfers and Dispositions

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

A. New Material (Condition A)

(1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.

(2) Line Pipe

(a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.

(b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.

(3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

B. Good Used Material (Condition B)

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

(1) Material moved to the Joint Property

(a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV.

(2) Material moved from the Joint Property

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

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

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

C. Other Used Material (Condition C and D)

(1) Condition C

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

(2) Condition D

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

D. Obsolete Material

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

E. Pricing Conditions

(1) Loading and unloading costs may be charged to the Joint Account at the rate of fifteen cents (15¢) per hundred weight on all tubular goods movements, in lieu of loading and unloading costs sustained, when actual hauling cost of such tubular goods are equalized under provisions of Paragraph 5 of Section II.

(2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

3. Premium Prices

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

4. Warranty of Material Furnished by Operator

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

V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

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

3. Special Inventories

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

4. Expense of Conducting Periodic Inventories

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

EXHIBIT "D"

ATTACHED TO AND MADE A PART OF OPERATING AGREEMENT DATED _____, BY AND BETWEEN _____, OPERATOR, AND _____, NON-OPERATOR.

INSURANCE

Operator shall carry Workmen's Compensation and Employer's Liability Insurance in full compliance with the Workmen's Compensation laws of the particular state where the work is being performed.

Operator shall require all contractors engaged in operations on the contract premises to carry Workmen's Compensation and Employer's Liability Insurance in full compliance with the Workmen's Compensation laws of the state where the work is being performed and to maintain such other insurance as Operator may require.

Operator shall not be obligated to provide any other insurance for the joint account of the parties hereto. Any party may, at its own expense, acquire such other insurance as it deems proper to protect itself against any claims, losses, damages, or destructions arising out of operations of the contract premises.

SUPPLEMENT "A"

EQUAL EMPLOYMENT OPPORTUNITY PROVISION

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

1. The Operator will not discriminate against any employee or applicant for employment because of race, color, religion, national origin or sex. The Operator will take affirmative action to ensure that applicants are employed, and that employees are treated during employment without regard to their race, color, religion, national origin or sex. Such action shall include, but not be limited to, the following: employment, upgrading, demotion or transfer, recruitment or recruitment advertising; layoff or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. The Operator agrees to post in conspicuous places, available to employees and applicants for employment, notices to be provided for the contracting officer setting forth the provisions of this nondiscrimination clause.

2. The Operator will, in all solicitations or advertisements for employees placed by or on behalf of the Operator, state that all qualified applicants will receive consideration for employment without regard to race, color, religion, national origin or sex.

3. The Operator will send to each labor union or representative of workers with which it has a collective bargaining agreement or other contract or understanding, a notice to be provided by the agency contracting officer, advising the labor union or workers' representative of the Operator's commitments under Section 202 of Executive Order 11246 of September 24, 1965, and shall post copies of the notice in conspicuous places available to employees and applicants for employment.

4. The Operator will comply with all provisions of Executive Order 11246 of September 24, 1965, and of the rules, regulations and relevant orders of the Secretary of Labor.

5. The Operator will furnish all information and reports required by Executive Order 11246 of September 24, 1965, and by the rules, regulations and orders of the Secretary of Labor, or pursuant thereto, and will permit access to its books, records and accounts by the contracting agency and the Secretary of Labor for purposes of investigation to ascertain compliance with such rules, regulations and orders.

6. In the event of the Operator's noncompliance with the nondiscrimination clauses of this contract or with any of such rules, regulations or orders, this contract may be cancelled, terminated or suspended, in whole or in part, and the Operator may be declared ineligible for further Government contracts in accordance with procedures authorized in Executive Order 11246 of September 24, 1965, and such other sanctions may be imposed and remedies invoked as provided in Executive Order 11246 of September 24, 1965, or by rule, regulation or order of the Secretary of Labor or as otherwise provided by law.

SUPPLEMENT "B"

CERTIFICATION OF NON-SEGREGATED FACILITIES

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

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

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

EXHIBIT "E"

ATTACHED TO AND MADE A PART OF OPERATING AGREEMENT DATED _____ BETWEEN

_____

GAS BALANCING AGREEMENT

1. Intent that Parties Share Total Production. It is the intent and aim of this Gas Balancing Agreement that during the productive life of the Unit Area, the parties shall have had the opportunity to share in the total cumulative production from the Unit Area in proportion to their Unit Area ownership. This Agreement is made to promote that purpose and to protect each Party against any other Party receiving more than its proportionate share of the total cumulative production. It shall never be construed to effect the unjust enrichment of any Party to the detriment of the others or to deprive any Party of its rights to its proportionate share of the total cumulative production.

2. Pipeline Requirements of Purchasers. The Parties hereto recognize that the pipeline requirements of the respective purchasers or other takers of Gas produced from the Unit Area will vary from time to time and may not be consistent except over short periods of time. It is the intent of the Parties hereto that the allocation of liquid substances shall not be affected by the respective pipeline requirements for Gas. Accordingly, the total well production shall be separated into liquids and gas. The liquids shall be all substances in liquid form when separated by primary separation facilities. The gas shall be all substances remaining in gaseous form after the substances in liquid form have been separated by primary separation facilities, and, if applicable, after solids such as sulphur and other substances have been removed to render the Gas marketable.

3. Parties not Selling Gas. In the event any of the Parties hereto desire to market their share of Gas production from the Unit Area prior to the time that other Parties are willing or able to market their share of Gas production, the Unit Area shall nevertheless be placed on production, and such non-taking Party's share of Gas shall be considered as stored in the reservoir and not produced.

4. Intent to Balance Gas Taken. In the event there is more than one purchaser or more than one disposition of the Gas produced from the Unit Area, each Party, to the extent possible under its Gas sales contract or other disposition arrangement, agrees to cooperate in an endeavor to maintain, as near as possible, the balance between the Gas allocated to its interest by virtue of this agreement and the actual deliveries of Gas for its account.

5. "Make Up" Gas. Therefore, deliveries of Gas in excess of or less than any Party's proportionate ownership of Gas production shall be adjusted out of future production, provided that in no event will a Party having taken excess Gas be required to reduce the volume of Gas such Party is entitled to take during any calendar month to less than 50% of said Party's interest in current production.

6. Depletion with Imbalance.

(a) If, at the depletion of Gas reserves from the Unit Area, there is a Party (for purposes of this article called "over-produced Party") who has delivered a quantity of Gas in excess of such Party's proportionate ownership of production, such over-produced Party, unless otherwise agreed to by the Parties involved, shall remit to the Operator for the account of the Party or Parties having taken less Gas than their proportionate ownership in Gas production (for purposes of this article called "under-produced Party"), the "value" (less appropriate deductions for taxes and royalty which have been paid with respect to such production), of the gas that has been over-produced by such Party, to the end that each Party shall receive credit for its proportionate ownership of Gas produced.

(b) For the purposes of this section, "value" shall be the price the over-produced Party actually received or would have received under the terms of a bona fide contract effective at the time of the production of such Gas, multiplied by the volume over-produced; but in any event not to exceed more than was actually received for all of the Gas over-produced; provided that if any portion of such price is being collected subject to refund upon orders of the Federal Power Commission, unless the under-produced Party furnishes a corporate undertaking agreement to hold the over-produced Party harmless from financial loss due to action by the Federal Power Commission,

then that portion of the price subject to refund shall be withheld by the over-produced Party and shall not be paid until and unless such refundable portion of said price is ultimately approved by the Federal Power Commission. All such payments shall be made by the over-produced Parties to the Operator, who shall be charged with the duty of maintaining a record of over- and under-production volumes for each Party's account, and of distributing the final settlement funds received proportionately to each under-produced Party based on its proportion of the total under-production, but the Operator shall have no liability with respect to the correctness of the funds received by it from the over-produced Parties for distribution, being entitled to rely on such statements as may be furnished by each over-produced Party as to the price and the amount recovered for the over-production.