

RIO PECOS CORPORATION

110 WEST LOUISIANA SUITE 460

MIDLAND TEXAS 79701

(915) 687-0127

LAND

SCOTT E WILSON

ROBERT ELLIOTT

GEOLOGY

MARK D WILSON

TODD M WILSON

HEATHER WILSON ECHOLS

July 16, 1987

TO: WORKING INTEREST OWNERS IN THE PROPOSED CASEY-EAST STRAWN WORKING INTEREST UNIT
(Addressee List Attached)

RE: Proposed Casey-East Strawn Working Interest Unit
Township 16 South, Range 37 East, N.M.P.M.
Section 26: S/2
containing 320.00 acres, more or less,
Lea County, New Mexico

Gentlemen:

By letter dated June 30, 1987, on behalf of Yates Petroleum Corporation, we proposed the formation of the Casey-East Strawn Working Interest Unit for the drilling of an 11,800-foot Strawn test in the NW/4 SE/4 of Section 26, T16S, R37E. Enclosed for your consideration is an operating agreement to be entered into by the parties who elect to participate or farm out for the drilling of the well. When all the parties have agreed to either participate or farm out, we shall send the parties signature and acknowledgement pages.

Please let us hear from you soon.

Very truly yours,

Scott E. Wilson
Vice President

SEW/sh

Enc.
Attachment

YATES PETROLEUM CORPORATION
Case No. 9181
7/29/87 Examiner Hearing
Exhibit No. 5

ADDRESSEE LIST

Proposed Casey-East Strawn Working Interest Unit
S/2 Section 26, T-16-S, R-37-E, NMPM
Lea County, New Mexico

Yates Group
207 South 4th Street
Artesia, New Mexico 88210
Attn: Mr. Ken Beardemphl

Inexco Oil Company
c/o The Louisiana Land and Exploration
2950 N. Loop West, Suite 1200
Houston, Texas 77092-8862
Attn: Mr. Ken Steer

Felmont Oil Corporation
P. O. Box 2266
Midland, Texas 79702
Attn: Mr. Bob Hinson

EP Operating Company
ClayDesta National Bank, Suite 5250
6 Desta Drive
Midland, Texas 79705
Attn: Mr. Jarlon Magee

Nitram Enterprises, Inc.
P. O. Box 3341
Midland, Texas 79702

H. L. Brown, Jr.
P. O. Box 2237
Midland, Texas 79702
Attn: Mr. James P. Shaw

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

MODEL FORM OPERATING AGREEMENT

CASEY-EAST STRAWN WORKING INTEREST UNIT

OPERATING AGREEMENT

DATED

June 30 , 19 87 ,

OPERATOR YATES PETROLEUM CORPORATION

CONTRACT AREA Township 16 South, Range 37 East

Section 26: S/2

Containing 320 acres, more or less

COUNTY ~~OR PARISH~~ OF LEA STATE OF NEW MEXICO

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AMERICAN ASSOCIATION OF PETROLEUM LANDMEN
APPROVED FORM. A.A.P.L. NO. 610 - 1977 REVISED
MAY BE ORDERED DIRECTLY FROM THE PUBLISHER
KRAFTBILT PRODUCTS, BOX 800, TULSA 74101

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

2
3 1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice
4 thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the
5 Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any
6 action by Non-Operator, except the selection of a successor. Operator may be removed if it fails or
7 refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership,
8 by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on owner-
9 ship as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting
10 interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M.
11 on the first day of the calendar month following the expiration of ninety (90) days after the giving of
12 notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor
13 Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effect-
14 ive date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of
15 a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary,
16 parent or successor corporation shall not be the basis for removal of Operator.
17

18 2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Op-
19 erator shall be selected by the Parties. The successor Operator shall be selected from the parties owning
20 an interest in the Contract Area at the time such successor Operator is selected. If the Operator that
21 is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the
22 affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown
23 on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the
24 Operator that was removed.
25

26 **C. Employees:**

27
28 The number of employees used by Operator in conducting operations hereunder, their selection,
29 and the hours of labor and the compensation for services performed, shall be determined by Operator,
30 and all such employees shall be the employees of Operator.
31

32 **D. Drilling Contracts:**

33
34 All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual
35 rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the
36 drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate
37 of such charges shall be agreed upon by the parties in writing before drilling operations are com-
38 menced, and such work shall be performed by Operator under the same terms and conditions as are
39 customary and usual in the area in contracts of independent contractors who are doing work of a sim-
40 ilar nature.
41

42 **ARTICLE VI.**
43 **DRILLING AND DEVELOPMENT**

44
45 **A. Initial Well:**

46
47 On or before 90 days after the execution of this / **Operating Agreement,** Operator shall commence the drill-
48 ing of a well for oil and gas at the following location:

49 Township 16 South, Range 37 East, NMPM
50 Section 26: NW/4SE/4
51 Lea County, New Mexico
52

53 and shall thereafter continue the drilling of the well with due diligence to adequately test
54 the Strawn formation at approximately 11,800 feet.
55

56
57
58 unless granite or other practically impenetrable substance or condition in the hole, which renders
59 further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or
60 abandon the well at a lesser depth.
61

62 Operator shall make reasonable tests of all formations encountered during drilling which give in-
63 dication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited
64 in its application to a specific formation or formations, in which event Operator shall be required to
65 test only the formation or formations to which this agreement may apply.
66

67 If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes
68 to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall
69 plug and abandon same as provided in Article VI.E.1. hereof.
70

1 **B. Subsequent Operations:**

2
3 1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area
4 other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled
5 at the joint expense of all parties or a well jointly owned by all the parties and not then producing
6 in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the
7 other parties written notice of the proposed operation, specifying the work to be performed, the loca-
8 tion, proposed depth, objective formation and the estimated cost of the operation. The parties receiv-
9 ing such a notice shall have thirty (30) days after receipt of the notice within which to notify the
10 parties wishing to do the work whether they elect to participate in the cost of the proposed operation.
11 If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given
12 by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday,
13 Sunday or legal holidays. Failure of a party receiving such notice to reply within the period above fixed
14 shall constitute an election by that party not to participate in the cost of the proposed operation. Any
15 notice or response given by telephone shall be promptly confirmed in writing.

16
17 2. Operations by Less than All Parties: If any party receiving such notice as provided in Article
18 VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to
19 the benefits of this article, the party or parties giving the notice and such other parties as shall elect
20 to participate in the operation shall, within sixty (60) days after the expiration of the notice period of
21 thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period
22 where the drilling rig is on location, as the case may be) actually commence work on the proposed
23 operation and complete it with due diligence. Operator shall perform all work for the account of the
24 Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Op-
25 erator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform
26 the work required by such proposed operation for the account of the Consenting Parties, or (b) desig-
27 nate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when
28 conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms
29 and conditions of this agreement.

30
31 If less than all parties approve any proposed operation, the proposing party, immediately after the
32 expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest
33 of the parties approving such operation, and (b) its recommendation as to whether the Consenting Par-
34 ties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48)
35 hours (exclusive of Saturday, Sunday or legal holidays) after receipt of such notice, shall advise the
36 proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A",
37 or (b) carry its proportionate part of Non-Consenting Parties' interest. The proposing party, at its
38 election, may withdraw such proposal if there is insufficient participation, and shall promptly notify
39 all parties of such decision.

40
41 The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in
42 the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting
43 Parties shall keep the leasehold estates involved in such operations free and clear of all liens and
44 encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such
45 an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole
46 cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions
47 of this Article results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall
48 complete and equip the well to produce at their sole cost and risk, and the well shall then be turned
49 over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties.
50 Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such
51 well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party
52 shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and
53 be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's
54 interest in the well and share of production therefrom until the proceeds of the sale of such share,
55 calculated at the well, or market value thereof if such share is not sold (after deducting production
56 taxes, crude oil excise taxes, royalty, overriding royalty and other interests
57 existing on the effective date hereof, payable out of or measured by the produc-
58 tion from such well accruing with respect to such interest until it reverts) shall
59 equal the total of the following:

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

68
69 (b) 300% of that portion of the costs and expenses of drilling reworking, deepening, or plugging
70 back, testing and completing, after deducting any cash contributions received under Article VIII.C., and

1 300 % of that portion of the cost of newly acquired equipment in the well (to and including the well-
2 head connections), which would have been chargeable to such Non-Consenting Party if it had partici-
3 pated therein.

4
5 Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's
6 election, shall be sold to its purchaser, if available, under the terms of its existing gas sales con-
7 tract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from
8 such sale direct to the Consenting Parties until the amounts provided for in this Article are recov-
9 ered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not
10 contracted for sale of its gas at the time such gas is available for delivery, or has not made the elec-
11 tion as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-
12 Consenting Party's share of gas as hereinabove provided during the recoupment period.

13
14 During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share
15 of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of
16 all production, crude oil excise taxes, severance, gathering and other taxes, and all
17 royalty, overriding royalty and other burdens applicable to Non-Consenting Party's
18 share of production.

19 In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall
20 be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of
21 all such equipment shall remain unchanged; and upon abandonment of a well after such reworking,
22 plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the
23 owners thereof, with each party receiving its proportionate part in kind or in value, less cost of
24 salvage.

25
26 Within sixty (60) days after the completion of any operation under this Article, the party con-
27 ducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an in-
28 ventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling,
29 deepening, plugging back, testing, completing, and equipping the well for production; or, at its option,
30 the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed
31 statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being
32 reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furn-
33 ish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the
34 operation of the well, together with a statement of the quantity of oil and gas produced from it and the
35 amount of proceeds realized from the sale of the well's working interest production during the preceding
36 month. In determining the quantity of oil and gas produced during any month, Consenting Parties
37 shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any
38 amount realized from the sale or other disposition of equipment newly acquired in connection with any
39 such operation which would have been owned by a Non-Consenting Party had it participated therein
40 shall be credited against the total unreturned costs of the work done and of the equipment purchased,
41 in determining when the interest of such Non-Consenting Party shall revert to it as above provided;
42 and if there is a credit balance, it shall be paid to such Non-Consenting party.

43
44 If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest
45 the amounts provided for above, the relinquished interests of such Non-Consenting Party shall auto-
46 matically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same
47 interest in such well, the material and equipment in or pertaining thereto, and the production there-
48 from as such Non-Consenting Party would have been entitled to had it participated in the drilling,
49 reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be
50 charged with and shall pay its proportionate part of the further costs of the operation of said well in
51 accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

52
53 Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent
54 of all parties, no wells shall be completed in or produced from a source of supply from which a well
55 located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing
56 well spacing pattern for such source of supply.

57
58 The provisions of this Article shall have no application whatsoever to the drilling of the initial
59 well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b)
60 to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall
61 prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article
62 VI.A.

63
64 **C. Right to Take Production in Kind:**

65 Each party electing to take in kind or separately dispose of its proportionate share of the production from the Contract Area
66 shall keep accurate records of the volume, selling price, royalty and taxes relative to its share of production. Non-Operators
67 shall, upon request, furnish Operator with true and complete copies of the records required to be kept hereunder whenever, under
68 the terms of this agreement or any agreement executed in connection herewith, it is necessary for Operator to obtain said informa-
69 tion. Any information furnished to Operator hereunder shall be used by Operator only to the extent necessary to carry out its
70 duties as Operator and shall otherwise be kept confidential.

Each party shall have the right to take in kind or separately dispose of its proportionate share of all oil and gas produced
from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and

1 D. Limitation of Expenditures:

2
3 1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, ex-
4 cept any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this Agreement, it being
5 understood that the consent to the drilling or deepening shall include:

6 ~~Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and~~
7 ~~equipping of the well, including necessary tankage and/or surface facilities.~~

8
9 Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When
10 such well has reached its authorized depth, and all tests have been completed, Operator shall give im-
11 mediate notice to the Non-Operators who have the right to participate in the completion costs. The parties
12 receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holi-
13 days) in which to elect to participate in the setting of casing and the completion attempt. Such election,
14 when made, shall include consent to all necessary expenditures for the completing and equipping of such
15 well, including necessary tankage and/or surface facilities. Failure of any party receiving such notice
16 to reply within the period above fixed shall constitute an election by that party not to participate in
17 the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and
18 to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or
19 plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to
20 the operations thereafter conducted by less than all parties.
21

22
23 2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged
24 back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agree-
25 ment, it being understood that the consent to the reworking or plugging back of a well shall include
26 consent to all necessary expenditures in conducting such operations and completing and equipping of
27 said well, including necessary tankage and/or surface facilities.
28

29 3. Other Operations: Operator shall not undertake any single project reasonably estimated to require
30 an expenditure in excess of TWENTY FIVE THOUSAND----- Dollars (\$25,000.00-----)
31 except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plug-
32 ging back of which has been previously authorized by or pursuant to this agreement; provided, how-
33 ever, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different
34 nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with
35 the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emer-
36 gency to the other parties. If Operator prepares "Authority for Expenditures" for its own use,
37 Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project
38 costing in excess of FIFTEEN THOUSAND----- Dollars (\$15,000.00-----).
39

40 E. Royalties, Overriding Royalties and Other Payments:

41
42 Each party shall pay or deliver, or cause to be paid or delivered, all royalties to the extent of
43 3/16 of 8/8ths due on its share of production and shall hold the other parties free
44 from any liability therefor. If the interest of any party in any oil and gas lease covered by this agree-
45 ment is subject to any royalty, overriding royalty, production payment, or other charge over and above
46 the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account
47 for or cause to be accounted for, such interest to the owners thereof. If the interest of any party in any oil and
48 gas lease covered by the agreement is subject to any overriding royalty, production payment, or other charge that is less than the
49 aforesaid royalty, such party shall retain for its own account the difference between the existing burden, and the aforesaid royal-

50 No party shall ever be responsible, on any price basis higher than the price received by such party, to any other party's lessor
51 or royalty owner; and if any such other party's lessor or royalty owner should demand and receive settlements on a higher price basis,
52 the party contributing such lease shall bear the royalty burden insofar as such higher price is concerned.

53 It is recognized by the parties hereto that in addition to each party's share of working interest production as shown in Exhibit
54 "A", such party shall have the right, subject to existing contracts, to market the royalty gas attributable to each lease which it
55 contributes to the Contract Area and to receive payments due for such royalty gas produced from or allocated to such lease or leases.
56 It is agreed that, regardless of whether each party markets or contracts for its share of gas, including the royalty gas under the
57 leases which it contributed to the Contract Area, such party agrees to pay or cause to be paid to the royalty owners under its lease
58 or leases the proceeds attributable to their respective royalty interest and to hold all other parties hereto harmless for its failure
59 to do so.

60 F. Rentals, Shut-in Well Payments and Minimum Royalties:

61 Rentals, shut-in well payments and minimum royalties which may be required under the terms of
62 any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their
63 expense. In the event two or more parties own and have contributed interests in the same lease to this
64 agreement, such parties may designate one of such parties to make said payments for and on behalf of all
65 such parties. Any party may request, and shall be entitled to receive, proper evidence of all such pay-
66 ments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum
67 royalty through mistake or oversight where such payment is required to continue the lease in force,
68 any loss which results from such non-payment shall be borne in accordance with the provisions of Article
69 IV.B.2.

70 Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shut-
ting in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sun-
day and holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action,
but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-
Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments

0/16/86

ATTACHED TO AND MADE A PART OF OPERATING AGREEMENT DATED JUNE 30, 1987, BETWEEN YATES PETROLEUM CORPORATION, "OPERATOR", AND INEXCO OIL COMPANY, ET AL, COVERING S/2 SECTION 26: T16S-R37E, NMPM, LEA COUNTY, NEW MEXICO

EXHIBIT "A"

- I. 1. Lands Subject to Agreement:
Township 16 South, Range 37 East, NMPM
Section 26: S/2
containing 320.00 acres, more or less,
Lea County, New Mexico
2. Depth Restriction:
Surface to stratigraphic equivalent of 100' below total depth in Initial Test Well.
3. Drilling Unit for Initial, Substitute or Optional Test Well:
Proration Unit as established by the New Mexico OCD.

II. Percentage Interests of Parties Under the Agreement:

<u>WORKING INTEREST OWNERS</u>	<u>NET ACRES</u>	<u>% OF UNIT</u>
Yates Petroleum Corporation	54.93723	17.16788%
Yates Drilling Company	54.93724	17.16789%
MYCO Industries, Inc.	54.93724	17.16789%
Abo Petroleum Corporation	54.93724	17.16789%
Inexco Oil Company	68.46355	21.39486%
Felmont Oil Corporation	24.00000	7.50000%
EP Operating Company	3.35000	1.04687%
Nitram Enterprises, Inc.	3.00000	.93750%
H. L. Brown, Jr.	1.43750	.44922%
Totals:	320.00000	100.00000%

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:

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

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

ii. The salaries wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property shall () shall not (X) 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 \$	<u>5,400.00</u>
Producing Well Rate \$	<u>540.00</u>

(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.