



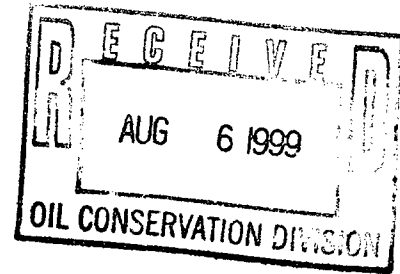
Manzano Oil Corporation

August 4, 1999

P.O. Box 2107
Roswell, New Mexico 88202-2107
(505) 623-1996
FAX (505) 625-2620

Mr. Michael L. Stogner
Oil Conservation Division
Department of Energy
Minerals and Natural Resources
2040 South Pacheco Street
Santa Fe, New Mexico 87505

Re: Application for Administrative Approval
of Unorthodox Well Location
Esperanza #2
Eddy County, New Mexico



Dear Mr. Stogner:

At one time all of the lands in Sections 2, 3, 4, 10, 11, and the N/2, SW/4, W/2SE/4, NW/4SE/4 of Section 9, Township 22 South, Range 27 East were subject to Operating Agreement dated November 4, 1968 between Union Oil Company of California as Operator and J.M. Huber, et al, as non-operators. Through its acquisition of Unocal's southeastern New Mexico properties in 1997, Matador Petroleum Corporation succeeded to the interest of Unocal as to this agreement which is still in full force and effect. All depths are included as to the lands contributed to the Operating Agreement and Matador Petroleum Corporation would be the Operator to any well drilled under the lands subject to the Operating Agreement. There are no unleased mineral interests in the W/2 of Section 2, all of Sections 3 and 4, and the N/2 of Sections 9 and 10. Any lands not subject to referenced Operating Agreement, Manzano Oil Corporation has under lease.

Enclosed is a copy of this Operating Agreement which is not of record although there is constructive notice filed in Eddy County and we have title opinions that reference said Operating Agreement on file in our office. I hope this is what you need in order to complete our Administrative Approval of Unorthodox Well Location for our Esperanza #2 well. If not, please contact me at (505) 623-1996.

Sincerely,

Mike Brown

Mike Brown

Enclosure

As per my request of 8-4-1999.
[Signature]

MODEL FORM OPERATING AGREEMENT—1956
Non-Federal Lands

OPERATING AGREEMENT

DATED

November 4, 1968,

FOR UNIT AREA IN TOWNSHIP 22 South, RANGE 27 East,

Eddy COUNTY, STATE OF New Mexico.

Published and for Sale by
ROSS-MARTIN CO.

Box 800
Tulsa, Oklahoma

Form 610

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OPERATING AGREEMENT

THIS AGREEMENT, entered into this 4th day of November, 1968, between
UNION OIL COMPANY OF CALIFORNIA

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:

There shall be no examination of title to leases, or to oil and gas interests, except that title to the ^{lease} ~~drilling~~ ^{lease} ~~unit~~ on which the exploratory well is to be drilled in accordance with Section 7, which ^{lease} ~~unit~~ is more particularly described in Exhibit "A", shall be examined on a complete abstract record by Operator's attorney, ^{by a competent New Mexico attorney selected by the Operator,} or, ~~if the location is on one of Operator's leases, by an attorney for one of the other parties,~~ and the title to both the oil and gas lease and to the fee title of the lessors must be approved by the examining attorney, or accepted by all parties. A copy of the examining attorney's opinion shall be sent to each party immediately after the opinion is written, and, also, each party shall be given, as they are written, a copy of all subsequent supplemental attorney's reports. A good faith effort to satisfy the examining attorney's requirements shall be made by the party owning the lease covering the drillsite.

If title to the proposed drillsite is not approved by the examining attorney or the lease is not acceptable for a material reason, and all the parties do not accept the title, the parties shall select a new drillsite for the first exploratory well; provided, if the parties are unable to agree upon another drillsite, this agreement shall, in that case, come to an end and all parties shall then forfeit their rights and be relieved of obligations hereunder. If a new drillsite is selected, title to the oil and gas lease covering it and to the fee title of the lessor shall be examined, and title shall be approved or accepted or rejected in like manner as provided above concerning the drillsite first selected. If title to the oil and gas lease covering the second choice drillsite is not approved or accepted, other drillsites shall be successively selected and title examined, until a drillsite is chosen

to which title is approved or accepted, or until the parties fail to select another drillsite. As in the case of the drillsite first selected, so also with successive choices if the time comes that the parties have not approved title and are unable to agree upon an alternate drillsite, the contract shall, in that case and at that time, come to an end and all parties shall forfeit their rights and be relieved of obligations under this contract.

No well other than the first test shall be drilled in the Unit Area until after (1) the title to the drilling unit has been examined by an attorney for one of the parties other than the party whose lease embraces the drillsite, and (2) the title has been approved by the examining attorney or the title has been accepted by all of the parties who are to participate in the drilling of the well.

B. Failure of Title:

Should any oil and gas lease, or interest therein, be lost through failure of title, this agreement shall, nevertheless, continue in force as to all remaining leases and interests, and

- (1) The party whose lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development or operating costs which it may have theretofore paid, but there shall be no monetary liability on its part to the other parties hereto by reason of such title failure; and
- (2) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Unit Area by the amount of the interest lost; and
- (3) If the proportionate interests of the other parties hereto in any producing well theretofore drilled on the Unit Area is increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such interests (less operating costs attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well; and
- (4) Should any person not a party to this agreement, who is determined to be the owner of any interest in the title which has failed, pay in any manner any part of the cost of operation, development, or equipment, or equipment previously paid under this agreement, such amount shall be proportionately paid to the party or parties hereto who in the first instance paid the costs which are so refunded; and
- (5) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be borne by the parties in the same proportions in which they shared in such prior production.

C. Loss of Leases for Causes 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, or if any lease or interest therein is lost due to the fact that the production therefrom is shut in by reason of lack of market, 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 Unit Area.

3. UNLEASED OIL AND GAS INTERESTS

There are no unleased interests.

4. INTERESTS OF PARTIES

Exhibit/B 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/B. 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 ($\frac{1}{8}$) 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

UNION OIL COMPANY OF CALIFORNIA 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 1st day of December, 1968, Operator shall commence the drilling of a well for oil and gas in the following location:

NW/4 Section 10, T-22-S, R-27-E, Eddy County, New Mexico,

and shall thereafter continue the drilling of the well with due diligence to a depth sufficient to test the Strawn Reef Formation, or to a maximum depth of 10,700 feet below the surface, whichever is the lesser,

unless granite or other practically impenetrable substance ^{or condition} 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 ^{eight percent (8%)} ~~six percent (6%)~~ per annum until paid. 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 remain or are continued in force as to any part of the Unit Area, whether by production, extension, renewal or otherwise; provided, however, that in the event the first well drilled hereunder results in a dry hole and no other well is producing oil or gas in paying quantities from the Unit Area, then at the end of ninety (90) days after abandonment of the first test well, this agreement shall terminate unless one or more of the parties are then engaged in drilling a well or wells pursuant to Section 12 hereof, or all parties have agreed to drill an additional well or wells under this agreement, in which event this agreement shall continue in force until such well or wells shall have been drilled and completed. If production results therefrom this agreement shall continue in force thereafter as if said first test well had been productive in paying quantities, but if production in paying quantities does not result therefrom this agreement shall terminate at the end of ninety (90) days after abandonment of such well or wells. 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 Five Thousand & No/100-----Dollars (\$ 5,000.00----) 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) ^{or legal holidays} 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 ^{all parties} ~~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 ^{all parties} ~~it~~ had participated therein.

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

Within sixty (60) days after the completion of any operation under this section, the party conducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds realized from the sale of the well's working interest production during the preceding month. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation which would have been owned by a Non-Consenting Party had ~~it~~ ^{all parties} participated therein shall be credited against the total unreturned costs of the work done and of the equipment purchased, in determining when the interest of such Non-Consenting Party shall revert to it as above provided; if there is a credit balance it shall be paid to such Non-Consenting Party.

If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it and from and after such reversion such Non-Consenting Party shall own the same interest in such well, the operating rights and working interest therein, the material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have owned had it participated in the drilling, reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this agreement and the accounting procedure schedule, Exhibit "C", attached hereto.

Notwithstanding the provisions of this Section 12, it is agreed that without the mutual consent of all parties, no wells shall be completed in or produced from a source of supply from which a well located elsewhere on the Unit Area is producing, unless such well conforms to the then-existing well spacing pattern for such source of supply.

The provisions of this section shall have no application whatsoever to the drilling of the initial test well on the Unit Area, but shall apply to the reworking, deepening, or plugging back of the initial test well after it has been drilled to the depth specified in Section 7, if it is, or thereafter shall prove to be, a dry hole or non-commercial well, and to all other wells drilled, reworked, deepened, or plugged back, or proposed to be drilled, reworked, deepened, or plugged back, upon the Unit Area subsequent to the drilling of the initial test well.

13. RIGHT TO TAKE PRODUCTION IN KIND

have the right to

Each party shall/take in kind or separately dispose of its proportionate share of all oil and gas produced from the Unit Area, exclusive of production which may be used in development and producing operations and in preparing and treating oil for marketing purposes and production unavoidably lost. Each party shall pay or deliver, or cause to be paid or delivered, all royalties, overriding royalties, or other payments due on its share of such production, and shall hold the other parties free from any liability therefor. Any extra expenditure incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. No communitization of any lease shall affect the rights of any party to take or dispose of its share of production.

Each party shall execute all division orders and contracts of sale pertaining to its interest in production from the Unit Area, and shall be entitled to receive payment direct from the purchaser or purchasers thereof for its share of all production.

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.

19. 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.

20. 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.

21. 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.

22. 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 insofar as it covers lands in the Unit Area 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.

23. 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, ^{insofar as it covers lands in the Unit Area} 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.

24. 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 ^{sharing in the} costs of the well on which the contribution is predicated 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. Contributions in connection with initial test well are governed by Section 30.

25. PROVISION CONCERNING TAXATION

fully and finally

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 ^{and all similar provisions.} 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 execute and file 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".

26. 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.

27. 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.

28. 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.

29. 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.

30. OTHER CONDITIONS, IF ANY, ARE:

A. Any party hereto, upon request, shall, as soon as practicable, submit to Unit Operator copies of its respective leases embracing lands committed to the Unit Area, together with all rental receipts and copies of any and all title opinions covering said lands, and shall loan to Unit Operator for examination all abstracts which it may have covering said lands. Unit Operator shall procure all supplemental abstracts and other title papers which may be necessary or required to examine title to any drillsite tract committed to the Unit Area. All expenses incurred in examining title in connection with the initial test well shall be charged as an expense to the parties participating in the drilling of same in proportion to their respective interests as shown in Column 8 of Exhibit "B" attached hereto. Title expense in connection with subsequent wells drilled hereunder shall be charged to the participants in their respective proportions as shown in Column 6 of Exhibit "B" attached hereto.

B. PARTICIPATION AND COST OF THE INITIAL WELL

Union Oil Company of California ("Union"), J. M. Huber Corporation ("Huber"), Pierce & Davis, David J. Sorenson ("Sorenson"), and T. J. Sivley ("Sivley") have agreed and do hereby agree to bear and pay, as shown in Column 8 of Exhibit "B" attached hereto, all costs and expenses (including title costs and expenses) incurred and assume all risks which are attributable to the interests of Stoltz & Company ("Stoltz"), Chambers & Kennedy, and Skelly Oil Company ("Skelly") in drilling, testing, plugging and abandoning (if a dry hole), and completing and equipping through the tanks or separator as applicable (if a well capable of producing oil or gas in paying quantities) the initial well required in Section 7 hereof. If said well is drilled to the anticipated depth, as required in Section 7 hereof, and the same is completed as a well capable of producing oil and/or gas in paying quantities, Stoltz, Chambers & Kennedy, and Skelly have agreed and do hereby agree to contribute an undivided one half (1/2) interest in and to their respective leasehold interests committed to this Unit Agreement as shown on Exhibit "A" attached hereto, said contributions being made in proportions as shown in Column 3 of Exhibit "B" attached hereto to Union, Huber, Pierce & Davis, Sorenson, and Sivley in proportions as shown in Column 4 of Exhibit "B" attached hereto.

C. If the initial test well is completed as a dry hole, all casing and other material which may be salvaged therefrom shall be owned by the parties in accordance with the participation percentage reflected in Column 8 of Exhibit "B" attached hereto.

D. ASSIGNMENT OF LEASEHOLD INTERESTS

In the event the initial test well is completed as a well capable of producing in paying quantities, Stoltz, Chambers & Kennedy, and Skelly shall promptly execute and deliver unto Union, Huber, Pierce & Davis, Sorenson, and Sivley such instruments, in recordable form, as may be necessary to transfer unto and establish record title in Union, Huber, Pierce & Davis, Sorenson, and Sivley an undivided one half (1/2) interest in and to their respective leases and leasehold estates described in Exhibit "A" attached hereto, and to the operating rights in and under such leases. Such interest shall be transferred without warranty of title either express or implied, and shall be subject to their proportionate burden of any and all overriding royalty interest or other lease burdens payable out of production from such leases created prior to the effective date hereof, and such interest shall further be subject to all terms and conditions of this agreement.

E. PARTICIPATION IN THE INITIAL WELL AND PRODUCTION THEREFROM

- 1) Stoltz, Chambers & Kennedy, and Skelly shall each be entitled to an interest in the nature of an overriding royalty of 1/16 of 8/8 of all production from the initial well reduced in the proportion that each party's surface acreage bears to the total gross surface acreage covered hereby.
- 2) In the event the initial test well is completed as a well capable of producing in paying quantities, all oil, gas and other liquids or gaseous hydrocarbons produced, saved, and marketed therefrom, and all casing, tubing, wellhead connections, tanks and other equipment installed in connection therewith and necessary to place same on production, shall be owned by the parties participating in the cost of the drilling of such well in accordance with the participation percentages reflected in Column 8 of Exhibit "B" hereto until payout of such well (hereinafter referred to as "payout period"). Such "payout period" terminates effective on the first day of the month next following the month during which Union, Huber, Pierce & Davis, Sorenson, and Sivley shall have recouped all reasonable and actual expenses incurred by its drilling, completing equipping and operating (including workovers, if any) said test well from the proceeds or market value of that share of production from such well credited to it in Column 8 of Exhibit "B" attached hereto, after deducting production taxes, royalty, overriding royalty and other interest payable out of or measured by such share of production from initial well, including Stoltz, Chambers & Kennedy, and Skelly overriding royalty interests.
- 3) The cost of drilling, testing, completing and equipping the initial well, if productive, and its operating costs for recovery of cost for payout purposes shall be determined in accordance with the Accounting Procedure - Exhibit "C" attached hereto. Union, as Operator, shall furnish all parties on an annual basis and at payout of recoverable costs cumulative statements of these costs and also cumulative production of oil and/or gas and the amounts received for such production; and after payout shall likewise furnish all parties evidence in the change of ownership of production and the well and equipment in connection therewith. At such time as the payout period for the initial well terminates, Stoltz, Chambers & Kennedy, and Skelly overriding royalty interests, reserved above, shall convert to a working interest in the initial well, reduced in the proportions that each party's net remaining surface acreage, as shown in Column 5 of Exhibit "B" attached hereto, bears to the total gross surface acreage covered hereby.

F. All costs, expenses and liabilities incurred in the operations of this Unit Agreement on the Unit Area, other than operations in connection with the initial test well until payout period, shall be borne and paid and all equipment and material required in the operations on the Unit Area shall be owned by the parties hereto in accordance with their respective participation percentages reflected in Column 6 of Exhibit "B" attached hereto.

G. Operator shall promptly notify each other party of the following:

- 1) The date of the first oil run from any well located on the Unit Area.
- 2) The date that gas from any well located on the Unit Area is first turned onto stream.
- 3) The date on which any gas well located on the Unit Area is shut-in and the reason therefor; however, prior to shutting in such gas well, Operator shall give ten (10) days notice and shall likewise give notice when a gas well is again put on stream.

Provided, however, that if Operator fails to make such notification there shall be no liability on the part of the Operator for failure to make such notification.

H. WAIVER OF RIGHT OF PARTITION

All of the parties hereby waive, during the effective term of this agreement with respect to the oil and gas leases, interests in oil and gas estates subject to this agreement and personal property located thereon, the benefit of any and all laws and statutes of the State of New Mexico relating to actions for partition of real and personal property, and all do hereby covenant during the existence of this agreement not to resort to any action at law or in equity to apportion the aforesaid real or personal property with respect hereto.

I. Fair and Equal Employment - Union is an Equal Opportunity Employer. It is agreed with each party as a condition of the Agreement as follows:

- 1) That in the performance of this Agreement 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, color, religion, national origin, sex, or age.
- 2) This contract or any subcontract in connection therewith is subject to the Rules and Regulations approved by the Secretary of Labor under Executive Order 11246, as amended; and a copy of the Equal Opportunity and Nondiscrimination Provision of Section 202 of Executive Order 11246, and a copy of the Certification of Non-Segregated Facilities are made a part hereof and are set forth below:

Equal Employment Opportunity Provision

During the performance of this contract, each party hereto agrees and will likewise require of contractors in connection herewith as follows:

- a) That it will not discriminate against any employee or applicant for employment because of race, religion, color, sex or national origin. That it will take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without regard to their race, religion, color, sex or national origin. Such action shall include, but not be limited to the following: Employment, upgrading, demotion, or transfer, recruitment or recruitment advertising; layoff or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. That it will agree to post in conspicuous places, available to employees and applicants for employment, notices to be provided by the contracting officer setting forth the provisions of this non-discrimination clause.
- b) That it will, in all solicitations or advertisements for employees placed by or on behalf of said party, state that all qualified applicants will receive consideration for employment without regard to race, religion, color, sex or national origin.
- c) That it 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 said party'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.
- d) That it 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.
- e) That it 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.
- f) In the event of noncompliance by any party hereto with the nondiscrimination clauses of this contract or with any of such rules, regulations, or orders, this contract may be canceled, terminated or suspended in whole or in part, insofar as such noncomplying party is concerned, and it 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.

- g) That it will include the provisions of paragraphs a) through g) in every subcontract or purchase order unless exempted by rules, regulations, or orders of the Secretary of Labor issued pursuant to Section 204 of Executive Order 11246 of September 24, 1965, so that such provisions will be binding upon each subcontractor or vendor. That it will take such action with respect to any subcontract or purchase order as the contracting agency may direct as a means of enforcing such provisions including sanctions for noncompliance: Provided, however, That in the event it should become involved in, or threatened with, litigation with a subcontractor or vendor as a result of such direction by the contracting agency, it may request the United States to enter into such litigation to protect the interests of the United States.
- h) Each party hereto acknowledges that it may be required to file Standard Form 100 (EEO-1) promulgated jointly by the Office of Federal Contract Compliance, the Equal Employment Opportunity Commission and Plans for Progress with Joint Reporting Committee, Federal Depot, Jeffersonville, Indiana, within thirty (30) days of the date of contract award if such report has not been filed for the current year and otherwise comply with or file such other compliance reports as may be required under Executive Order 11246, as amended and Rules and Regulations adopted thereunder.
- i) Each party hereto further acknowledges that it may be required to develop a written affirmative action compliance program as required by the Rules and Regulations approved by the Secretary of Labor under authority of Executive Order 11246 and supply operator and all other parties with a copy of such program if operator or any or all other parties so request.

CERTIFICATION OF NON-SEGREGATED FACILITIES

- 1) Operator assures each party 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.
- 2) 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 Operator; and further understands that whoever knowingly and willfully makes any false, fictitious or fraudulent representation may be liable to criminal prosecution under 18 U.S.C. § 1001.

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

ATTEST:

UNION OIL COMPANY OF CALIFORNIA

By _____ *JSB*
Attorney-in-Fact

O P E R A T O R

ATTEST:

J. M. HUBER CORPORATION

By _____

ATTEST:

STOLTZ & COMPANY

By _____

DAVID J. SORENSON

MARTIN YATES, III

ATTEST:

NIELSON ENTERPRISES, INC.

By _____

ATTEST:

PENNZOIL UNITED, INC.

By _____

ATTEST:

STETCO 68 LIMITED

By _____

T. J. SIVLEY

ATTEST:

PAN AMERICAN PETROLEUM CORPORATION

By

ATTEST:

SKELLY OIL COMPANY

By

ATTEST:

TEXAS OIL & GAS CORPORATION

By

ATTEST:

CHAMBERS & KENNEDY

By

ATTEST:

PIERCE & DAVIS

By

N O N - O P E R A T O R S

E X H I B I T "A"

Attached to and made a part of Operating Agreement dated November 4, 1968, between UNION OIL COMPANY OF CALIFORNIA, as Operator, and J. M. HUBER, et al., as Non-Operators, covering the lands described below in Eddy County, New Mexico.

1. The Unit Area shall consist of the following described lands:

Township 22 South, Range 27 East, N.M.P.M.

Section 2: All

Section 3: All

Section 4: All

Section 9: N/2, SW/4, N/2 SE/4, SW/4 SE/4

Section 10: All

Section 11: All

EXHIBIT "A"
Carlsbad Drilling Block
Carlsbad Prospect-7382
Eddy County, New Mexico

PENNZOIL COMPANY - 50%, STETCO 68 LIMITED - 50%

Lease 96350

Lessor: U.S.A. (NM 0473303)
 Lessee: W. Hirshon
 Assignor: H. T. Hilliard and wife, Barbara P. Hilliard
 Assignee: Pennzoil Company
 Date of Lse: 1-1-64
 Term: 10 years
 Royalty: 12.5% plus 5% production payment until \$750.00
 per acre for number of acres assigned and paid
 Desc: Lots 1 and 2, S/2 SE/4 Section 3, and N/2 NE/4
 Section 10, Township 22 South, Range 27 East
 Net acres:

Lease 96349

Lessor: U.S.A. (NM-0454018)
 Lessee: A. J. Heiser
 Assignor: H. T. Hillard and wife, Barbara Hilliard
 Assignee: Pennzoil Company
 Date of Lse: 12-1-63
 Term: 10 years
 Royalty: 12.5% plus 5% production payment until \$750.00
 per acre for number of acres assigned and paid
 Desc: S/2 NE/4, N/2 SE/4 Section 3, Lots 3 and 4,
 and S/2 NW/4 Section 4, and S/2 NE/4 Section 10,
 Township 22 South, Range 27 East
 Net acres:

Lease 96351

Lessor: Paul H. Wersell and wife, Lila L. Wersell;
 Clara Wersell, a single woman; John Wersell,
 a single man; individually and as the sole and
 only beneficiaries and heirs at law of the
 estate of Joe Wersell, deceased.
 Lessee: G. Dee Williamson
 Date of Lse: 10-12-65
 Term: 10 years
 Royalty: 12.5% plus 5% production payment until \$750.00
 per acre for number of acres assigned and paid
 Desc: Lots 3 and 4, Section 3; Lots 1 and 2, Section 4;
 Township 22 South, Range 27 East
 Net acres: 159.25

CHAMBERS & KENNEDY - 50%, STOLTZ & COMPANY - 50%

Lease

Lessor: U.S.A. (NM 0554481)
 Lessee: Jo Ann Walker
 Date of Lse: 8-1-64
 Term: 10 years
 Royalty: 12.5% - plus 5% of 8/8 ORR
 Desc: NW/4 and NW/4 SW/4 Section 11;
 Township 22 South, Range 27 East
 Net acres: 200.00

SKELLY OIL COMPANY

Lease

Lessor: State of New Mexico (K-1255)
 Lessee: Skelly Oil Company
 Date of Lse: 3-21-61
 Term: 10 years
 Royalty: 12.5%
 Desc: S/2 SW/4, SW/4 SE/4 Sec. 2, T-22-S, R-27-E
 Net acres: 280.00

J. M. HUBER CORPORATION - 50%, Pierce & David - 50%Lease

Lessor: Ralph Nix and Frances Nix, husband and wife 1/2
 Lessee:
 Assignor:
 Assignee: J.M. Huber Corporation, a New Jersey Corporation 50%
 Pierce and Davis, a Partnership 50%
 Date of Lse: 10-15-66
 Term: 5 years
 Royalty: 18.75%
 Desc: NE/4 Section 2, Township 22 South, Range 27 East,
 Eddy County, New Mexico
 Net Acres: 80.18

Lease

Lessor: U.S.A. (NM 0554482)
 Lessee:
 Assignor: Lucy M. English and husband, Lawrence English
 and Ernest A. Hanson and his wife Beulah I. Hanson
 (10% English, 90% Hanson)
 Assignee: J.M. Huber Corporation, a New Jersey Corporation 50%
 Pierce & Davis, a Partnership 50%
 Date of Lse: 8-1-64
 Term: 10 years
 Royalty: 12.5% -plus 5% of 8/8 ORR to Assignors
 Desc: SW/4 SW/4 Section 11, Township 22 South, Range 27 East
 Net acres: 40

DAVID J. SORENSONLease

Lessor: James L. Dyche, individually (dealing in his sole
 and separate property) and as Executor of the Last
 Will and Testament of Carmen Cornell, deceased;
 and M. J. Clayburgh, as Executor of the Last Will
 and Testament of Dudley Cornell, deceased.
 Lessee: David J. Sorenson
 Date of Lse: 3-23-67
 Term: 5 years
 Royalty: 12.5%
 Desc: SW/4, S/2 NW/4 Section 3, SE/4, S/2 NE/4 Section 4,
 NE/4, S/2 NW/4 Section 9, NW/4 and that portion of
 the SE/4 lying north and east of the Pecos River
 of Section 10; Township 22 South, Range 27 East
 Net acres: 10

Lease

Lessor: Mary Lee Cornell, an Incompetent, acting by and
 through D. E. Cornell, III, Guardian
 Lessee: David J. Sorenson
 Date of Lse: 6-12-67
 Term: 5 years
 Royalty: 12.5%
 Desc: SW/4, S/2 NW/4 Section 3, SE/4, S/2 NE/4 Section 4,
 NE/4 S/2 NW/4 Section 9, NW/4 and that portion of
 the SE/4 lying north and east of the Pecos River
 of Section 10; Township 22 South, Range 27 East
 Net acres: 10

Lease _____

Lessor:	Derby D. Thompson and Dorothy M. Thompson, husband and wife
Lessee:	David J. Sorenson
Date of Lse:	11-2-66
Term:	5 years
Royalty:	12.5%
Desc:	All of the North 10 acres of the NE/4 SW/4, also described as the N/2 N/2 NE/4 SW/4 Section 9, Township 22 South, Range 27 East
Net acres:	10

T. J. SIVLEY

Lease _____

Lessor:	
Lessee:	T. J. Sivley
Date of Lse:	10-20-66
Term:	7 years
Royalty:	12.5% plus 6.25% production payment until \$1,000.00 per acre for number of acres assigned and paid covering (421.378 acres)
Desc:	SE/4 SW/4, E/2 SW/4 SW/4 Section 9, also described as Lots I.J. & K. of Riverside Farms
Net acres:	60

PAN AMERICAN PETROLEUM CORPORATIONLease 254023

Lessor:	Pecos Irrigation Co., a Corporation
Lessee:	Pan American Petroleum Corporation
Date of Lse:	9-28-66
Term:	6 years
Royalty:	12.5%
Desc:	S/2 SE/4, NE/4 SE/4 Section 2, Township 22 South, Range 27 East
Net Acres:	120.00

Lease 254024

Lessor:	Pecos Irrigation Co., a Corporation
Lessee:	Pan American Petroleum Corporation
Date of Lse:	9-28-66
Term:	6 years
Royalty:	12.5%
Desc:	E/2 Section 11, Township 22 South, Range 27 East
Net acres:	320.00

TEXAS OIL AND GAS CORPORATION - 50%, NIELSON ENTERPRISES, INC. - 50%Lease 2479

Lessor:	Wilson W. Simpson, Jr.
Lessee:	James R. Stephens
Date of Lse:	2-11-65
Term:	5 years
Royalty:	12.5%
Desc:	Lots 3 and 4 (N/2 NW/4) Section 2, Township 22 South, Range 27 East
Net acres:	40.035

MARTIN YATES, III1/2 Mineral Interest

Desc:	NE/4 Section 2, Township 22 South, Range 27 East
Royalty:	
Net Acres:	80.18

UNION OIL COMPANY OF CALIFORNIALease 77173

Lessor: Annette Standley, a feme sole
 Lessee: Union Oil Company of California
 Date of Lse: 1-11-68
 Term: 5 years
 Royalty: 18.75%
 Desc: That part of the SE/4 lying south and west of the Pecos River containing 60 acres more or less, of Section 10, Township 22 South, Range 27 East
 Net acres: 60.00

Lease 77174

Lessor: Walterscheid Brothers, a partnership composing of Alfred J. Walterscheid, Edward J. Walterscheid and John L. Walterscheid
 Lessee: Union Oil Company of California
 Date of Lse: 12-20-67
 Term: 5 years
 Royalty: 18.75%
 Desc: SW/4 Section 10, Township 22 South, Range 27 East
 Net acres: 160.00

Lease 77175

Lessor: Albert J. Calvani and Mildred L. Calvani, his wife
 Lessee: Union Oil Company of California
 Date of Lse: 1-2-68
 Term: 5 years
 Royalty: 18.75%
 Desc: NW/4 SW/4 Section 9, T-22-S, R-27-E, N.M.P.M., also described as Lots D, E, R & S of Riverside Farms; W/2 SW/4 SW/4 Section 9, T-22-S, R-27-E, N.M.P.M., also described as Lot H of Riverside Farms; the South 30 acres of the NE/4 SW/4 Section 9, T-22-S, R-27-E, N.M.P.M.; the above containing 90 acres, more or less
 Net acres: 90.00

Lease 77181

Lessor: Francis G. Tracy and Bessie D. Tracy, his wife; Josephine Tracy Eddy and George G. Eddy, her husband
 Lessee: Union Oil Company of California
 Date of Lse: 12-27-67
 Term:
 Royalty: 18.75%
 Desc: S/2 NW/4, NE/4 Sec. 9; NW/4 and SE/4 except that part thereof lying south and west of the Pecos River of Section 10; E/2 SW/4 of Section 11
 Net Acres: 455.00

Lease 77182

Lessor: Francis G. Tracy and Bessie D. Tracy, his wife; Josephine Tracy Eddy and George G. Eddy, her husband
 Lessee: Union Oil Company of California
 Date of Lse: 12-27-67
 Term: 5 years
 Royalty: 18.75%
 Desc: S/2 NW/4, SW/4 Sec. 3; S/2 NE/4, SE/4 Sec. 4; Township 22 South, Range 27 East
 Net acres: 360.00

Lease 77185

Lessor: Jarvis Mead and Roderick F. Mead, her husband
 Lessee: Union Oil Company of California
 Date of Lse: 12-31-67
 Term: 5 years
 Royalty: 18.75%
 Desc: SW/4 Section 4, N/2 NW/4 Section 9, Township 22 South
 Range 27 East
 Net Acres: 240.00

Lease 77187

Lessor: W. A. Cloman, a married man dealing in his sole and
 separate estate, joined pro-forma by his wife Ruth
 Cloman; and R. L. Powers and Norma Powers, his wife
 Lessee: Union Oil Company of California
 Date of Lse: 4-11-68
 Term: 5 years
 Royalty: 18.75%
 Desc: S/2 NW/4, SW/4 Section 3, S/2 NE/4, SE/4 Section 4,
 S/2 NW/4, NE/4 Section 9, NW/4 and all that part of
 the SE/4 lying north and east of the Pecos River -
 Section 10, Township 22 South, Range 27 East
 Net acres: 100.00

Lease 77374

Lessor: Walter Craft and Elsie Craft, his wife
 Lessee: Union Oil Company of California
 Date of Lse: 5-9-68
 Term: 5 years
 Royalty: 12.5%
 Desc: SW/4 SE/4 Section 9, Township 22 South, Range 27 East
 Net acres: 20.00

Lease 77382

Lessor: Jesse E. Buckner and Barbara W. Buckner, his wife
 Lessee: Union Oil Company of California
 Date of Lse: 5-9-68
 Term: 5 years
 Royalty: 12.5%
 Desc: N/2 SE/4 Section 9, Township 22 South, Range 27 East
 Net acres: 80.00

Lease 77383

Lessor: Helen M. Sears, a widow
 Lessee: Union Oil Company of California
 Date of Lse: 5-13-68
 Term: 5 years
 Royalty: 12.5%
 Desc: SW/4 SE/4 Section 9, Township 22 South, Range 27 East
 Net acres: 20.00

Lease 77385

Lessor: Atlas Corporation, a Delaware Corporation
 Lessee: Union Oil Company of California
 Date of Lse: 7-2-68
 Term: 5 years
 Royalty: 20%
 Desc: S/2 NW/4, SW/4 Section 3, S/2 NE/4, SE/4 Section 4,
 NE/4, S/2 NW/4 Section 9, NW/4 and all that part of
 the SE/4 lying north and east of the Pecos River
 being 980 acres more or less-Section 10, Township 22
 South, Range 27 East
 Net acres: 125.00

ADDRESSES OF PARTIES

Union Oil Company of California
300 Security National Bank Building
Roswell, New Mexico 88201

Att: Mr. W. M. Stanley

J. M. Huber Corporation
1900 Wilco Building
Midland, Texas 79701

Att: Mr. Ron Holcomb

Stoltz & Company
P. O. Box 1714
Midland, Texas 79701

David J. Sorenson
P. O. Box 1453
Roswell, New Mexico 88201

Martin Yates, III
323 Carper Building
Artesia, New Mexico

Nielson Enterprises, Inc.
P. O. Box 370
Cody, Wyoming 82414

Att: Mr. W. B. Macey

Pennzoil United, Inc. &
Stetco 68 Limited
1007 Midland Savings Building
Midland, Texas 79701

Att: Mr. Rex Richardson

T. J. Sivley
Drawer GG
212 Booker Building
Artesia, New Mexico

Pan American Petroleum Corporation
P. O. Box 1410
Fort Worth, Texas

Att: Mr. Pete Abbey

Skelly Oil Company
P. O. Box 993
Midland, Texas 79701

Att: Mr. Victor E. Bartlett

Texas Oil & Gas Corporation
Federal Union Tower Building
Dallas, Texas 75201

Att: Mr. Bernard Dietz

Chambers & Kennedy
607 Midland National Bank Building
Midland, Texas 79701

Pierce & Davis
204 V&J Tower
Midland, Texas 79701

E X H I B I T "B"

Attached to and made a part of Operating Agreement dated November 4, 1968, between UNION OIL COMPANY OF CALIFORNIA, as Operator, and J. M. HUBER, et al., as Non-Operators.

CARLSBAD DRILLING BLOCK - OWNERSHIP AND PARTICIPATION SCHEDULE

EDDY COUNTY, NEW MEXICO

	1	2	3	4	5	6	7	8
WORKING INTEREST OWNER	Committed Acres	Percentage Committed	Acreage Contributed Initial Test	Acreage Earned Initial Test	Eventual Net Acres	Ownership Percentage	Initial Acres	Initial Well Percentage
Union Oil Company of California	1710.000	45.00367	-0-	213.730	1923.730	50.62860	2137.460	56.25354
J. M. Huber Corporation	60.090	1.58145	-0-	7.510	67.600	1.77909	75.110	1.97674
Pierce & Davis	60.090	1.58144	-0-	7.510	67.600	1.77909	75.110	1.97674
David J. Sorenson	30.000	.78954	-0-	3.750	33.750	.88824	37.500	.98692
T. J. Sivley	60.000	1.57908	-0-	7.500	67.500	1.77647	75.000	1.97385
Pan American Petroleum Corporation	440.000	11.57989	-0-	-0-	440.000	11.57989	440.000	11.57989
Pennzoil United, Inc.	399.630	10.51743	-0-	-0-	399.630	10.51743	399.630	10.51743
Stetco 68 Limited	399.630	10.51744	-0-	-0-	399.630	10.51744	399.630	10.51744
Nielson Enterprises, Inc.	40.035	1.05364	-0-	-0-	40.035	1.05364	40.035	1.05364
Texas Oil & Gas Corporation	40.035	1.05364	-0-	-0-	40.035	1.05364	40.035	1.05364
Stoltz & Company	100.000	2.63179	50.000	-0-	50.000	1.31589	-0-	-0-
Chambers & Kennedy	100.000	2.63180	50.000	-0-	50.000	1.31590	-0-	-0-
Skelly Oil Company	280.000	7.36902	140.000	-0-	140.000	3.68451	-0-	-0-
Martin Yates, III	<u>80.180</u> 3799.690	<u>2.11017</u> 100.00000	<u>-0-</u> 240.000	<u>-0-</u> 240.000	<u>80.180</u> 3799.690	<u>2.11017</u> 100.00000	<u>80.180</u> 3799.690	<u>2.11017</u> 100.00000

Col. 1 is six-section drilling block less unleased cemetery SE/4 SE/4 Section 9.

Col. 6 is percentage of participation of subsequent well costs, operating costs, production therefrom and operating costs and production initial well after payout.

Col. 8 is percentage of initial well costs, operating cost and production until payout.

Col. 3 is subject to proportionately reduced 1/16 of 8/8 overriding royalty, during payout of initial well to be absorbed by earning parties in proportion to acreage earned as shown in Col. 4.

(Total override - initial test to be 480/3799.69 x 1/16 of 3/8 - 12.63261% x 6.25% = .78954%)

EXHIBIT "C"

Attached to and made a part of Operating Agreement dated November 4, 1968, between UNION OIL COMPANY OF CALIFORNIA, as Operator, and J. M. HUBER, et al., as Non-Operators.

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.

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

"Non-Operators" shall mean the nonoperating parties, whether one or more.

"Joint Account" shall mean the account showing the charges and credits accruing because of the Joint Operations and which are to be shared by the Parties.

"Parties" shall mean Operator and Non-Operators.

"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. Conflict with Agreement

In the event of a conflict between the provisions of this Accounting Procedure and the provisions of the agreement to which this Accounting Procedure is attached, the provisions of the agreement shall control.

3. Collective Action by Non-Operators

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

4. Statements and Billings

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

A. Statement in detail of all charges and credits to the Joint Account.

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

C. Statement of all charges and credits to the Joint Account summarized by appropriate classifications indicative of the nature thereof, except that items of Controllable Material and unusual charges and credits shall be detailed.

5. Payment and Advances by Non-Operators

Each Non-Operator shall pay its proportion of all such bills within fifteen (15) days after receipt thereof. If payment is not made within such time, the unpaid balance shall bear interest at the rate of ~~xxxxxxxxxx(8%)~~ per annum until paid. **eight percent (8%)**

6. Adjustments

Payment of any such bills shall not prejudice the right of any Non-Operators 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 the Joint Property as provided for in Section VII.

7. Audits

A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the accounting hereunder for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided however, the making of an audit shall not extend the time for the taking of written exception to and the adjustment of accounts as provided for in Paragraph 6 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.

II. DIRECT CHARGES

Subject to limitations hereinafter prescribed, Operator shall charge the Joint Account with the following items:

1. Rentals and Royalties

Delay or other rentals and royalties when such rentals and royalties are paid by Operator for the Joint Account of the Parties.

2. Labor

A. Salaries and wages of Operator's employees directly engaged on the Joint Property in the conduct of the Joint Operations, and salaries or wages of technical employees who are temporarily assigned to and directly employed on the Joint Property.

B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to the employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II and Paragraph 1 of Section III; except that in the case of those employees only a pro rata portion of whose salaries and wages are chargeable to the Joint Account under Paragraph 1 of Section III, not more than the same pro rata portion of the benefits and allowances herein provided for shall be charged to the Joint Account. Cost 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 and Paragraph 1 of Section III. 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 labor cost of salaries and wages chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II and Paragraph 1 of Section III.

D. Reasonable personal expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II and for which expenses the employees are reimbursed under Operator's usual practice.

3. Employee Benefits

Operator's current cost of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost; provided however, the total of such charges shall not exceed ten percent (10%) of Operator's labor costs chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II and Paragraph 1 of Section III.

4. Material

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

5. Transportation

Transportation of employees 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 or railway receiving point where like material is available, except by agreement with Non-Operators.
- 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 or railway receiving point, except by agreement with Non-Operators. No charge shall be made to Joint Account for moving Material to other properties belonging to Operator, except by agreement with Non-Operators.
- C. In the application of subparagraphs A and B above, there shall be no equalization of actual gross trucking costs of \$100 or less.

6. Services

- A. The cost of contract services and utilities procured from outside sources other than services covered by Paragraph 8 of this Section II and Paragraph 2 of Section III.
- B. Use and service of equipment and facilities furnished by Operator as provided in Paragraph 5 of Section IV.

7. 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 any other cause, except to the extent that the damage or loss could have been avoided through the exercise of reasonable diligence on the part of Operator. Operator shall furnish Non-Operators written notice of damages or losses incurred as soon as practicable after a report thereof has been received by Operator.

8. Legal Expense

All costs and expenses of handling, investigating and settling litigation or claims arising by reason of the Joint Operations or necessary to protect or recover the Joint Property, including, but not limited to, attorneys' fees, court costs, cost of investigation or procuring evidence and amounts paid in settlement or satisfaction of any such litigation or claims; provided, (a) no charge shall be made for the services of Operator's legal staff or other regularly employed personnel (such services being considered to be Administrative Overhead under Section III), except by agreement with Non-Operators, and (b) no charge shall be made for the fees and expenses of outside attorneys unless the employment of such attorneys is agreed to by Operator and Non-Operators.

9. 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.

10. Insurance Premiums

Premiums paid for insurance required to be carried on the Joint Property for the protection of the Parties.

11. 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 for the necessary and proper conduct of the Joint Operations.

III. INDIRECT CHARGES

Operator may charge the Joint Account for indirect costs either by use of an allocation of district expense items plus a fixed rate for administrative overhead, and plus the warehousing charges, all as provided for in Paragraphs 1, 2, and 3 of this Section III OR by combining all three of said items under the fixed rate provided for in Paragraph 4 of this Section III, as indicated next below:

OPERATOR SHALL CHARGE THE JOINT ACCOUNT UNDER THE TERMS OF:

- ☐ Paragraphs 1, 2 and 3. (Allocation of district expense plus fixed rate for administrative overhead plus warehousing.)
- ☒ Paragraph 4. (Combined fixed rate)

1. District Expense

Operator shall charge the Joint Account with a pro rata portion of the salaries, wages and expenses of Operator's production superintendent and other employees serving the Joint Property and other properties of the Operator in the same operating area, whose time is not allocated directly to the properties, and a pro rata portion of the cost of maintaining and operating a production office known as Operator's (or a comparable office if location changed), and necessary sub-offices (if any), maintained for the convenience of the above-described office, and all necessary camps, including housing facilities for employees if required, used in connection with the operations of the Joint Property and other properties in the same operating area. The expense of, less any revenue from, such facilities may, at the option of Operator, include depreciation of investment or a fair monthly rental in lieu of depreciation. Such charges shall be apportioned to all properties served on some equitable basis consistent with Operator's accounting practice.

2. Administrative Overhead

Operator shall charge administrative overhead to the Joint Account at the following rates, which charge shall be in lieu of the cost and expense of all offices of the Operator not covered by Paragraph 1 of this Section III, including salaries, wages and expenses of personnel assigned to such offices. Such charges shall be in addition to the salaries, wages and expenses of employees of Operator authorized to be charged as direct charges as provided in Paragraphs 2 and 8 of Section II.

WELL BASIS (RATE PER WELL PER MONTH)

Well Depth	DRILLING WELL RATE (Use Total Depth)	PRODUCING WELL RATE (Use Current Producing Depth)		
	Each Well	First Five	Next Five	All Wells Over Ten
.....
.....
.....
.....

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 this Paragraph 2 of Section III, unless such cost and expense are agreed upon between Operator and Non-Operators as a direct charge to the Joint Account.

3. Operator's Fully Owned Warehouse Operating and Maintenance Expense
(Describe fully the agreed procedure to be followed by the Operator.)

4. Combined Fixed Rates

Operator shall charge the Joint Account for the services covered by Paragraph 1, 2 and 3 of this Section III, the following fixed per well rates:

WELL BASIS (RATE PER WELL PER MONTH)

Well Depth	DRILLING WELL RATE	PRODUCING WELL RATE		
	(Use Total Depth)	(Use Current Producing Depth)		
	Each Well	First Five	Next Five	All Wells Over Ten
0 - 4,000'	\$503	\$100	\$ 90	\$ 79
4,000 - 8,000	613	129	117	105
8,000 - 12,000	725	151	140	129
Over - 12,000	838	169	156	145

Said fixed rate (shall) (shall not) include salaries and expenses of production foremen.

5. Application of Administrative Overhead or Combined Fixed Rates

The following limitations, instructions and charges shall apply in the application of the per well rates as provided under either Paragraph 2 or Paragraph 4 of this Section III:

- Charges for drilling wells shall begin on the date each 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 the suspension of drilling operations for fifteen (15) or more consecutive days.
 - The status of wells shall be as follows:
 - Producing gas wells, injection wells for recovery operations, water supply wells utilized for water flooding operations and salt water disposal wells shall be considered the same as producing wells.
 - Wells permanently shut down but on which plugging operations are deferred shall be dropped from the well schedule at the time the shutdown is effected. When such a well is plugged a charge shall be made at the producing well rates.
 - Wells being plugged back, drilled deeper, converted to a source or input well, or which are undergoing any type of workover that requires the use of a drilling or workover rig shall be considered the same as drilling wells.
 - Temporarily shut-down wells, which are not produced or worked upon for a period of a full calendar month, shall not be included in the well schedule, provided however, wells shut in by governmental regulatory body shall be included in the well schedule only in the event the allowable production is transferred to some other well or wells on the Joint Property. In the event of a unit allowable, all wells capable of producing will be counted in determining the charge.
 - Gas wells shall be included in the well schedule if directly connected to a permanent sales outlet even though temporarily shut in due to overproduction or failure of purchaser to take the allowed production.
 - Wells completed in multiple horizons, in which the production is not commingled down hole, shall be considered as a producing well for each separately producing horizon.
 - The well rates shall apply to the total number of wells being drilled or operated under the agreement to which this Accounting Procedure is attached, irrespective of individual leases.
 - The well rates shall be adjusted on the first day of April of 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 preceding calendar year as shown by "The Index of Average Weekly Earnings of Crude Petroleum and Gas Production Workers" as published by the United States Department of Labor, Bureau of Labor Statistics. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.
6. For the construction of compressor plants, water stations, secondary recovery systems, salt water disposal facilities, and other such projects, as distinguished from the more usual drilling and producing operations, Operator in addition to the Administrative Overhead or Combined Fixed Rates provided for in Paragraph 2 and 4 of this Section III, shall charge the Joint Account with an additional overhead charge as follows:
- Total cost less than \$25,000, no charge.
 - Total cost more than \$25,000 but less than \$100,000, _____% of total cost.
 - Total cost of \$100,000 or more, _____% of the first \$100,000 plus _____% of all over \$100,000 of total cost.
- Total cost shall mean the total 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 wells shall be excluded.
7. The specific rates provided for in this Section III may be amended from time to time by mutual agreement between the Parties hereto if, in practice, the rates are found to be insufficient or excessive.

IV. BASIS OF CHARGES TO JOINT ACCOUNT

Subject to the further provisions of this Section IV, Operator will procure all Material and services for the Joint Property. At the Operator's option, Non-Operator may supply Material or services for the Joint Property.

1. Purchases

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

2. Material furnished from Operator's Warehouse or Other Properties

A. New Material (Condition "A")

- Tubular goods, two inch (2") and over, shall be priced on Eastern Mill base (i. e. Youngstown, Ohio; Lorain, Ohio; and Indiana Harbor, Indiana) on a minimum ~~freight~~ ^{freight rate} basis effective at date of movement and f. o. b. railway receiving point nearest the Joint Property, regardless of quantity. In equalized hauling charges, Operator is permitted to include ten cents (10c) per hundred-weight on all tubular goods furnished from his stocks in lieu of loading and unloading costs sustained.
- Other Material shall be priced at the current replacement cost of the same kind of Material, effective at date of movement and f. o. b. the supply store or railway receiving point nearest the Joint Property where Material of the same kind is available.
- The Joint Account shall not be credited with cash discounts applicable to prices provided for in this Paragraph 2 of Section IV.

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

- Material in sound and serviceable condition and suitable for reuse without reconditioning, shall be classified as Condition "B" and priced at seventy-five per cent (75%) of the current price of new Material.
- Material which cannot be classified as Condition "B" but which,
 - After reconditioning will be further serviceable for original function as good secondhand Material (Condition "B"), or
 - Is serviceable for original function but substantially not suitable for reconditioning, shall be classified as Condition "C" and priced at fifty per cent (50%) of current new price.
- Obsolete Material or Material which cannot be classified as Condition "B" or Condition "C" shall be priced at a value commensurate with its use. 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.

- (4) 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 prices specified in Paragraphs 1 and 2 of this Section IV 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 procuring such Material, in making it suitable for use, and in moving it to the Joint Property, provided, that 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 10 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.

5. Equipment and Facilities Furnished by Operator

A. Operator shall charge the Joint Account for use of equipment and facilities at rates commensurate with cost of ownership and operation. Such rates shall include cost of maintenance, repairs, other operating expense, insurance, taxes, depreciation and interest on investment not to exceed six per cent (6%) per annum, provided such rates shall not exceed those currently prevailing in the immediate area within which the Joint Property is located. Rates for automotive equipment shall generally be in line with the schedule of rates adopted by the Petroleum Motor Transport Association, or some other recognized organization, as recommended uniform charges against Joint Property operations. Rates for laboratory services shall not exceed those currently prevailing if performed by outside service laboratories. Rates for trucks, tractors and well service units may include wages and expenses of operator.

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

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

V. DISPOSAL OF MATERIAL

The Operator may purchase, but shall be under no obligation to purchase, interest of Non-Operators in surplus Condition "A" or "B" Material. The disposition of surplus Controllable Material, not purchased by Operator, shall be subject to agreement between Operator and Non-Operators, provided Operator shall dispose of normal accumulations of junk and scrap Material either by transfer or sale from the Joint Property.

1. Material Purchased by the Operator or Non-Operators

Material purchased by either the Operator or Non-Operators shall be credited by the Operator to the Joint Account for the month in which the Material is removed by the purchaser.

2. Division in Kind

Division of Material in kind, if made between Operator and Non-Operators, shall be in proportion to the respective interests in such Material. The Parties will thereupon be charged individually with the value of the Material received or receivable. Proper credits shall be made by the Operator in the monthly statement of operations.

3. Sales to Outsiders

Sales to outsiders of Material from the Joint Property shall be credited by Operator to the Joint Account at the net amount collected by Operator from vendee. Any claim by vendee related to such sale shall be charged back to the Joint Account if and when paid by Operator.

VI. BASIS OF PRICING MATERIAL TRANSFERRED FROM JOINT ACCOUNT

Material purchased by either Operator or Non-Operators or divided in kind, unless otherwise agreed to between Operator and Non-Operators shall be priced on the following basis:

1. New Price Defined

New price as used in this Section VI shall be the price specified for New Material in Section IV.

2. New Material

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

3. Good Used Material

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

A. At seventy-five per cent (75%) of current new price if Material was charged to Joint Account as new, or

B. At sixty-five per cent (65%) of current new price if Material was originally charged to the Joint Account as secondhand at seventy-five percent (75%) of new price.

4. Other Used Material

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

A. Is not in sound and serviceable condition but suitable for reuse after reconditioning, or

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

5. Bad-Order Material

Material (Condition "D"), no longer suitable for its original purpose without excessive repair cost but usable for some other purpose at a price comparable with that of items normally used for such other purpose.

6. Junk Material

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

7. Temporarily Used Material

When the use of Material is temporary and its service to the Joint Property does not justify the reduction in price as provided for in Paragraph 3 B of this Section VI, such Material shall be priced on a basis that will leave a net charge to the Joint Account consistent with the value of the service rendered.

VII. INVENTORIES

The Operator shall maintain detailed records of Material generally considered controllable by the Industry.

1. Periodic Inventories, Notice and Representation

At reasonable intervals, inventories shall be taken by Operator of the Joint Account Material, which shall include all such Material as is ordinarily considered controllable. 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, who shall in that event furnish Non-Operators with a copy thereof.

2. Reconciliation and Adjustment of Inventories

Reconciliation of inventory with charges to the Joint Account shall be made, and a list of overages and shortages shall be jointly determined by Operator and Non-Operators. Inventory adjustments shall be made by Operator with the Joint Account for overages and shortages, but Operator shall be held accountable to Non-Operator only for shortages due to lack of reasonable diligence.

3. Special Inventories

Special inventories may be taken 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.

EXHIBIT "D"

Attached to and made a part of Operating Agreement dated November 4, 1968
for the Carlsbad Drilling Block, Eddy County, New Mexico

INSURANCE

Operator shall, at the joint expense of the parties hereto, at all times while operations are conducted hereunder, provide with responsible insurance companies, insurance as follows:

- a) Workmen's Compensation Insurance in accordance with the laws of the State of New Mexico;
- b) Employers' Liability Insurance with limits of not less than \$100,000.00;
- c) Public Liability Insurance with respect to bodily injuries with limits of not less than \$100,000.00 as to any one person and \$300,000.00 as to any one accident; and Property Damage Liability Insurance with limits of not less than \$100,000.00 as to any one accident; and
- d) Automobile Public Liability Insurance with respect to bodily injuries with limits of not less than \$100,000.00 as to any one person and \$300,000.00 as to any one accident; also, Automobile Public Liability Insurance with respect to Property Damage with limits of not less than \$100,000.00 as to any one accident.