



T. Kent Woolley, CPL  
Senior Landman

OXY USA INC.

Box 50250, Midland, TX 79710

Phone (915) 685-5906  
FAX: (915) 685-6742

March 27, 1997

Threshold Development Company  
Broad Street Financial Company  
Leland Hodges and  
Herbert F. Boles  
c/o Threshold Development Company  
Fort Worth Club Tower  
Penthouse II, Suite D  
777 Taylor Street  
Fort Worth, Texas 76102

Re: Sections 8 as to all rights below three thousand (3000) feet subsurface and Section 9 as to all rights below five thousand (5000) feet subsurface, Township 19 South, Range 29 East, N.M.P.M., Eddy County, New Mexico (hereinafter the "Subject Lands")

Gentlemen:

This letter shall serve to confirm the terms and provisions of the Agreement between OXY USA Inc., hereinafter "OXY" and Threshold Development Company, Broad Street Financial Company, Leland A. Hodges, and Herbert F. Boles (hereinafter referred to collectively as "Farmors") regarding the acquisition by OXY of a portion of Farmors' interest in those certain Oil, Gas and Mineral Leases more particularly described in Exhibit "A" attached hereto and incorporated herein for all purposes (hereinafter the "Subject Leases") as to the depths specified herein and in Exhibit "A" (hereinafter the "Subject Depths").

For, and in consideration of the mutual covenants and Agreements of the parties hereto, OXY and Farmors do hereby covenant and agree as follows:

1. OXY shall commence, or cause to be commenced actual drilling operations for the first test well at a location of OXY's choice on the Subject Lands on or before the later of July 1, 1997, or sixty (60) days after execution of this Agreement by all of the Farmors, and thereafter drill such well in a continuous, good and workmanlike manner, with no cessation of operations for more than thirty (30) consecutive days, to a depth sufficient in OXY's opinion to test the Morrow formation, but in no event less than 11,000 feet below the surface of the Subject Lands (hereinafter the "Objective Depth"), and thereafter either plug and abandon such well if it is a dry hole, or complete and equip such well through the tanks if completed as an oil well, or through the christmas tree if completed as a gas well, all at OXY's sole risk, cost and expense.
2. OXY shall commence or cause to be commenced actual drilling operations for the second well at a location of OXY's choice on the other section of the Subject Lands within sixty (60) days of the release of the drilling rig from the location for the first test well, said second test well shall be drilled and completed on the same terms and to the same depth as required for the first test well as provided herein.

3. Should OXY fail to timely commence actual drilling operations for the first test well as provided herein for any reason, OXY shall pay Farmers the sum of fifty thousand dollars (\$50,000.00) as liquidated damages, and not as a penalty, in full settlement for OXY's failure to perform hereunder whereupon OXY's rights hereunder shall immediately terminate. After drilling the first test well as required hereunder, should OXY fail, for any reason, to commence actual drilling operations for the drilling of the second test well in a timely manner OXY shall pay to Farmers the sum of twenty five thousand dollars (\$25,000.00) as liquidated damages, and not as a penalty, in full settlement for OXY's failure to perform hereunder whereupon OXY's rights hereunder with respect to any portion of the Subject Lands other than that portion of the same earned by the drilling and completion of the first test well, shall terminate.

4. Should either first test well or second test well be lost or should conditions therein be encountered which make the continuation of drilling operations therein impractical for any reason, said well shall be deemed to be a lost well and OXY may continue its rights under this Agreement by commencing actual drilling operations for a substitute well therefor within sixty (60) days of the date the drilling rig was released from the location for the lost well. Any substitute well timely drilled to the Objective Depth and completed as specified herein for either the first test well or the second test well shall be deemed for all purposes to be such test well.

5. Separately as to first test well and the second test well, upon reaching the Objective Depth therein and the same being completed and equipped as a well capable of producing oil and/or gas in commercial quantities, OXY shall earn all of Farmers' right, title and interest in and to the Subject Leases, insofar and only insofar as they cover the lands lying within the minimum spacing unit for production established by the New Mexico Oil Conservation Division (hereinafter "NMOCD") for the said well or 320 acres, whichever is smaller (hereinafter the "Earned Unit") but only as to the Subject Depths 100 feet below the total depth drilled in said well (hereinafter the "Earned Depths"), subject to a right of Farmers to receive a forty-six and one-half percent (46.5%) working interest in said well and Earned Unit upon the occurrence of "payout" as hereinafter defined; provided, however, that, with respect to all zones, horizons, depths and formations within the Subject Depths and above the base of the Bone Springs Formation in the Earned Unit, OXY shall only earn fifty percent (50%) of Farmers' interest in such zones, horizons, depths and formations within the Subject Depths and above the base of the Bone Springs formation. Within ten (10) business days after receipt of a notice from OXY advising that the subject well has been completed and equipped as required herein, Farmers shall deliver to OXY an assignment in the form attached hereto as Exhibit "B" covering the Earned Unit for such well as to the Earned Depths.

6. With regard to those portions of the Subject Lands not within an Earned Unit for either the first test well or the second test well, OXY shall have the option to continue drilling wells on the Subject Leases until the said lands shall be fully developed with one well on each minimum spacing unit for production as such units shall be prescribed by the NMOCD, provided, that no more than one hundred eighty (180) days shall elapse between the drilling rig release date for one well and the commencement of actual drilling operations for the drilling of the next succeeding well. The failure to commence operations for the drilling of a well on or before the one hundred eightieth (180th) day from the drilling rig release date for the preceding well shall terminate OXY's right to drill more wells on the then unearned portions of the Subject Lands. With regard to any such well drilled to or completed in the Bone Springs formation or any shallower formation covered by this Agreement, the

Farmors shall have the right and option to participate in the drilling of such well to the extent of their respective pro-rata portion of an undivided fifty percent (50%) working interest under the terms and conditions of an Operating Agreement in the form of that attached hereto as Exhibit "C". Any well proposed and completed in a horizon lying below the base of the Bone Springs formation shall be drilled under the same provisions as provided herein for the first test well. Any well drilled pursuant to this paragraph shall be hereinafter referred to as an "Option Well".

7. Upon reaching total depth in any Option Well OXY shall earn either 1) fifty percent (50%) of all of Farmors' right, title, and interest, in and to the Subject Leases, insofar and only insofar as the same cover the lands contained within the minimum spacing unit for production attributed to such Option Well as may be prescribed by the NMOCD for those wells completed in any zone, horizon or formation within the Subject Depths but above the base of the Bone Springs formation, the Farmors having elected to participate in the drilling of such Option Well or elected non-consent status under Article IV.B. of the Operating Agreement; or 2) one hundred percent (100%) of Farmors' right, title and interest, in and to the Subject Leases insofar and only insofar as the same cover lands contained within said minimum spacing unit for production attributed to such Option Well as may be prescribed by the NMOCD subject to Farmor's right to receive a forty-six and one half percent (46.5%) working interest at "payout" (as hereinafter defined) for those wells completed below the base of the Bone Springs formation. In either case, OXY shall only earn an assignment of the Subject Leases as to the minimum spacing unit and only as to the Subject Depths 100 feet below the total depth drilled in any such well and the assignment from Farmors to OXY shall be in substantially the form as attached hereto revised only to reflect the delivery and retention of the correct interests for the well which earned such assignment.

8. Should any Option Well drilled hereunder be lost for any reason or should conditions be encountered in such well which make continued drilling operations impractical prior to reaching total depth therein said well shall be deemed to be a lost well and the date the drilling rig shall have been released from the location for such lost well shall be fixed as the completion date for said well for the purposes of commencing the next one hundred eighty (180) day continuous development period and OXY's rights under this Agreement shall continue as though said well had been duly completed, save and except no assignment shall have been earned due to the drilling of said lost well. Unless OXY's rights under this Agreement shall be preserved by some other provision hereof, failure to commence operations for the drilling of a well on or before the one hundred eightieth (180th) day from the drilling rig release date for the preceding well shall terminate OXY's right to drill more wells on the Subject Lands and earn additional portions of the same pursuant hereto.

9. With regard to any well to be drilled on the Subject Lands below the base of the Bone Springs formation whether such well is an Option Well or a well proposed to be drilled on an Earned Unit, all such wells shall be drilled at the sole risk, cost and expense of OXY and Farmors shall be entitled to receive an undivided forty-six and one half percent (46.5%) working interest in such well upon the occurrence of payout (as hereinafter defined), it being the expressed intention hereof that, any and all wells drilled on the Subject Lands below the base of the Bone Springs formation shall be subject to the Farmor's right to back-in for a full forty-six and one half percent (46.5%) working interest upon the occurrence of payout (as hereinafter defined.).

10. If the Subject Leases cover less than the full oil and gas leasehold estate in and to the Subject

Lands or if Farmers' interest in such lease(s) and lands is less than the full oil and gas leasehold estate (excluding and disregarding any royalty, overriding royalty, production payment or other burden to which such leasehold estate is subject), then with respect to any well in which Farmers may have a right to back-in for a working interest, that working interest shall be in the proportion that the oil and gas leasehold estate in such lease(s) covering the lands described herein bears to the full oil and gas leasehold estate in said lands.

11. Any interest reserved to or to be received by, or any monies to be paid to Farmers herein, shall be shared between the Farmers as follows: fifty percent (50%) to Threshold Development Company; thirty seven and one half percent (37.5%) to Broad Street Financial Company, eleven and seven eighths percent (11.875%) to Leland A. Hodges; and five eighths of one percent (0.625%) to Herbert F. Boles.

12. Operations on the Subject Lands shall be governed by and the parties hereto shall execute the Operating Agreement which is attached hereto as Exhibit "C", including those exhibits to that Agreement as are included therewith.

13. The term "Payout" as used herein shall mean that point in time when the value of proceeds from the sale of OXY's gross working interest share in the production obtained by and through the wellbore of the initial test well, second test well or any other well to which the occurrence of "payout" may be relevant, after the payment of OXY's share of production and severance or similar taxes, royalties and overriding royalties, if any, (but specifically excluding any overriding royalties or other burdens created after the date of this Agreement) equals the lesser of (i) Nine Hundred Thousand Dollars (\$900,000.00) [hereinafter the "Maximum Amount"] or (ii) the actual, reasonable and necessary expenses paid by OXY (and which are permitted by the Accounting Procedures attached to the Operating Agreement) in connection with the drilling, testing, completing, equipping, and operating of the initial test well, second test well, or any other well to which the occurrence of payout may be relevant. Separate payout accounts shall be established and maintained for the first test well, the second test well and any other well to which the occurrence of payout is relevant.

Within thirty (30) days after completion of the initial test well, the second test well, and any other well to which the occurrence of payout may be relevant, OXY shall furnish Farmers with a detailed statement of the cost incurred in the drilling, completing and equipping of each such well. Thereafter, until the occurrence of payout, OXY shall provide Farmers with monthly statements indicating the status of payout for each such well.

Separately, upon the occurrence of payout of the initial test well, the second test well, or any other well to which the occurrence of payout may be relevant, an undivided forty-six and one half percent (46.5%) interest in the Subject Leases as to the Earned Unit and Earned Depth for the well on which payout has occurred shall automatically revert to Farmers, together with a like interest in all of the materials, pipelines, plants and all equipment used in connection with producing such well or pertaining thereto, and the production therefrom, free of any liens, claims, encumbrances or other burdens placed thereon by OXY. Such reversion shall be effective as of 7:00 a.m. on the day following the date payout occurs. OXY shall execute, acknowledge and deliver to Farmers such assignments, division orders, transfer orders, documents of conveyance or other documents necessary to evidence the occurrence of payout and the reversion of the interests in the Subject Leases resulting

therefrom; provided that the Assignment by OXY to Farmers shall be in substantially the form of the Assignment attached hereto as Exhibit "B". Should any well drilled pursuant to this Agreement in which Farmers retain and are entitled to a reversionary interest be lost for any reason prior to the occurrence of payout for that well, OXY may drill a replacement well therefor. The then outstanding balance of the payout account for such lost well shall be added to the costs of drilling, testing, completing, equipping and operating said replacement well for the purpose of determining the occurrence of payout for such well.

14. Upon the cessation of production from the Subject Depths from an Earned Unit all of OXY's rights, titles and interests in and to the Subject Leases, insofar as they cover such Earned Unit shall terminate and OXY shall reassign its interest in the Subject Leases to Farmers free and clear of any liens, encumbrances or burdens which arise after the date of this Agreement; provided, however, OXY's rights shall nevertheless remain in full force and effect if OXY commences further operations for reworking an existing well or for drilling an additional well or for otherwise obtaining or restoring production on the subject Earned Unit or within 90 days after completion of operations on such dry hole or within 90 days after such cessation of all production and OXY's rights hereunder shall continue and no reassignment shall be due to Farmers so long as any one or more of such operations are prosecuted with no cessation of more than 90 consecutive days and, if any such operations result in the production of oil or gas or other substances covered hereby, so long thereafter as there is production in paying quantities from the Earned Unit.

No termination of OXY's rights in and to the Subject Leases as to such Earned Unit pursuant to this provision shall relieve OXY of its obligation to properly plug and abandon all such wells from which production has ceased in accordance with NMOCD regulations.

15. OXY shall indemnify and save and hold Farmers, and each of them (and their respective agents, officers, directors and shareholders), harmless, from and against any and all claims, demands, liabilities, debts, actions or causes of action (including attorney's fees and related expenses incurred in connection with the defense or investigation of any of such claims, demands, liabilities, debts, actions or causes of action) relating to or arising in connection with operations by OXY on the Subject Lands.

16. OXY agrees to give Farmers and their designated representatives access at all times to the well site, including the derrick floor, for the purpose of observation. In addition to the common mudlogging and open hole logging programs typically run by a prudent operator in an exploratory well in this area, OXY agrees that in regard to the interval to be covered by surface casing (hereinafter the "Surface Hole") and in order to assist Farmers in evaluating same, OXY shall, at its sole expense, conduct prudent drilling operations with ample drilling fluids so that representative formation samples and open hole logs are obtained, and OXY shall, maintain an on-site mudlogger to circulate and collect samples and report to Farmers all mudlog shows across all prospective pay zones including depths and horizons not within the Subject Depths and specifically including, but not limited to, the Yates, Seven Rivers, Queen, Grayburg and San Andres formations and to run a normal suite of Schlumberger open hole logs across these zones of interest. The minimum requirements for the open hole logs shall be a Dual Induction, Compensated Neutron-Formation Density, GammaRay and Caliper. Any information requested by Farmers concerning any relevant operations to all wells while the same are being drilled, completed or operated shall be promptly

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furnished by OXY. OXY shall provide Farmors copies of all daily drilling and completion reports, open-hole and cased-hole logs, test results, plugging records, all NMOCD filings and other similar data and information.

17. Any interest which OXY may earn pursuant to this Agreement shall be subject to all of the terms and provisions of the Subject Leases and any assignments thereof, and to any farmout agreements, or other agreements or contract rights to which the Subject Leases or the interests of Farmors' therein may be subject and with regard to which such agreements are either contained in the County Records for the Eddy County, New Mexico, or with regard to which Farmors' have give actual notice in writing to OXY.

18. The parties hereto have entered into an Operating Agreement of the same date covering and effecting the Contract Area. The terms, conditions and provisions contained within this Letter Agreement are subject to the terms, conditions and provisions contained within the Operating Agreement. Reference to the Operating Agreement is hereby made for all purposes and the terms, conditions and provisions of the Operating Agreement are incorporated herein for all purposes. In the event of a conflict between the terms and provisions contained within this Letter Agreement, and the terms and provisions contained within the Operating Agreement, the terms and provisions of this Letter Agreement shall control.

19. It is the intention of the parties that the laws of the State of New Mexico shall govern the validity of this Agreement and the construction of its terms and the interpretation of the rights and duties of the parties.

20. This Agreement may not be altered or amended except by an instrument in writing executed by all parties to this Agreement.

21. This Agreement shall be binding upon, and shall inure to the benefit of, the parties hereto and their respective heirs, successors and assigns. OXY shall not assign its rights herein prior to the drilling and completion of the second test well without the prior written consent of all other parties; however, such consent will not be unreasonably withheld and no assignment by Farmors or any of them shall be effective to bind OXY until thirty (30) days after OXY shall have received written notice with respect thereto from Farmor(s).

In the event any party fails to assign or reassign to any other party as required by the terms of this Agreement, the party entitled to receive such assignment or reassignment shall be entitled to the remedy of specific performance, in addition to and not in lieu of any other remedy, at law or at equity.

22. The parties do not intend to create, nor shall this Agreement be construed as creating, any mining or other partnership or association, nor does this Agreement render the parties hereto liable as partners. The liability of the parties hereto shall be several and not joint or collective.

23. In the performing, closing and consummation of this Agreement, time is of the essence.

24. This Agreement together with the Exhibits annexed hereto contain the entire agreement of

Threshold Development Company  
Sections 8 & 9, T19S-R29E,  
Eddy County, New Mexico

March 27, 1997  
Page 7

the parties hereto with respect to the subject matter hereof and supersede all negotiations, prior discussions, prior agreements and understandings relating to such subject matter.

If the above and foregoing correctly sets forth your understanding of our agreement regarding the subject matter hereof, please execute two (2) copies of this Agreement in the space provided below and return the same to the attention of Mr. T. Kent Woolley. This Agreement may be executed in any number of counterparts, no one of which need bear the signatures of all of the parties, but any one of which will constitute an original hereof for all purposes. Timely execution and return of this letter by all the Farmers is a condition precedent to any obligation on the part of OXY under this Agreement. Should any of the Farmers fail to execute and return a copy of this letter to OXY within thirty (30) days of the receipt hereof this proposal shall terminate and this Agreement shall be deemed to have been rejected and to be null and void for all purposes.

Upon receipt of fully executed copies of this Agreement OXY will complete its examination of Farmers' title in and to the Subject Leases and advise as to any objections it may have as well as commence preparations to undertake performance, assuming OXY can clear and approve title.

Very truly yours,

OXY USA Inc.

T. Kent Woolley  
Senior Landman

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

THRESHOLD DEVELOPMENT COMPANY

By: \_\_\_\_\_  
Its: \_\_\_\_\_

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

BROAD STREET FINANCIAL COMPANY

By: \_\_\_\_\_  
Its: \_\_\_\_\_

Threshold Development Company  
Sections 8 & 9, T19S-R29E,  
Eddy County, New Mexico

March 27, 1997  
Page 8

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Leland A. Hodges

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Margery Ann Hodges

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Herbert F. Boles

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Norma J. Boles



Threshold Development Company  
Sections 8 & 9, T19S-R29E,  
Eddy County, New Mexico

March 27, 1997  
Page 7

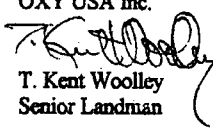
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Upon receipt of fully executed copies of this Agreement OXY will complete its examination of Farmers' title in and to the Subject Leases and advise as to any objections it may have as well as commence preparations to undertake performance, assuming OXY can clear and approve title.

Very truly yours,

OXY USA Inc.

  
T. Kent Woolley  
Senior Landman

AGREED to and ACCEPTED this  
3rd day of April, 1997.

THRESHOLD DEVELOPMENT COMPANY

By:   
Its: President

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

BROAD STREET FINANCIAL COMPANY

By: \_\_\_\_\_  
Its: \_\_\_\_\_

Threshold Development Company  
Sections 8 & 9, T19S-R29E,  
Eddy County, New Mexico

March 27, 1997  
Page 7


the parties hereto with respect to the subject matter hereof and supersede all negotiations, prior discussions, prior agreements and understandings relating to such subject matter.

If the above and foregoing correctly sets forth your understanding of our agreement regarding the subject matter hereof, please execute two (2) copies of this Agreement in the space provided below and return the same to the attention of Mr. T. Kent Woolley. This Agreement may be executed in any number of counterparts, no one of which need bear the signatures of all of the parties, but any one of which will constitute an original hereof for all purposes. Timely execution and return of this letter by all the Farmers is a condition precedent to any obligation on the part of OXY under this Agreement. Should any of the Farmers fail to execute and return a copy of this letter to OXY within thirty (30) days of the receipt hereof this proposal shall terminate and this Agreement shall be deemed to have been rejected and to be null and void for all purposes.

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Very truly yours,

OXY USA Inc.

  
T. Kent Woolley  
Senior Landman

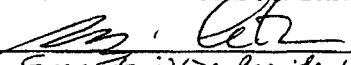
AGREED to and ACCEPTED this  
\_\_\_\_\_ day of \_\_\_\_\_, 1997.

THRESHOLD DEVELOPMENT COMPANY

By: \_\_\_\_\_  
Its: \_\_\_\_\_

AGREED to and ACCEPTED this  
9 day of April, 1997.

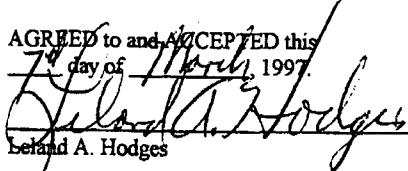
BROAD STREET FINANCIAL COMPANY

By:   
Its: Executive Vice President

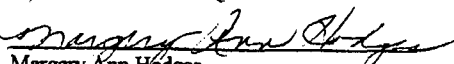
Threshold Development Company  
Sections 8 & 9, T19S-R29E,  
Eddy County, New Mexico

March 27, 1997  
Page 8

AGREED to and ACCEPTED this  
28 day of March, 1997.

  
Leland A. Hodges

AGREED to and ACCEPTED this  
7 day of March, 1997.

  
Margery Ann Hodges

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Herbert F. Boles

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Norma J. Boles

Threshold Development Company  
Sections 8 & 9, T19S-R29E,  
Eddy County, New Mexico

March 27, 1997  
Page 8

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Leland A. Hodges

AGREED to and ACCEPTED this  
\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Margery Ann Hodges

AGREED to and ACCEPTED this  
3rd day of April, 1997.

Herbert F. Boles  
\_\_\_\_\_  
Herbert F. Boles

AGREED to and ACCEPTED this  
3rd day of April, 1997.

Norma J. Boles  
\_\_\_\_\_  
Norma J. Boles

EXHIBIT "C"

A.A.P.L. FORM 610-1982

**MODEL FORM OPERATING AGREEMENT**

**OPERATING AGREEMENT**

**DATED**

March 1, 19 97

**OPERATOR** OXY USA Inc.

**CONTRACT AREA** Sections 8 and 9, Township 19 South

Range 29 East, N.M.P.M., covering all rights below

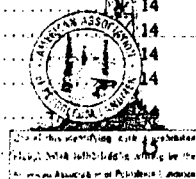
3000' subsurface

**COUNTY OR ~~TERRITORY~~ OF** Eddy **STATE OF** New Mexico

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AMERICAN ASSOCIATION OF PETROLEUM  
LANDMEN, 2408 CONTINENTAL LIFE BUILDING,  
FORT WORTH, TEXAS, 76102, APPROVED FORM.  
A.A.P.L. NO. 610 - 1982 REVISED

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between OXY USA Inc., hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators".

WITNESSETH:

WHEREAS, the parties to this agreement are owners of oil and gas leases and/or oil and gas interests in the land identified in Exhibit "A", and the parties hereto have reached an agreement to explore and develop these leases and/or oil and gas interests for the production of oil and gas to the extent and as hereinafter provided.

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.  
DEFINITIONS

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

A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.

B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

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

D. The term "Contract Area" shall mean 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".

E. 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 Contract Area or as fixed by express agreement of the Drilling Parties.

F. The term "drill site" shall mean the oil and gas lease or interest on which a proposed well is to be located.

G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.

H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

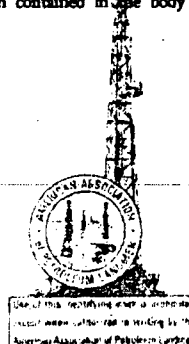
Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II.  
EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

- ☒ A. Exhibit "A", shall include the following information:
  - (1) Identification of lands subject to this agreement,
  - (2) Restrictions, if any, as to depths, formations, or substances,
  - (3) Percentages or fractional interests of parties to this agreement,
  - (4) Oil and gas leases and/or oil and gas interests subject to this agreement,
  - (5) Addresses of parties for notice purposes.
- ☐ B. Exhibit "B", Form of Lease.
- ☒ C. Exhibit "C", Accounting Procedure.
- ☒ D. Exhibit "D", Insurance.
- ☒ E. Exhibit "E", Gas Balancing Agreement.
- ☒ F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.
- ☐ G. Exhibit "G", Tax Partnership.

If any provision of any exhibit, except Exhibits "E" and "G", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.



### ARTICLE III. INTERESTS OF PARTIES

#### A. Oil and Gas Interests:

If any party owns an oil and gas interest in the Contract Area, that interest shall be treated for all purposes of this agreement and during the term hereof as if it were covered by the form of oil and gas lease attached hereto as Exhibit "B", and the owner thereof shall be deemed to own both the royalty interest reserved in such lease and the interest of the lessee thereunder.

#### B. Interests of Parties in Costs and Production:

Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties as their interests are set forth in Exhibit "A". In the same manner, the parties shall also own all production of oil and gas from the Contract Area subject to the payment of royalties to the extent of one-eighth (1/8) which shall be borne as hereinafter set forth.

Regardless of which party has contributed the lease(s) and/or oil and gas interest(s) hereto on which royalty is due and payable, each party entitled to receive a share of production of oil and gas from the Contract Area shall bear and shall pay or deliver, or cause to be paid or delivered, to the extent of its interest in such production, the royalty amount stipulated hereinabove and shall hold the other parties free from any liability therefor. No party shall ever be responsible, however, on a price basis higher than the price received by such party, to any other party's lessor or royalty owner, and if any such other party's lessor or royalty owner should demand and receive settlement on a higher price basis, the party contributing the affected lease shall bear the additional royalty burden attributable to such higher price.

Nothing contained in this Article III.B. shall be deemed an assignment or cross-assignment of interests covered hereby.

#### C. Excess Royalties, Overriding Royalties and Other Payments:

Unless changed by other provisions, if the interest of any party in any lease covered hereby is subject to any royalty, overriding royalty, production payment or other burden on production in excess of the amount stipulated in Article III.B., such party so burdened shall assume and alone bear all such excess obligations and shall indemnify and hold the other parties hereto harmless from any and all claims and demands for payment asserted by owners of such excess burden.

#### D. Subsequently Created Interests:

If any party should hereafter create an overriding royalty, production payment or other burden payable out of production attributable to its working interest hereunder, or if such a burden existed prior to this agreement and is not set forth in Exhibit "A", or was not disclosed in writing to all other parties prior to the execution of this agreement by all parties, or is not a jointly acknowledged and accepted obligation of all parties (any such interest being hereinafter referred to as "subsequently created interest" irrespective of the timing of its creation and the party out of whose working interest the subsequently created interest is derived being hereinafter referred to as "burdened party"), and:

1. If the burdened party is required under this agreement to assign or relinquish to any other party, or parties, all or a portion of its working interest and/or the production attributable thereto, said other party, or parties, shall receive said assignment and/or production free and clear of said subsequently created interest and the burdened party shall indemnify and save said other party, or parties, harmless from any and all claims and demands for payment asserted by owners of the subsequently created interest; and,
2. If the burdened party fails to pay, when due, its share of expenses chargeable hereunder, all provisions of Article VII.B. shall be enforceable against the subsequently created interest in the same manner as they are enforceable against the working interest of the burdened party.

### ARTICLE IV. TITLES

#### A. Title Examination:

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and/or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and/or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including federal lease status reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of the title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

- ☐ Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be a part of the administrative overhead as provided in Exhibit "C" and shall not be a direct charge, whether performed by Operator's staff attorneys or by outside attorneys.



# ARTICLE IV continued

☒ Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Exhibit "A". Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection with leases or oil and gas interests contributed by such party. Operator shall be responsible for the preparation and recording of pooling designations or declarations as well as the conduct of hearings before governmental agencies for the securing of spacing or pooling orders. This shall not prevent any party from appearing on its own behalf at any such hearing.

No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to participate in the drilling of the well.

## B. Loss of Title:

~~1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A", the party contributing the affected lease or interest shall have ninety (90) days from final determination of title failure to acquire a new lease or other instrument curing the entirety of the title failure, which acquisition will not be subject to Article VIII.B., and failing to do so, this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests; and,~~

(a) The party whose oil and gas 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 or incurred, but there shall be no additional liability on its part to the other parties hereto by reason of such title failure;

(b) 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 Contract Area by the amount of the interest lost;

(c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract 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 interest (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well;

(d) 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, such amount shall be paid to the party or parties who bore the costs which are so refunded;

(e) 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 party or parties whose title failed in the same proportions in which they shared in such prior production; and,

(f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in connection therewith.

2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, is not paid or is erroneously paid, and as a result a lease or interest therein terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new lease covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties shall be revised on an acreage basis, effective as of the date of termination of the lease involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the lease or interest which has terminated. In the event the party who failed to make the required payment shall not have been fully reimbursed, at the time of the loss, from the proceeds of the sale of oil and gas attributable to the lost interest, calculated on an acreage basis, for the development and operating costs theretofore paid on account of such interest, it shall be reimbursed for unrecovered actual costs theretofore paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost interest, on an acreage basis, up to the amount of unrecovered costs;

(b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an acreage basis, of that portion of oil and gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such lease termination, would be attributable to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said portion of the oil and gas to be contributed by the other parties in proportion to their respective interests; and,

(c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall be joint losses and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of the Contract Area.



Use of this Agreement shall be permitted  
without charge to members of the  
American Association of Petroleum Engineers, under the  
terms of the license agreement.

ARTICLE V.  
OPERATOR

A. Designation and Responsibilities of Operator:

OXY USA Inc. shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract 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 willful misconduct.

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

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

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. The successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A"; provided, however, if an Operator which has been removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

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

D. Drilling Contracts:

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area 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 are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

ARTICLE VI.  
DRILLING AND DEVELOPMENT

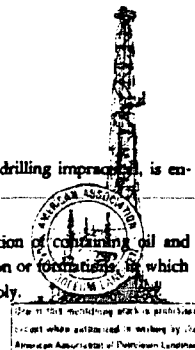
A. Initial Well:

On or before the 1st day of July, 1997, Operator shall commence the drilling of a well for oil and gas at the following location:  
at Operator's choice in either Section 8 or 9, Township 19 South,  
Range 29 East, Eddy County, New Mexico

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

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



## ARTICLE VI

continued

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, the provisions of Article VI.E.1. shall thereafter apply.

## B. Subsequent Operations:

1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided for in Article VI.A., or to rework, deepen or plug back 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, the party desiring to drill, rework, deepen or plug back such a well shall 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 after receipt of the notice within which to notify the party wishing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of a proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday and legal holidays. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or response given by telephone shall be promptly confirmed in writing.

If all parties elect to participate in such a proposed operation, Operator shall, within ninety (90) days after expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period when a drilling rig is on location, as the case may be), actually commence the proposed operation and complete it with due diligence at the risk and expense of all parties hereto; provided, however, said commencement date may be extended upon written notice of same by Operator to the other parties, for a period of up to thirty (30) additional days if, in the sole opinion of Operator, such additional time is reasonably necessary to obtain permits from governmental authorities, surface rights (including rights-of-way) or appropriate drilling equipment, or to complete title examination or curative matter required for title approval or acceptance. Notwithstanding the force majeure provisions of Article XI, if the actual operation has not been commenced within the time provided (including any extension thereof as specifically permitted herein) and if any party hereto still desires to conduct said operation, written notice proposing same must be resubmitted to the other parties in accordance with the provisions hereof as if no prior proposal had been made.

2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VII.D.1. (Option No. 2) elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this Article, the party or parties giving the notice and such other parties as shall elect to participate in the operation shall, within ninety (90) days after the expiration of the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period when a drilling rig is on location, as the case may be) actually commence the proposed operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of the total interest of the parties approving such operation and its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A" or (b) carry its proportionate part of Non-Consenting Parties' interests, and failure to advise the proposing party shall be deemed an election under (a). In the event a drilling rig is on location, the time permitted for such a response shall not exceed a total of forty-eight (48) hours (inclusive of Saturday, Sunday and legal holidays). The proposing party, at its election, may withdraw such proposal if there is insufficient participation and shall promptly notify all parties of such decision.

The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. 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 and restore the surface location at their sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article resulting 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.



Use of this operating lease is governed by the rules and regulations of the American Association of Petroleum Landmen.

## ARTICLE VI

continued

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 Article, 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 and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or market value thereof if such share is not sold, (after deducting production taxes, excise taxes, royalty, overriding royalty and other interests not excepted by Article III.D. 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 Article, 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 such Non-Consenting Party had it participated in the well from the beginning of the operations; and

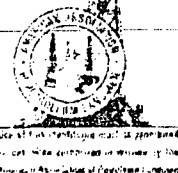
(b) 300 % of that portion of the costs and expenses of drilling, reworking, deepening, plugging back, testing and completing, after deducting any cash contributions received under Article VIII.C., and 300 % of that portion of the cost of newly acquired equipment in the well (to and including the wellhead connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

An election not to participate in the drilling or the deepening of a well shall be deemed an election not to participate in any reworking or plugging back operation proposed in such a well, or portion thereof, to which the initial Non-Consent election applied that is conducted at any time prior to full recovery by the Consenting Parties of the Non-Consenting Party's recoupment account. Any such reworking or plugging back operation conducted during the recoupment period shall be deemed part of the cost of operation of said well and there shall be added to the sums to be recouped by the Consenting Parties one hundred percent (100%) of that portion of the costs of the reworking or plugging back operation which would have been chargeable to such Non-Consenting Party had it participated therein. If such a reworking or plugging back operation is proposed during such recoupment period, the provisions of this Article VI.B. shall be applicable as between said Consenting Parties in said well.

During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, excise, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production not excepted by Article III.D.

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, less cost of salvage.

Within sixty (60) days after the completion of any operation under this Article, 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 party conducting the operations for 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. In determining the quantity of oil and gas produced during any month, Consenting Parties shall use industry accepted methods such as, but not limited to, metering or periodic well tests. 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 participated therein shall be credited against the total unreimbursed 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; and if there is a credit balance, it shall be paid to such Non-Consenting Party.



## ARTICLE VI

continued

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 material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have been entitled to 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 attached hereto.

Notwithstanding the provisions of this Article VI.B.2., 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 Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such source of supply.

The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A. except (a) as to Article VII.D.1. (Option No. 2), if selected, or (b) as to the reworking, deepening and plugging back of such initial well after it has been drilled to the depth specified in Article VI.A. if it shall thereafter prove to be a dry hole or, if initially completed for production, ceases to produce in paying quantities.

3. Stand-By Time: When a well which has been drilled or deepened has reached its authorized depth and all tests have been completed, and the results thereof furnished to the parties, stand-by costs incurred pending response to a party's notice proposing a reworking, deepening, plugging back or completing operation in such a well shall be charged and borne as part of the drilling or deepening operation just completed. Stand-by costs subsequent to all parties responding, or expiration of the response time permitted, whichever first occurs, and prior to agreement as to the participating interests of all Consenting Parties pursuant to the terms of the second grammatical paragraph of Article VI.B.2, shall be charged to and borne as part of the proposed operation, but if the proposal is subsequently withdrawn because of insufficient participation, such stand-by costs shall be allocated between the Consenting Parties in the proportion each Consenting Party's interest as shown on Exhibit "A" bears to the total interest as shown on Exhibit "A" of all Consenting Parties.

4. Sidetracking: Except as hereinafter provided, those provisions of this agreement applicable to a "deepening" operation shall also be applicable to any proposal to directionally control and intentionally deviate a well from vertical so as to change the bottom hole location (herein called "sidetracking"), unless done to straighten the hole or to drill around junk in the hole or because of other mechanical difficulties. Any party having the right to participate in a proposed sidetracking operation that does not own an interest in the affected well bore at the time of the notice shall, upon electing to participate, tender to the well bore owners its proportionate share (equal to its interest in the sidetracking operation) of the value of that portion of the existing well bore to be utilized as follows:

(a) If the proposal is for sidetracking an existing dry hole, reimbursement shall be on the basis of the actual costs incurred in the initial drilling of the well down to the depth at which the sidetracking operation is initiated.

(b) If the proposal is for sidetracking a well which has previously produced, reimbursement shall be on the basis of the well's salvageable materials and equipment down to the depth at which the sidetracking operation is initiated, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning.

In the event that notice for a sidetracking operation is given while the drilling rig to be utilized is on location, the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday and legal holidays; provided, however, any party may request and receive up to eight (8) additional days after expiration of the forty-eight (48) hours within which to respond by paying for all stand-by time incurred during such extended response period. If more than one party elects to take such additional time to respond to the notice, stand-by costs shall be allocated between the parties taking additional time to respond on a day-to-day basis in the proportion each electing party's interest as shown on Exhibit "A" bears to the total interest as shown on Exhibit "A" of all the electing parties. In all other instances the response period to a proposal for sidetracking shall be limited to thirty (30) days.

C. TAKING PRODUCTION IN KIND:

Each party shall take in kind or separately dispose of its proportionate share of all oil and gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating oil and gas for marketing purposes and production unavoidably lost. 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. Any party taking its share of production in kind shall be

**ARTICLE VI**  
continued

required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment directly from the purchaser 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 produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. 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 not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year.

In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and/or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any gas balancing agreement between the parties hereto, whether such an agreement is attached as Exhibit "E", or is a separate agreement.

**D. Access to Contract Area and Information:**

Each party shall have access to the Contract Area at all reasonable times, at its sole cost and 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, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily 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 Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the information.

**E. Abandonment of Wells:**

1. Abandonment of Dry Holes: Except for any well drilled or deepened pursuant to Article VI.B.2., any well which has been drilled or deepened under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling or deepening such well. Any party who objects to plugging and abandoning such well shall have the right to take over the well and conduct further operations in search of oil and/or gas subject to the provisions of Article VI.B.

2. Abandonment of Wells that have Produced: Except for any well in which a Non-Consent operation has been conducted hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of any well, all parties do not agree to the abandonment of such well, those wishing to continue its operation from the interval(s) of the formation(s) then open to production shall tender to each of the other parties its proportionate share of the value of the well's salvageable 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 assign the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and material, all of its interest in the well and related 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. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one (1) year and so long thereafter as oil and/or gas is produced from the interval or intervals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit

# ARTICLE VI

## continued

"B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interests in the remaining portion of the Contract Area.

Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon request, 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. Upon proposed abandonment of the producing interval(s) assigned or leased, the assignor or lessor shall then have the option to repurchase its prior interest in the well (using the same valuation formula) and participate in further operations therein subject to the provisions hereof.

3. Abandonment of Non-Consent Operations: The provisions of Article VI.E.1. or VI.E.2. above shall be applicable as between Consenting Parties in the event of the proposed abandonment of any well excepted from said Articles; provided, however, no well shall be permanently plugged and abandoned unless and until all parties having the right to conduct further operations therein have been notified of the proposed abandonment and afforded the opportunity to elect to take over the well in accordance with the provisions of this Article VI.E.

# ARTICLE VII.

## EXPENDITURES AND LIABILITY OF PARTIES

### A. 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 Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are 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 the parties liable as partners.

### B. Liens and Payment Defaults:

Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share of oil and/or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon at the rate provided in Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the state, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's share of oil and/or gas until the amount owed by such Non-Operator, plus interest, has been paid. Each purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a life lien and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.

If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.

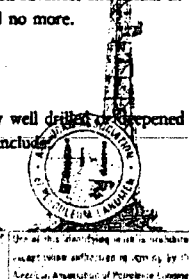
### C. Payments and Accounting:

Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in Exhibit "C". Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

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 expense 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 expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense 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 as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

### D. Limitation of Expenditures:

1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling or deepening shall include



## ARTICLE VII

continued

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

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

2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the reworking or plugging back of a well shall include all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage and/or surface facilities.

3. Other Operations: Without the consent of all parties, Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Fifty Thousand Dollars (\$ 50,000.00 ) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, 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 to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares an authority for expenditure (AFE) for its own use, Operator shall furnish any Non-Operator so requesting an information copy thereof for any single project costing in excess of Twenty-five Thousand Dollars (\$ 25,000.00 ) but less than the amount first set forth above in this paragraph.

#### E. Rentals, Shut-in Well Payments and Minimum Royalties:

Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and in behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.3.

Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sunday and legal holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

#### F. Taxes:

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. If the ad valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then notwithstanding anything to the contrary herein, charges to the joint account shall be made and paid by the parties hereto in accordance with the tax value generated by each party's working interest. Operator shall bill the other parties for their proportionate shares of all tax payments in the manner provided in Exhibit "C".

If Operator considers any tax assessment improper, Operator may, at its discretion, protest 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. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint account, together with any 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".

Each party shall pay or cause to be paid all production, severance, excise, gathering and other taxes imposed upon or with respect to the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.



**ARTICLE VII**  
continued

**G. 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; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be as provided in Exhibit "C". Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract 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 automotive equipment.

**ARTICLE VIII.**  
**ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST**

**A. Surrender of Leases:**

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

However, should any party desire to surrender its interest in any lease or in any portion thereof, and the other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not consenting to such surrender. If the interest of the assigning party is or includes an oil and gas interest, the assigning party shall execute and deliver to the party or parties not consenting to such surrender an oil and gas lease covering such oil and gas interest for a term of one (1) year and so long thereafter as oil and/or gas is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B". Upon such assignment or lease, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the interest assigned or leased and the operation of any well attributable thereto, and the assigning party shall have no further interest in the assigned or leased premises and its equipment and production other than the royalties retained in any lease made under the terms of this Article. The party assignee or lessee shall pay to the party assignor or lessor the reasonable salvage value of the latter's interest in any wells and equipment attributable to the assigned or leased acreage. The value of all material shall be 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 or lease is in favor of more than one party, the interest shall be shared by such parties in the proportions that the interest of each bears to the total interest of all such parties.

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

**B. Renewal or Extension of Leases:**

If any party secures a renewal of any oil and gas lease subject to this agreement, all other parties shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract 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 Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all 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 Article 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 agreement.

The provisions in this Article shall also be applicable to extensions of oil and gas leases.

**C. Acreage or Cash Contributions:**

While this agreement is in force, if any party contracts for a contribution of cash towards the drilling of a well or any other operation on the Contract 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 tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions

## ARTICLE VIII

continued

1 said Drilling Parties shared the cost of drilling the well. Such acreage shall become a separate Contract Area and, to the extent possible, be  
2 governed by provisions identical to this agreement. Each party shall promptly notify all other parties of any acreage or cash contributions  
3 it may obtain in support of any well or any other operation on the Contract Area. The above provisions shall also be applicable to op-  
4 tional rights to earn acreage outside the Contract Area which are in support of a well drilled inside the Contract Area.

6 If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such  
7 consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

## D. Maintenance of Uniform Interest:

11 For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, no  
12 party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells,  
13 equipment and production unless such disposition covers either:

- 15 1. the entire interest of the party in all leases and equipment and production; or
- 17 2. an equal undivided interest in all leases and equipment and production in the Contract Area.

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

22 If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may  
23 require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for  
24 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  
25 party's interest within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter  
26 into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract  
27 Area and they shall have the right to receive, separately, payment of the sale proceeds thereof.

## E. Waiver of Rights to Partition:

31 If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an  
32 undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided  
33 interest therein.

## F. Preferential Right to Purchase:

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

ARTICLE IX.  
INTERNAL REVENUE CODE ELECTION

50 This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association  
51 for profit between or among the parties hereto. Notwithstanding any provision herein that the rights and liabilities hereunder are several  
52 and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for federal income tax  
53 purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded  
54 from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as per-  
55 mitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to ex-  
56 ecute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the  
57 United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements,  
58 and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further  
59 evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the  
60 Federal Internal Revenue Service or as may be necessary to evidence this election. No such party shall give any notices or take any other  
61 action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract  
62 Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1,  
63 Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is per-  
64 mitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing elec-  
65 tion, each such party states that the income derived by such party from operations hereunder can be adequately determined without the  
66 computation of partnership taxable income.



ARTICLE X.  
CLAIMS AND LAWSUITS

Operator may settle any single uninsured third party damage claim or suit arising from operations hereunder if the expenditure does not exceed Thirty thousand Dollars (\$ 30,000.00 ) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expenses of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties participating in the operation from which the claim or suit arises. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, such party shall immediately notify all other parties, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

ARTICLE XI.  
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 reasonable diligence to remove the force majeure situation as quickly as practicable.

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 action, governmental delay, restraint or inaction, 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.

ARTICLE XII.  
NOTICES

All notices authorized or required between the parties and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by mail or telegram, postage or charges prepaid, or by telex or telecopier and addressed to the parties to whom the notice is given at the addresses listed on Exhibit "A". The originating notice 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 mail or with the telegraph company, with postage or charges prepaid, or sent by telex or telecopier. 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.

ARTICLE XIII.  
TERM OF AGREEMENT

This agreement shall remain in full force and effect as to the oil and gas leases and/or oil and gas interests subject hereto for the period of time selected below; provided, however, no party hereto shall ever be construed as having any right, title or interest in or to any lease or oil and gas interest contributed by any other party beyond the term of this agreement.

☐ Option No. 1: So long as any of the oil and gas leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise.

☒ Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and/or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of 90 days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling, reworking, deepening, plugging back, testing or attempting to complete a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and/or gas from the Contract Area, this agreement shall terminate unless drilling, deepening, plugging back or reworking operations are commenced within 90 days from the date of abandonment of said well.

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.



ARTICLE XIV.  
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the conservation laws of the state in which the Contract Area is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and orders.

B. Governing Law:

This agreement and all matters pertaining hereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state of New Mexico shall govern.

C. Regulatory Agencies:

Nothing herein contained shall grant, or be construed to grant, Operator the right or authority to waive or release any rights, privileges, or obligations which Non-Operators may have under federal or state laws or under rules, regulations or orders promulgated under such laws in reference to oil, gas and mineral operations, including the location, operation, or production of wells, on tracts offsetting or adjacent to the Contract Area.

With respect to operations hereunder, Non-Operators agree to release Operator from any and all losses, damages, injuries, claims and causes of action arising out of, incident to or resulting directly or indirectly from Operator's interpretation or application of rules, rulings, regulations or orders of the Department of Energy or predecessor or successor agencies to the extent such interpretation or application was made in good faith. Each Non-Operator further agrees to reimburse Operator for any amounts applicable to such Non-Operator's share of production that Operator may be required to refund, rebate or pay as a result of such an incorrect interpretation or application, together with interest and penalties thereon owing by Operator as a result of such incorrect interpretation or application.

Non-Operators authorize Operator to prepare and submit such documents as may be required to be submitted to the purchaser of any crude oil sold hereunder or to any other person or entity pursuant to the requirements of the "Crude Oil Windfall Profit Tax Act of 1980", as same may be amended from time to time ("Act"), and any valid regulations or rules which may be issued by the Treasury Department from time to time pursuant to said Act. Each party hereto agrees to furnish any and all certifications or other information which is required to be furnished by said Act in a timely manner and in sufficient detail to permit compliance with said Act.

ARTICLE XV.  
OTHER PROVISIONS

PRIORITY OF ELECTIONS:

Notwithstanding anything herein to the contrary, it is agreed that where a well shall have been drilled to the objective depth or the objective formation and the Consenting Parties in the well cannot mutually agree upon the sequence and timing of further operations regarding said well, the following elections shall control in order of priority enumerated hereafter:

- a. An election to do additional logging, coring or testing;
- b. An election to attempt to complete the well at either the objective depth or objective formation;
- c. An election to plug back and attempt to complete said well at an alternative depth or formation;
- d. An election to deepen said well;
- e. An election to sidetrack said well.

It is provided, however, that if, at the time the Consenting Parties are considering any of the above elections, the hole is in such a condition that a reasonably prudent Operator would not conduct the operations contemplated by the particular election involved for fear of placing the hole in jeopardy or losing the same prior to completing the well in the objective depth or objective formation, such election shall be eliminated from the priorities hereinabove set forth.



ARTICLE XVI.  
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of 1st day of March, 19 97.

OPERATOR

OXY USA Inc.

\_\_\_\_\_  
Attorney-in-Fact

NON-OPERATORS

Threshold Development Company

By: \_\_\_\_\_

\_\_\_\_\_  
Leland Hodges

Broad Street Financial Company

By: \_\_\_\_\_

\_\_\_\_\_  
Herbert F. Boles

\_\_\_\_\_  
Norma J. Boles



## EXHIBIT "A"

Attached to and made a part of that certain Operating Agreement dated March 1, 1997 by and between OXY USA Inc., as Operator, and Threshold Development Company, as Non-Operator.

I. Identification of lands subject to this agreement:

Sections 8 and 9, T19S-R29E, N.M.P.M., Eddy County, New Mexico.

II. Restrictions, if any, as to depths, formations, or substances:

All rights below 3,000' subsurface

III. Percentages or fractional interests of parties to this Agreement:

Wells completed below the base of the Bone Springs

	<u>BPO</u>	<u>APQ</u>
OXY USA Inc.	100	53.50000
Broad Street Financial Company	0	17.43750
Leland A. Hodges, et vir	0	5.521875
Herbert F. Boles	0	.290625
Threshold Development Company	0	<u>23.250000</u>
	100	100

Wells completed above the base of the Bone Springs

OXY USA Inc.	50.000%
Broad Street Financial Company	18.750%
Leland A. Hodges, et vir	5.938%
Herbert F. Boles	0.312%
Threshold Development Company	<u>25.000%</u>
	100

IV. Addresses of parties for notice purposes:

OXY USA Inc.  
Attention: Primary Oil & Gas Team Landman-NM  
P. O. Box 50250  
Midland, Texas 79710

Broad Street Financial Company  
37 West Broad Street, Suite 1100  
Columbus, Ohio 43215-4132

Leland A. Hodges  
115 West 7th Street, Suite 1310  
Fort Worth, Texas 76102-7013

Herbert F. Boles  
P. O. Box 2021  
Midland, Texas 79702-2021

Threshold Development Company  
Attention: Bud Vinson  
Fort Worth Club Tower  
Penthouse II, Suite D  
777 Taylor Street  
Fort Worth, Texas 76102

V. Lease Schedule:

LEASE DATE: April 10, 1939  
LESSOR: State of New Mexico  
LESSEE: Continental Oil Company  
SERIAL NO. B-8096  
RECORDING DATA: Not Available

DESCRIPTION: All of Section 8, the SW/4NE/4, the NW/4, the SE/4 and the SW/4 of Section 9, T19S-R29E, N.M.P.M. limited to depths below 3000', Eddy County, New Mexico.

LEASE DATE: December 1, 1991  
LESSOR: State of New Mexico  
LESSEE: Mitchell Energy Corporation  
SERIAL NO. VA-0465  
RECORDING DATA: Not Available

DESCRIPTION: The NE/4NE/4 of Section 9, T19S-R29E, N.M.P.M. limited to depths below 3000', Eddy County, New Mexico.

LEASE DATE: December 1, 1995  
LESSOR: State of New Mexico  
LESSEE: Ameristate Oil and Gas, Inc.  
SERIAL NO. VB-0455  
RECORDING DATA: Not Available

DESCRIPTION: The NW/4NE/4 and the SE/4NE/4 of Section 9, T19S-R29E, N.M.P.M. limited to depths below 3000', Eddy County, New Mexico.

EXHIBIT

" C "

Attached to and made a part of that certain Operating Agreement dated March 1, 1997  
with OXY USA Inc. as Operator and Threshold Development Company as  
Non-Operator.

## ACCOUNTING PROCEDURE JOINT OPERATIONS

### I. GENERAL PROVISIONS

#### 1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

#### 2. Statement and Billings

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

#### 3. Advances and Payments by Non-Operators

A. Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation within fifteen (15) days after receipt of the billing or by the first day of the month for which the advance is required, whichever is later. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

B. Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the prime rate in effect at Bank of America in San Francisco on the first day of the month in which delinquency occurs plus 1% or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts.

#### 4. Adjustments

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



## 5. Audits

A. A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct a joint audit in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator. The audits shall not be conducted more than once each year without prior approval of Operator, except upon the resignation or removal of the Operator, and shall be made at the expense of those Non-Operators approving such audit.

B. The Operator shall reply in writing to an audit report within 180 days after receipt of such report.

## 6. Approval By Non-Operators

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

## II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

### 1. Ecological and Environmental

Costs incurred for the benefit of the Joint Property as a result of governmental or regulatory requirements to satisfy environmental considerations applicable to the Joint Operations. Such costs may include surveys of an ecological or archaeological nature and pollution control procedures as required by applicable laws and regulations.

### 2. Rentals and Royalties

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

### 3. Labor

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

~~(2) Salaries of First Level Supervisors in the field.~~

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

~~(4) Salaries and wages of Technical Employees either temporarily or permanently assigned to and directly employed in the operation of the Joint Property if such charges are excluded from the overhead rates.~~

B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II. Such costs under this Paragraph 3B 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 3A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.

C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II.

D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II.

### 4. Employee Benefits

Operator's current costs of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II shall be Operator's actual cost not to exceed the percent most recently recommended by the Council of Petroleum Accountants Societies.

### 5. Material

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

### 6. 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 where like material is normally available or railway receiving point nearest the Joint Property unless agreed to by the Parties.

- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store where like material is normally available, or railway receiving point nearest the Joint Property unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.
- C. In the application of subparagraphs A and B above, the option to equalize or charge actual trucking cost is available when the actual charge is \$400 or less excluding accessorial charges. The \$400 will be adjusted to the amount most recently recommended by the Council of Petroleum Accountants Societies.

#### 7. Services

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 10 of Section II and Paragraph i, ii, and iii, of Section III. The cost of professional consultant services and contract services of technical personnel directly engaged on the Joint Property if such charges are excluded from the overhead rates. The cost of professional consultant services or contract services of technical personnel not directly engaged on the Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.

#### 8. Equipment and Facilities Furnished By Operator

- A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on gross investment less accumulated depreciation not to exceed eight percent (8%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.
- B. In lieu of charges in paragraph 8A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

#### 9. Damages and Losses to Joint Property

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

#### 10. Legal Expense

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

#### 11. 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. If the ad valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then notwithstanding anything to the contrary herein, charges to the Joint Account shall be made and paid by the Parties hereto in accordance with the tax value generated by each party's working interest.

#### 12. Insurance

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

#### 13. Abandonment and Reclamation

Costs incurred for abandonment of the Joint Property, including costs required by governmental or other regulatory authority.

#### 14. Communications

Cost of acquiring, leasing, installing, operating, repairing and maintaining communication systems, including radio and microwave facilities directly serving the Joint Property. In the event communication facilities/systems serving the Joint Property are Operator owned, charges to the Joint Account shall be made as provided in Paragraph 8 of this Section II.

#### 15. 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 of direct benefit to the Joint Property and is incurred by the Operator in the necessary and proper conduct of the Joint Operations.

## III. OVERHEAD

## 1. Overhead - Drilling and Producing Operations

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

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

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 3A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

- ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property:

( ) shall be covered by the overhead rates, or  
 (X) shall not be covered by the overhead rates.

- iii. The salaries, wages and Personal Expenses of Technical Employees and/or costs of professional consultant services and contract services of technical personnel either temporarily or permanently assigned to and directly employed in the operation of the Joint Property:

( ) shall be covered by the overhead rates, or  
 (X) shall not be covered by the overhead rates.

## A. Overhead - Fixed Rate Basis

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

Drilling Well Rate \$ 5500.00  
 (Prorated for less than a full month)

Producing Well Rate \$ 550.00

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

## (a) Drilling Well Rate

- (1) Charges for drilling wells shall begin on the date the well is spudded and terminate on the date the drilling rig, completion rig, or other units used in completion of the well is released, whichever is later, except that no charge shall be made during suspension of drilling or completion operations for fifteen (15) or more consecutive calendar days.
- (2) Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive work days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig or other units used in workover, commence through date of rig or other unit release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive calendar days.

## (b) Producing Well Rates

- (1) An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.
- (2) Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.
- (3) An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.
- (4) A one-well charge shall be made for the month in which plugging and abandonment operations are completed on any well. This one-well charge shall be made whether or not the well has produced except when drilling well rate applies.
- (5) All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

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

~~B. Overhead - Percentage Basis~~

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

~~(a) Development~~

~~Percent ( ) of the cost of development of the Joint Property exclusive of costs provided under Paragraph 10 of Section II and all salvage credits.~~

~~(b) Operating~~

~~Percent ( ) of the cost of operating the Joint Property exclusive of costs provided under Paragraphs 2 and 10 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.~~

~~(2) Application of Overhead - Percentage Basis shall be as follows:~~

~~For the purpose of determining charges on a percentage basis under Paragraph 1B of this Section III, development shall include all costs in connection with drilling, redrilling, deepening, or any remedial operations on any or all wells involving the use of drilling rig and crew capable of drilling to the producing interval on the Joint Property; also, preliminary expenditures necessary in preparation for drilling and expenditures incurred in abandoning when the well is not completed as a producer, and original cost of construction or installation of fixed assets, the expansion of fixed assets and any other project clearly discernible as a fixed asset, except Major Construction as defined in Paragraph 2 of this Section III. All other costs shall be considered as operating.~~

~~2. Overhead - Major Construction~~

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

- ~~A. 5 % of first \$100,000 or total cost if less, plus~~  
~~B. 3 % of costs in excess of \$100,000 but less than \$1,000,000, plus~~  
~~C. 2 % of costs in excess of \$1,000,000.~~

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

~~3. Catastrophe Overhead~~

~~To compensate Operator for overhead costs incurred in the event of expenditures resulting from a single occurrence due to oil spill, blowout, explosion, fire, storm, hurricane, or other catastrophes as agreed to by the Parties, which are necessary to restore the Joint Property to the equivalent condition that existed prior to the event causing the expenditures, Operator shall either negotiate a rate prior to charging the Joint Account or shall charge the Joint Account for overhead based on the following rates:~~

- ~~A. 5 % of total costs through \$100,000; plus~~  
~~B. 3 % of total costs in excess of \$100,000 but less than \$1,000,000; plus~~  
~~C. 2 % of total costs in excess of \$1,000,000.~~

~~Expenditures subject to the overheads above will not be reduced by insurance recoveries, and no other overhead provisions of this Section III shall apply.~~

~~4. Amendment of Rates~~

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

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

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

## 1. Purchases

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

## 2. Transfers and Dispositions

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

A. New Material (Condition A)

(1) Tubular Goods Other than Line Pipe

- (a) Tubular goods, sized 2½ inches OD and larger, except line pipe, shall be priced at Eastern mill published carload base prices effective as of date of movement plus transportation cost using the 80,000 pound carload weight basis to the railway receiving point nearest the Joint Property for which published rail rates for tubular goods exist. If the 80,000 pound rail rate is not offered, the 70,000 pound or 90,000 pound rail rate may be used. Freight charges for tubing will be calculated from Lorain, Ohio and casing from Youngstown, Ohio.
- (b) For grades which are special to one mill only, prices shall be computed at the mill base of that mill plus transportation cost from that mill to the railway receiving point nearest the Joint Property as provided above in Paragraph 2.A.(1)(a). For transportation cost from points other than Eastern mills, the 30,000 pound Oil Field Haulers Association interstate truck rate shall be used.
- (c) Special end finish tubular goods shall be priced at the lowest published out-of-stock price, f.o.b. Houston, Texas, plus transportation cost, using Oil Field Haulers Association interstate 30,000 pound truck rate, to the railway receiving point nearest the Joint Property.
- (d) Macaroni tubing (size less than 2½ inch OD) shall be priced at the lowest published out-of-stock prices f.o.b. the supplier plus transportation costs, using the Oil Field Haulers Association interstate truck rate per weight of tubing transferred, to the railway receiving point nearest the Joint Property.

(2) Line Pipe

- (a) Line pipe movements (except size 24 inch OD and larger with walls ¼ inch and over) 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain, Ohio.
- (b) Line pipe movements (except size 24 inch OD and larger with walls ¼ inch and over) less than 30,000 pounds shall be priced at Eastern mill published carload base prices effective as of date of shipment, plus 20 percent, plus transportation costs based on freight rates as set forth under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain, Ohio.
- (c) Line pipe 24 inch OD and over and ¼ inch wall and larger shall be priced f.o.b. the point of manufacture at current new published prices plus transportation cost to the railway receiving point nearest the Joint Property.
- (d) Line pipe, including fabricated line pipe, drive pipe and conduit not listed on published price lists shall be priced at quoted prices plus freight to the railway receiving point nearest the Joint Property or at prices agreed to by the Parties.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint Property.
- (4) Unused new Material, except tubular goods, moved from the Joint Property shall be priced at the current new price, in effect on date of movement, as listed by a reliable supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint Property. Unused new tubulars will be priced as provided above in Paragraph 2 A (1) and (2).

B. Good Used Material (Condition B)

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

(1) Material moved to the Joint Property

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

(2) Material used on and moved from the Joint Property

- (a) At seventy-five percent (75%) of current new price, as determined by Paragraph A, if Material was originally charged to the Joint Account as new Material or
- (b) At sixty-five percent (65%) of current new price, as determined by Paragraph A, if Material was originally charged to the Joint Account as used Material.

(3) Material not used on and moved from the Joint Property

At seventy-five percent (75%) of current new price as determined by Paragraph A.

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

C. Other Used Material

(1) Condition C

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

(2) Condition D

Material, excluding junk, no longer suitable for its original purpose, but usable for some other purpose shall be priced on a basis commensurate with its use. Operator may dispose of Condition D Material under procedures normally used by Operator without prior approval of Non-Operators.

- (a) Casing, tubing, or drill pipe used as line pipe shall be priced as Grade A and B seamless line pipe of comparable size and weight. Used casing, tubing or drill pipe utilized as line pipe shall be priced at used line pipe prices.
- (b) Casing, tubing or drill pipe used as higher pressure service lines than standard line pipe, e.g. power oil lines, shall be priced under normal pricing procedures for casing, tubing, or drill pipe. Upset tubular goods shall be priced on a non upset basis.

(3) Condition E

Junk shall be priced at prevailing prices. Operator may dispose of Condition E Material under procedures normally utilized by Operator without prior approval of Non-Operators.

D. Obsolete Material

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

E. Pricing Conditions

- (1) Loading or unloading costs may be charged to the Joint Account at the rate of twenty-five cents (25¢) per hundred weight on all tubular goods movements, in lieu of actual loading or unloading costs sustained at the stocking point. The above rate shall be adjusted as of the first day of April each year following January 1, 1985 by the same percentage increase or decrease used to adjust overhead rates in Section III, Paragraph 1.A(3). Each year, the rate calculated shall be rounded to the nearest cent and shall be the rate in effect until the first day of April next year. Such rate shall be published each year by the Council of Petroleum Accountants Societies.
- (2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

3. Premium Prices

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

4. Warranty of Material Furnished By Operator

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

## V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

Adjustments to the Joint Account resulting from the reconciliation of a physical inventory shall be made within six months following the taking of the inventory. Inventory adjustments shall be made by Operator to the Joint Account for overages and shortages, but, Operator shall be held accountable only for shortages due to lack of reasonable diligence.

3. Special Inventories

Special inventories may be taken whenever there is any sale, change of interest, or change of Operator 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. In cases involving a change of Operator, all Parties shall be governed by such inventory.

4. Expense of Conducting Inventories

- A. The expense of conducting periodic inventories shall not be charged to the Joint Account unless agreed to by the Parties.
- B. The expense of conducting special inventories shall be charged to the Parties requesting such inventories, except inventories required due to change of Operator shall be charged to the Joint Account.

Exhibit "D" - Attached to and made a part of that certain Operating Agreement dated March 1, 1997, by and between OXY USA Inc., as "Operators" and Threshold Development Company as "Non-Operator".

Insurance Exhibit

The Operator shall provide for Workmen's Compensation coverage in accordance with the law of the State in which operations are being conducted. The cost thereof shall be borne by the Joint Account accordance with the terms of the Accounting Procedure attached to the Operating Agreement referenced above. No other insurance shall be provided by the Operator for the benefit of the parties hereto.

EXHIBIT "E" - Attached to and made a part of that certain Operating Agreement dated March 1, 1997, by and between OXY USA Inc., as "Operator" and Threshold Development Company as "Non-Operators".

**EXHIBIT "E"**  
**GAS BALANCING AGREEMENT ("AGREEMENT")**  
**ATTACHED TO AND MADE PART OF THAT CERTAIN**  
**OPERATING AGREEMENT DATED \_\_\_\_\_**

**BY AND BETWEEN \_\_\_\_\_, AND \_\_\_\_\_**  
**( "OPERATING AGREEMENT" ) RELATING TO THE \_\_\_\_\_**  
**AREA, \_\_\_\_\_ COUNTY, STATE OF \_\_\_\_\_**

**1. DEFINITIONS**

The following definitions shall apply to this Agreement:

- 1.01 "Arm's Length Agreement" shall mean any gas sales agreement with an unaffiliated purchaser or any gas sales agreement with an affiliated purchaser where the sales price and delivery conditions under such agreement are representative of prices and delivery conditions existing under other similar agreements in the area between unaffiliated parties at the same time for natural gas of comparable quality and quantity.
- 1.02 "Balancing Area" shall mean each well subject to the Operating Agreement that produces Gas or is allocated a share of Gas production. If a single well is completed in two or more producing intervals, each producing interval from which the Gas production is not commingled in the wellbore shall be considered a separate well or Balancing Area.
- 1.03 "Full Share of Current Production" shall mean the Percentage Interest of each Party in the Gas actually produced from the Balancing Area during each month.
- 1.04 "Gas" shall mean all hydrocarbons produced or producible from the Balancing Area, whether from a well classified as an oil well or gas well by the regulatory agency having jurisdiction in such matters, which are or may be made available for sale or separate disposition by the Parties, excluding oil, condensate and other liquids recovered by field equipment operated for the joint account. For the purposes of this Agreement, "Gas" does not include gas used in joint operations, such as for fuel, recycling or reinjection, or which is vented or lost prior to its sale or delivery from the Balancing Area.
- 1.05 "Makeup Gas" shall mean any Gas taken by an Underproduced Party from the Balancing Area in excess of its Full Share of Current Production, whether pursuant to Section 3.3 or Section 4.1 hereof.
- 1.06 "Mcf" shall mean one thousand cubic feet. A cubic foot of Gas shall mean the volume of gas contained in one cubic foot of space at a standard pressure base and at a standard temperature base.
- 1.07 "MMBtu" shall mean one million British Thermal Units. A British Thermal Unit shall mean the quantity of heat required to raise one pound avoirdupois of pure water from 58.5 degrees Fahrenheit to 59.5 degrees Fahrenheit at a constant pressure of 14.73 pounds per square inch absolute.
- 1.08 "Operator" shall mean the individual or entity designated under the terms of the Operating Agreement or, in the event this Agreement is not employed in connection with an operating agreement, the individual or entity designated as the operator of the well(s) located in the Balancing Area.
- 1.09 "Overproduced Party" shall mean any Party having taken a greater quantity of Gas from the Balancing Area than the Percentage Interest of such Party in the cumulative quantity of all Gas produced from the Balancing Area.
- 1.10 "Overproduction" shall mean the cumulative quantity of Gas taken by a Party in excess of its Percentage Interest in the cumulative quantity of all Gas produced from the Balancing Area.
- 1.11 "Party" shall mean those individuals or entities subject to this Agreement, and their respective heirs, successors, transferees and assigns.



- 1.12 "Percentage Interest" shall mean the percentage or decimal interest of each Party in the Gas produced from the Balancing Area pursuant to the Operating Agreement covering the Balancing Area. For the purposes of applying the Oklahoma Production Revenue Standards Act hereto the terms "Percentage Interest", "Proportionate Production Interest, and "Working Interest Share of Production" shall be considered equivalent terms.
- 1.13 "Royalty" shall mean payments on production of Gas from the Balancing Area to all owners of royalties, overriding royalties, production payments or similar interests.
- 1.14 "Underproduced Party" shall mean any Party having taken a lesser quantity of Gas from the Balancing Area than the Percentage Interest of such Party in the cumulative quantity of all Gas produced from the Balancing Area.
- 1.15 "Underproduction" shall mean the deficiency between the cumulative quantity of Gas taken by a Party and its Percentage Interest in the cumulative quantity of all Gas produced from the Balancing Area.
- 1.16 "Winter Period" shall mean the months of November, December, January and February.

## 2. BALANCING AREA

2.1 If this Agreement covers more than one Balancing Area, it shall be applied as if each Balancing Area were covered by separate but identical agreements. All balancing hereunder shall be on the basis of Gas taken from the Balancing Area measured in MMBtus.

2.2 In the event that all or part of the Gas deliverable from a Balancing Area is or becomes subject to one or more maximum lawful prices, any Gas not subject to price controls shall be considered as produced from a single Balancing Area and Gas subject to each maximum lawful price category shall be considered produced from a separate Balancing Area.

## 3. RIGHT OF PARTIES TO TAKE GAS

3.1 Each Party desiring to take Gas will notify the Operator, or cause the Operator to be notified of the volumes nominated, the name of the transporting pipeline and the pipeline contract number (if available) and meter station relating to such delivery, sufficiently in advance for the Operator, acting with reasonable diligence, to meet all nomination and other requirements. Operator is authorized to deliver the volumes so nominated and confirmed (if confirmation is required) to the transporting pipeline in accordance with the terms of this Agreement.

3.2 Each Party shall make a reasonable, good faith effort to take its Full Share of Current Production each month, to the extent that such production is required to maintain leases in effect, to protect the producing capacity of a well or reservoir, to preserve correlative rights, or to maintain oil production.

3.3 When a Party fails for any reason to take its Full Share of Current Production (as such Share may be reduced by the right of the other Parties to make up for Underproduction as provided herein), the other Parties shall be entitled to take any Gas which such Party fails to take. To the extent practicable, such Gas shall be made available initially to each Underproduced Party in the proportion that its Percentage Interest in the Balancing Area bears to the total Percentage Interests of all Underproduced Parties desiring to take such Gas. If all such Gas is not taken by the Underproduced Parties, the portion not taken shall then be made available to the other Parties in the proportion that their respective Percentage Interests in the Balancing Area bear to the total Percentage Interests of such Parties.

3.4 All Gas taken by a Party in accordance with the provisions of this Agreement, regardless of whether such Party is underproduced or overproduced, shall be regarded as Gas taken for its own account with title thereto being in such taking Party.

3.5 Notwithstanding the provisions of Section 3.3 hereof, no Overproduced Party shall be entitled in any month to take any Gas in excess of three hundred percent (300%) of its Percentage Interest of the Balancing Area's then-current Maximum Monthly Availability; provided, however, that this limitation shall not apply to the extent that it would preclude production that is required to maintain leases in effect, to protect the producing capacity of a well or reservoir, to preserve correlative rights, or to maintain oil production. "Maximum Monthly Availability" shall mean the maximum average monthly rate of production at which Gas

can be delivered from the Balancing Area, as determined by the Operator, considering the maximum efficient well rate for each well within the Balancing Area, the maximum allowable(s) set by the appropriate regulatory agency, mode of operation, production facility capabilities and pipeline pressures.

3.6 In the event that a Party fails to make arrangements to take its Full Share of Current Production required to be produced to maintain leases in effect, to protect the producing capacity of a well or reservoir, to preserve correlative rights, or to maintain oil production, the Operator may sell any part of such Party's Full Share of Current Production that such Party fails to take for the account of such Party and render to such Party, on a current basis, the full proceeds of the sale, less any reasonable marketing, compression, treating, gathering or transportation costs incurred directly in connection with the sale of such Full Share of Current Production. In making the sale contemplated herein, the Operator shall be obligated only to obtain such price and conditions of the sale as are reasonable under the circumstances and shall not be obligated to share any of its markets. Any such sale by Operator under the terms hereof shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one year. Notwithstanding the provisions of article 3.4 hereof, Gas sold by Operator for a Party under the provisions hereof shall be deemed to be Gas taken for the account of such Party.

#### 4. IN-KIND BALANCING

4.1 Effective the first day of any calendar month following at least thirty (30) days' prior written notice to the Operator, any Underproduced Party may begin taking, in addition to its Full Share of Current Production and any Makeup Gas taken pursuant to Section 3.3 of this Agreement, a share of current production determined by multiplying fifty percent (50%) of the Full Shares of Current Production of all Overproduced Parties by a fraction, the numerator of which is the Percentage Interest of such Underproduced Party and the denominator of which is the total of the Percentage Interests of all Underproduced Parties desiring to take Makeup Gas. In no event will an Overproduced Party be required to provide more than fifty percent (50%) of its Full Share of Current Production for Makeup Gas. The Operator will promptly notify all Overproduced Parties of the election of an Underproduced Party to begin taking Makeup Gas.

4.2 Notwithstanding the provisions of Section 4.1, no Overproduced Party will be required to provide more than twelve and one half percent (12.5%) of its Full Share of Current Production for Makeup Gas during the Winter Period.

4.3 Notwithstanding anything herein to the contrary no Underproduced Party which is a Non-Consenting Party under the Operating Agreement and is not then entitled to participate in any operation regarding a Balancing Area shall be entitled to take gas from said Balancing Area for which it is a Non-Consenting Party.

#### 5. STATEMENT OF GAS BALANCES

5.1 The Operator will maintain appropriate accounting on a monthly and cumulative basis of the volumes of Gas that each Party is entitled to receive and the volumes of Gas actually taken or sold for each Party's account. Within forty-five (45) days after the month of production, the Operator will furnish a statement for such month showing (1) each Party's Full Share of Current Production, (2) the total volume of Gas actually taken or sold for each Party's account, (3) the difference between the volume taken by each Party and that Party's Full Share of Current Production, (4) the Overproduction or Underproduction of each Party, and (5) other data as recommended by the provisions of the Council of Petroleum Accountants Societies Bulletin No. 24, as amended or supplemented hereafter. Each Party taking Gas will promptly provide to the Operator any data required by the Operator for preparation of the statements required hereunder.

5.2 If any Party fails to provide the data required herein for four (4) consecutive production months, the Operator, or where the Operator has failed to provide data, another Party, may audit the production and Gas sales and transportation volumes of the non-reporting Party to provide the required data. Such audit shall be conducted only after reasonable notice and during normal business hours in the office of the Party whose records are being audited. All costs associated with such audit will be charged to the account of the Party failing to provide the required data.

#### 6. PAYMENTS ON PRODUCTION

6.1 Each Party taking Gas shall pay or cause to be paid all production and severance taxes due

on all volumes of Gas actually taken by such Party.

6.2 Each Party shall pay or cause to be paid all Royalty due with respect to Royalty owners to whom it is accountable as if such Party were taking its Full Share of Current Production, and only its Full Share of Current Production.

6.3 In the event that any governmental authority requires that Royalty payments be made on any other basis than that provided for in this Section 6, each Party agrees to make such Royalty payments accordingly, commencing on the effective date required by such governmental authority, and the method provided for herein shall be thereby superseded.

## 7. CASH SETTLEMENTS

7.1 Upon the earlier of the plugging and abandonment of the last producing interval in the Balancing Area, the termination of the Operating Agreement or any pooling or unit agreement covering the Balancing Area, or at any time no Gas is taken from the Balancing Area for a period of twelve (12) consecutive months, any Party may give written notice calling for cash settlement of the Gas production imbalances among the Parties. Such notice shall be given to all Parties in the Balancing Area.

7.2 Within sixty (60) days after the notice calling for cash settlement under Section 7.1, the Operator will distribute to each Party a Final Gas Settlement Statement detailing the quantity of Overproduction owed by each Overproduced Party to each Underproduced Party and identifying the month to which such Overproduction is attributed, pursuant to the methodology set out in Section 7.4.

7.3 Within sixty (60) days after receipt of the Final Gas Settlement Statement, each Overproduced Party will pay to each Underproduced Party entitled to settlement the appropriate cash settlement, accompanied by appropriate accounting detail. At the time of payment, the Overproduced Party will notify the Operator of the Gas imbalance settled by the Overproduced Party's payment.

7.4 The amount of the cash settlement will be based on the proceeds received by the Overproduced Party under an Arm's Length Agreement for the Gas taken from time to time by the Overproduced Party in excess of the Overproduced Party's Full Share of Current Production. Any Makeup Gas taken by the Underproduced Party prior to monetary settlement hereunder will be applied to offset Overproduction chronologically in the order of accrual.

7.5 The values used for calculating the cash settlement under Section 7.4 will include all proceeds received for the sale of the Gas by the Overproduced Party calculated at the Balancing Area, after deducting any production or severance taxes paid and any Royalty actually paid by the Overproduced Party to an Underproduced Party's Royalty owner(s), to the extent said payments amounted to a discharge of said Underproduced Party's Royalty obligation, as well as any reasonable marketing, compression, treating, gathering or transportation costs incurred directly in connection with the sale of the Overproduction.

7.5.1 For Overproduction sold under a gas purchase contract providing for payment based on a percentage of the proceeds obtained by the purchaser upon resale of residue gas and liquid or liquifiable hydrocarbons extracted at a gas processing plant, the values used for calculating cash settlement will include proceeds received by the Overproduced Party for both the liquid hydrocarbons (including liquifiable hydrocarbons) and the residue gas attributable to the Overproduction.

7.5.2 For Overproduction processed for the account of the Overproduced Party at a gas processing plant for the extraction of liquid hydrocarbons, where settlement for the gas so processed was on a basis other than percentage of the proceeds, the values used for calculating cash settlement will include the proceeds received by the Overproduced Party for the sale of the liquid hydrocarbons extracted from the Overproduction, less the actual reasonable costs incurred by the Overproduced Party to process the Overproduction and to transport, fractionate and handle the liquid hydrocarbons extracted therefrom prior to sale.

7.6 To the extent the Overproduced Party did not sell all Overproduction under an Arm's Length Agreement, the cash settlement will be based on the weighted average price received by the Overproduced Party for any gas sold from the Balancing Area under Arm's Length Agreements during the months to which such Overproduction is attributed. In the event that no sales under Arm's Length Agreements were made during any such month, the cash settlement for such month will be based on the spot sales prices published for the applicable geographic area during such month in a mutually acceptable pricing bulletin.

7.7 Interest compounded at the maximum lawful rate of interest applicable to the Balancing Area will accrue for all amounts due under Section 7.1, beginning the first day following the date payment is due pursuant to Section 7.3. Such interest shall be borne by the Operator or any Overproduced Party in the proportion that their respective delays beyond the deadlines set out in Section 7.2 and 7.3 contributed to the accrual of the interest.

7.8 In lieu of the cash settlement required by Section 7.3, an Overproduced Party may deliver to the Underproduced Party an offer to settle its Overproduction in-kind and at such rates, quantities, times and sources as may be agreed upon by the Underproduced Party. If the Parties are unable to agree upon the manner in which such in-kind settlement gas will be furnished within sixty (60) days after the Overproduced Party's offer to settle in kind, which period may be extended by agreement of said Parties, the Overproduced Party shall make a cash settlement as provided in Section 7.3. The making of an in-kind settlement offer under this Section 7.8 will not delay the accrual of interest on the cash settlement should the Parties fail to reach agreement on an in-kind settlement.

7.9 That portion of any monies collected by an Overproduced Party for Overproduction which is subject to refund by orders of the Federal Energy Regulatory Commission or other governmental authority may be withheld by the Overproduced Party until such prices are finally approved by such governmental authority, unless the Underproduced Party furnishes a corporate undertaking, acceptable to the Overproduced Party, agreeing to hold the Overproduced Party harmless from financial loss due to refund orders by such governmental authority.

#### **8. TESTING**

Notwithstanding any provision of this Agreement to the contrary, any Party shall have the right, from time to time, to produce and take up to one hundred percent (100%) of a well's entire Gas stream to meet the reasonable deliverability test(s) required by such Party's Gas purchaser, and the right to take any Makeup Gas shall be subordinate to the right of any Party to conduct such tests; provided, however, that such tests shall be conducted in accordance with prudent operating practices only after fifteen (15) day's prior written notice to the Operator and shall last no longer than seventy-two (72) hours.

#### **9. OPERATING COSTS**

Nothing in this Agreement shall change or affect any Party's obligation to pay its proportionate share of all costs and liabilities incurred in operations on or in connection with the Balancing Area, as its share thereof is set forth in the Operating Agreement, irrespective of whether any Party is at any time selling and using Gas or whether such sales or use are in proportion to its Percentage Interest in the Balancing Area.

#### **10. LIQUIDS**

The Parties shall share proportionately in and own all liquid hydrocarbons recovered with Gas by field equipment operated for the joint account in accordance with their Percentage Interests in the Balancing Area.

#### **11. AUDIT RIGHTS**

Notwithstanding any provision in this Agreement or any other agreement between the Parties hereto, and further notwithstanding any termination or cancellation of this Agreement, for a period of two (2) years from the end of the calendar year in which any information to be furnished under Section 5 or 7 hereof is supplied, any Party shall have the right to audit the records of any other Party regarding quantity, including but not limited to information regarding Btu-content. Any Underproduced Party shall have the right for a period of two (2) years from the end of the calendar year in which any cash settlement is received pursuant to Section 7 to audit the records of any Overproduced Party as to all matters concerning values, including but not limited to information regarding prices and disposition of Gas from the Balancing Area. Any such audit shall be conducted at the expense of the Party or Parties desiring such audit, and shall be conducted, after reasonable notice, during normal business hours in the office of the Party whose records are being audited. Each Party hereto agrees to maintain records as to the volumes and prices of Gas sold each month and the volumes of Gas used in its own operations, along with the Royalty paid on any such Gas used by a Party in its own operations. The audit rights provided for in this Section 11 shall be in addition to those provided for in Section 5.2 of this Agreement.

## 12. MISCELLANEOUS

12.1 As between the Parties, in the event of any conflict between the provisions of this Agreement and the provisions of any gas sales contract, or in the event of any conflict between the provisions of this Agreement and the provisions of the Operating Agreement, the provisions of this Agreement shall govern.

12.2 Each Party agrees to defend, indemnify and hold harmless all other Parties from and against any and all liability for any claims, which may be asserted by any third party which now or hereafter stands in a contractual relationship with such indemnifying Party and which arise out of the operation of this Agreement or any activities of such indemnifying Party under the provisions of this Agreement, and does further agree to save the other Parties harmless from all judgments or damages sustained and costs incurred in connection therewith.

12.3 Except as otherwise provided in this Agreement, Operator is authorized to administer the provisions of this Agreement, but shall have no liability to the other Parties for losses sustained or liability incurred which arise out of or in connection with the performance of Operator's duties hereunder, except such as may result from Operator's gross negligence or willful misconduct. Operator shall not be liable to any Underproduced Party for the failure of any Overproduced Party (other than Operator) to pay any amounts owed pursuant to the terms hereof.

12.4 This Agreement shall remain in full force and effect for as long as the Operating Agreement shall remain in force and effect as to the Balancing Area, and thereafter until the Gas accounts between the Parties are settled in full, and shall inure to the benefit of and be binding upon the Parties hereto, and their respective heirs, successors, legal representatives and assigns, if any. The Parties hereto agree to give notice of the existence of this Agreement to any successor in interest of any such Party and to provide that any such successor shall be bound by this Agreement, and shall further make any transfer of any interest subject to the Operating Agreement, or any part thereof, also subject to the terms of this Agreement.

12.5 Unless the context clearly indicates otherwise, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

12.6 This Agreement shall bind the Parties in accordance with the provisions hereof, and nothing herein shall be construed or interpreted as creating any rights in any person or entity not a signatory hereto, or as being a stipulation in favor of any such person or entity.

12.7 If contemporaneously with this Agreement becoming effective, or thereafter, any Party requests that any other Party execute an appropriate memorandum or notice of this Agreement in order to give third parties notice of record of same and submits same for execution in recordable form, such memorandum or notice shall be duly executed by the Party to which such request is made and delivered promptly thereafter to the Party making the request. Upon receipt, the Party making the request shall cause the memorandum or notice to be duly recorded in the appropriate real property or other records affecting the Balancing Area.

12.8 With respect to accounting treatment of any gas imbalances as may exist, the parties agree to use the "cumulative method" [as defined in Income Tax Regulation §1.761-2 (d) (4)] of accounting for federal income tax purposes. The "entitlements method" shall not be used for reporting gas sales from the properties subject hereto.

## 13. ASSIGNMENT AND RIGHTS UPON ASSIGNMENT

13.1 Subject to the provisions of Section 13.2 hereof, and notwithstanding anything in this Agreement or in the Operating Agreement to the contrary, if any Party assigns (including any sale, exchange or other transfer) any of its working interest in the Balancing Area when such Party is an Underproduced or Overproduced Party, the assignment or other act of transfer shall, insofar as the Parties hereto are concerned, include all interest of the assigning or transferring Party in the Gas, all rights to receive or obligations to provide or take Makeup Gas and all rights to receive or obligations to make any monetary payment which may ultimately be due hereunder, as applicable. Operator and each of the other Parties hereto shall thereafter treat the assignment accordingly, and the assigning or transferring Party shall look solely to its assignee or other transferee for any interest in the Gas or monetary payment that such Party may have or to which it may be entitled, and shall cause its assignee or other transferee to assume its obligations hereunder.

13.2 The provisions of this Section 13 shall not be applicable in the event any Party mortgages its interest or disposes of its interest by merger, reorganization, consolidation or sale of substantially all of its

Exhibit "E"  
Gas Balancing Agreement  
Page 7

assets to a subsidiary or parent company, or to any company in which any parent or subsidiary of such Party owns a majority of the stock of such company.

EXHIBIT " F "

EQUAL OPPORTUNITY AND AFFIRMATIVE ACTION

During the performance of this contract, the Operator (meaning and referring separately to each party hereto) agrees as follows:

1. **NONSEGREGATED FACILITIES REQUIREMENTS:** The provisions of this Section apply only if the total contract amount exceeds \$10,000. A Certification of Nonsegregated Facilities, as required by 41 CFR §1-12.803-10(d)(1) and 60-1.8, shall be submitted prior to the award of a subcontract exceeding \$10,000 which is not exempt from the provisions of the Equal Opportunity clause. The certification may be submitted either for each subcontract or for all subcontracts during a period.
2. **EQUAL EMPLOYMENT OPPORTUNITY:** The provisions of this Section apply only if the total contract amount exceeds \$10,000. During the performance of this contract, the Seller agrees that it will comply with all provisions of Executive Order No. 11246 which is incorporated into this agreement by this reference.
3. **EQUAL EMPLOYMENT OPPORTUNITY REPORTING REQUIREMENTS:** The following applies only if Seller has 50 or more employees and holds contracts, subcontracts or purchase orders amounting to more than \$50,000: Seller will complete and file Government Standard Form 100, Equal Employment Opportunity Employer Information Report EEO-1 (or such other form as may have superseded it), in accordance with the instructions contained therein.
4. **AFFIRMATIVE ACTION COMPLIANCE PROGRAMS:** The provisions of this Section apply only if Seller has 50 or more employees and holds contracts, subcontracts or purchase orders amounting to more than \$50,000.
  - (a) In compliance with Paragraph 60-1.40, and in accordance with Sections 60-2.1 through 60-2.32 of the rules of the Office of Federal Contract Compliance Programs, Seller shall develop a written affirmative action compliance program for each of its establishments. Within 120 days from the issue date of this contract, Seller shall maintain a copy of separate affirmative action compliance programs for each of its establishments.
  - (b) Seller shall require each of its subcontractors who have 50 or more employees and a subcontract placed hereunder of \$50,000 or more to develop a written affirmative action compliance program for each of its establishments in conformance with the requirements of this Section.
5. **EMPLOYMENT OF QUALIFIED HANDICAPPED INDIVIDUALS:** The provisions of this Section apply only if the total contract amount exceeds \$2,500. Seller agrees to comply with Section 503 of the Rehabilitation Act of 1973, Section III of the Rehabilitation Act amendments of 1974 and 41 CFR §60-741.4 which are incorporated into this agreement by this reference.
6. **EMPLOYMENT OF VETERANS:** The provisions of this Section apply only if the total contract amount exceeds \$10,000. Seller agrees to comply with Section 2012 of the Vietnam Era Veterans Readjustment Act of 1974, and 41 CFR §60-250.4 which are incorporated into this agreement by this reference.
7. **UTILIZATION OF MINORITY BUSINESS ENTERPRISES:** The provisions of this Section apply only if the total contract amount exceeds \$10,000.
  - (a) It is the policy of the Government that minority business enterprises shall have the maximum practicable opportunity to participate in the performance of Government contracts.
  - (b) Contractor agrees to use its best efforts to carry out this policy in the award of its subcontracts to the fullest extent consistent with the efficient performance of this contract. As used in this contract, the term "minority business enterprise" means a business, at least 50 percent of which is owned by minority group members or, in case of publicly owned businesses, at least 51 percent of the stock of which is owned by minority group members. For the purpose of this definition, minority group members are Negroes, Spanish-speaking American persons, American-Orientals, American-Indians, American-Eskimos, and American Aleuts. Contractors may rely on written representations by subcontractors regarding their status as minority business enterprises in lieu of an independent investigation. 41 CFR §1-1.1310-2(a).
8. **UTILIZATION OF LABOR SURPLUS AREA CONCERNS:** The provisions of this Section apply only if the total contract amount exceeds \$10,000.
  - (a) It is the policy of the Government to award contracts to labor surplus area concerns that agree to perform substantially in labor surplus areas, where this can be done consistent with the efficient performance of the contract and at prices no higher than are obtainable elsewhere. Contractor agrees to use its best efforts to place its subcontracts in accordance with this policy.
  - (b) In complying with subsection (a) of this Section and with subsection (b) of Section 9 of this contract entitled "Utilization of Small Business Concerns," the Contractor in placing his subcontracts shall observe the following order of preference: (1) small business concerns that are labor surplus area concerns, (2) other small business concerns, and (3) other labor surplus area concerns.
  - (c)(1) The term "labor surplus area" means a geographical area identified by the Department of Labor as an area of concentrated unemployment or underemployment or an area of labor surplus.
  - (2) The term "labor surplus area concern" means a concern that together with its first-tier subcontractors will perform substantially in labor surplus areas.
  - (3) The term "perform substantially in a labor surplus area" means that the costs incurred on account of manufacturing, production, or appropriate services in labor surplus areas exceed 50 percent of the contract price. 41 CFR §1-1.805-3(a).
9. **UTILIZATION OF SMALL BUSINESS CONCERNS:** The provisions of this Section apply only if the total contract amount exceeds \$10,000.
  - (a) It is the policy of the Government as declared by Congress that a fair proportion of the purchases and contracts for supplies and services for the Government be placed with small business concerns.
  - (b) Contractor agrees to accomplish the maximum amount of subcontracting to small business concerns that Contractor finds to be consistent with the efficient performance of this contract. 41 CFR §1-1.710-3(a).
10. **AFFIRMATIVE ACTION FOR DISABLED VETERANS AND VETERANS OF THE VIETNAM ERA:** The provisions of this Section apply only if the total contract amount exceeds \$10,000. Seller agrees to comply with Section 402 of the Vietnam Era Veterans Readjustment Assistance Act of 1974 and 41 CFR §60-250.1 which are incorporated into this agreement by this reference.
11. **UTILIZATION OF WOMEN-OWNED BUSINESS CONCERNS:** The provisions of this Section apply only if the total contract amount exceeds \$10,000.
  - (a) It is the policy of the United States Government that women-owned businesses shall have the maximum practicable opportunity to participate in the performance of contracts awarded by any Federal agency.
  - (b) Contractor agrees to use its best efforts to carry out this policy in the award of subcontracts to the fullest extent consistent with the efficient performance of this contract. As used in this contract, a "woman-owned business" concern means a business that is at least 51% owned by a woman or women who also control and operate it. "Control" in this context means exercising the power to make policy decisions. "Operate" in this context means being actively involved in the day-to-day management. "Women" mean all women business owners. Temporary Regulation 54, Appendix to 41 CFR Chapter 1. (See Executive Order 12138).

**Exhibit "A" - Lease Schedule**

**LEASE DATE:** April 10, 1939  
**LESSOR:** State of New Mexico  
**LESSEE:** Continental Oil Company  
**SERIAL NO.** B-8096  
**RECORDING DATA:** Not Available

**DESCRIPTION:** All of Section 8, the SW/4NE/4, the NW/4, the SE/4 and the SW/4 of Section 9, T19S-R29E, N.M.P.M. limited to depths below 3000', Eddy County, New Mexico.

**LEASE DATE:** December 1, 1991  
**LESSOR:** State of New Mexico  
**LESSEE:** Mitchell Energy Corporation  
**SERIAL NO.** VA-0465  
**RECORDING DATA:** Not Available

**DESCRIPTION:** The NE/4NE/4 of Section 9, T19S-R29E, N.M.P.M. limited to depths below 3000', Eddy County, New Mexico.

**LEASE DATE:** December 1, 1995  
**LESSOR:** State of New Mexico  
**LESSEE:** Ameristate Oil and Gas, Inc.  
**SERIAL NO.** VB-0455  
**RECORDING DATA:** Not Available

**DESCRIPTION:** The NW/4NE/4 and the SE/4NE/4 of Section 9, T19S-R29E, N.M.P.M. limited to depths below 3000', Eddy County, New Mexico.



Exhibit "B"

ASSIGNMENT OF OIL AND GAS LEASE(S)

KNOW ALL MEN BY THESE PRESENTS that Threshold Development Company, a Texas corporation, Broad Street Financial Company, a Texas corporation, Leland A. Hodges and his wife, (Mrs. Hodges), and Herbert F. Boles, a single man dealing in his sole and separate property, hereinafter individually and collectively called "Assignor" all of whose address for the purposes of this document shall be C/O Threshold Development Company, Fort Worth Club Tower, Penthouse II, Suite D, 777 Taylor Street, Fort Worth, Texas 76102, for and in consideration of Ten Dollars (\$10.00) and other valuable consideration paid, does hereby, subject to the exceptions and reservations hereinafter contained, grant, convey, sell, assign and transfer unto OXY USA Inc., a Delaware corporation, whose address is P. O. Box 50250 Midland, Texas 79710, herein called "Assignee",

herein called "Assignee",

[all][fifty percent (50%)] of its right, title and interest in and to the following described lease(s), insofar only as said lease(s) cover(s) and grant(s) rights from below (insert 3,000' or 5,000' subsurface, as appropriate) down to and including all greater depths, under the lands described below, to-wit:

Lessor:

Lessee:

Dated:

Recording Date:

Description:                   INSOFAR AND ONLY INSOFAR as said lease shall concern

1. Assignor excepts and reserves from the lease(s) and lands assigned herein (1) all rights granted by said lease(s) above the depth to which this Assignment is made, together with the right to drill wells for and produce and market any and all minerals appearing in said lands above and below said depth [and (2) an overriding royalty equal to three percent (3%) of all oil, gas, casinghead gas, distillate and/or condensate and other minerals produced and saved from the lands assigned herein under the said lease(s), said overriding royalty interest to be convertible at payout of the well named hereinbelow to a forty five percent (45%) working interest. Said interest, whether working interest or overriding royalty interest, to be shared between the parties, Assignor, fifty percent (50%) Threshold Development Company, thirty seven and one half percent (37.5%) Broad Street Financial Company, eleven and seven eighths percent (11.875%) Leland A. Hodges, and five eighths of one percent (0.625%) Herbert F. Boles.] All interests set forth above are subject to proportionate reduction as provided in Paragraph 3. below.

2. The overriding royalty, as provided in Paragraph 1. above, on oil, gas and other substances produced and saved hereunder shall be paid by Assignee to Assignor as follows: (a) For oil and other liquid hydrocarbons separated at Assignee's separator facilities, said overriding royalty shall be delivered at Assignee's option to Assignor at the wellhead or to Assignor's credit at the oil purchaser's transportation facilities, less a proportionate part of ad valorem taxes and production, severance or other excise taxes and the costs incurred by Assignee in delivering, treating or otherwise marketing such oil or other liquid hydrocarbons, provided that Assignee shall have the continuing right to sell such production to itself or an affiliate at the wellhead market price then prevailing in the same field (or if there is no such price then prevailing in the same field, then in the nearest field in which there is such a prevailing price) for production of similar grade and gravity; (b) for gas (including casinghead gas) and all other substances covered hereby, the royalty shall be three percent (3%) (subject to proportionate reduction as provided below) of the proceeds realized by Assignee from the sale thereof, less a proportionate part of ad valorem taxes and production, severance, or other excise taxes and the costs incurred by Assignee in delivering, processing or otherwise marketing such gas or other substances, provided that Assignee shall have the continuing right to sell such production to itself or an affiliate at the prevailing wellhead market price paid for production of similar quality in the same field (or if there is no such price then prevailing in the same field, then in the nearest field in which there is such a prevailing price) pursuant to comparable purchase contracts entered into on the same or nearest preceding date as the date on which Assignee commences its purchases hereunder.

2. Assignor grants Assignee, insofar as Assignor has the right to do so and subject always to the terms and conditions of the lease(s) herein assigned, the right to pool or combine said lease(s) with other leases or lands, and in the event any lease assigned herein is pooled or unitized with other leases or lands for production, the overriding royalty reserved herein shall, as to the lands covered by this Assignment and so unitized, be paid to Assignor in the proportion that the number of acres assigned herein and so unitized bears to the total number of acres in such unit and the Assignor's after payout working interest in the well shall be in the proportion that the number of acres assigned herein and so unitized bears to the total number of acres in such unit.

Assignment of  
Oil and Gas Lease

1           4. If a lease described herein covers less than a full oil and gas leasehold estate in any lands  
2 described herein under such lease, or if Assignor's interest in such lease covering any lands described herein  
3 under such lease is less than the full oil and gas leasehold estate (excluding and disregarding any applicable  
4 royalty, overriding royalty, production payment or other burden to which such leasehold estate is subject),  
5 then the overriding royalty reserved out of the production from the lands in which Assignor's interest is less  
6 than the full oil and gas leasehold estate in such lands herein described under such lease shall be payable in  
7 the proportion that Assignor's interest in the oil and gas lease bears to the full oil and gas leasehold estate in  
8 such lands, and the interest in the well in which Assignor may elect to receive a working interest shall be in  
9 the proportion that the oil and gas leasehold estate in such lease conveying the lands described herein bears  
10 to the full oil and gas leasehold estate in said lands.

11  
12           5. As to each well in which the Assignor is not participating with a working interest that Assignee  
13 drills on the said lands, or on lands within a unit for production which includes any lands described herein,  
14 Assignee shall notify Assignor in writing of the following items:

- 15  
16                   (1) The exact legal description of the location.  
17                   (2) The date actual drilling is commenced.  
18                   (3) The total depth drilled.  
19                   (4) The date of completion.  
20                   (5) Whether completed as a producer of oil and/or gas or as a dry hole.  
21                   (6) The date any production commences.  
22                   (7) The date the well is shut-in.  
23                   (8) The date and amount of payment of any shut-in royalty.

24  
25 Such written notice shall be given to Assignor within thirty (30) days after the occurrence of each of said  
26 items.

27  
28           6. The Assignee shall deliver to Assignor in the pipeline to which Assignee's wells may be  
29 connected the fraction of the minerals reserved herein, all free and clear of cost and expense of production,  
30 Assignor's overriding royalty interest shall bear its proportionate part of any third party transportation charge  
31 necessary to deliver the product to market, severance taxes, production taxes, ad valorem taxes, or excise  
32 taxes measured or assessed on production, and shall execute any contract or division order which may be  
33 necessary in connection with payment of proceeds of said reserved minerals to Assignor or appropriate to  
34 effectuate such payments.

35  
36           7. Within one hundred twenty (120) days following the first sale of oil and/or gas from the lands or  
37 leases described herein or lands pooled therewith, Assignee shall pay, or cause to be paid, to Assignor such  
38 sums as shall have accrued to Assignor as overriding royalties under this lease and thereafter such payments  
39 shall be made monthly without the necessity of the execution by Assignor, or any other party, of a division  
40 or transfer order. Notwithstanding anything herein to the contrary, in the event such amounts accruing to  
41 Assignor as overriding royalty total less than twenty-five dollars (\$25.00) such amounts may be remitted the  
42 earlier of annually or when such amounts shall exceed twenty-five dollars (\$25.00). Subject to the usury laws  
43 of the State of New Mexico, all sums not paid timely shall bear interest at the prime rate as fixed by the Bank  
44 of America at San Francisco on the date such sums become due and payable, to accrue from the date they are  
45 due until the date payment is received by the Assignor.

46  
47           8. This Assignment is made subject to, and Assignee shall comply with, all applicable rules,  
48 regulations, laws and orders issued or promulgated by any court or governmental agency having jurisdiction  
49 over operation, production or marketing on and from the lands covered hereby.

50  
51           9. Assignor agrees to execute such other and further documents as may be required to convey  
52 and deliver to Assignee good and merchantable title in and to the lands and leases described herein and to  
53 properly reflect said title and interest in the county records and any applicable state or federal records.

54  
55           TO HAVE AND TO HOLD the same unto the said Assignee, its successors and assigns, according  
56 to the terms and conditions of said lease(s), the said Assignee to perform all of such conditions and covenants  
57 thereof as to the portion of lands herein assigned, but subject however to the provisions and conditions of said  
58 Agreement hereinbefore mentioned. This Assignment is made without warranty of title either express or  
59 implied.  
60

The reservations herein made and the provisions and covenants contained herein shall attach to and run with the lease or leases assigned and the land herein described or referred to and shall be binding upon and inure to the benefit of Assignor and Assignee and their respective successors and assigns.

IN WITNESS WHEREOF, the undersigned parties, Assignor, have executed this instrument or caused this instrument to be executed on their behalf as of this \_\_\_\_\_ day of \_\_\_\_\_, 199\_\_\_\_, but effective as of the earlier of such date or the date of first production of the \_\_\_\_\_ Well.

**Herbert F. Boles**

**Notary Public**

**Notary Public**

Exhibit "A" - Lease Schedule

LEASE DATE: April 10, 1939  
LESSOR: State of New Mexico  
LESSEE: Continental Oil Company  
SERIAL NO. B-8096  
RECORDING DATA: Not Available

DESCRIPTION: All of Section 8, limited to depths below 3000', the SW/4NE/4, the NW/4, the SE/4 and the SW/4 of Section 9, T19S-R29E, N.M.P.M. limited to depths below 5000', Eddy County, New Mexico.

LEASE DATE: December 1, 1991  
LESSOR: State of New Mexico  
LESSEE: Mitchell Energy Corporation  
SERIAL NO. VA-0465  
RECORDING DATA: Not Available

DESCRIPTION: The NE/4NE/4 of Section 9, T19S-R29E, N.M.P.M. limited to depths below 5000', Eddy County, New Mexico.

LEASE DATE: December 1, 1995  
LESSOR: State of New Mexico  
LESSEE: Ameristate Oil and Gas, Inc.  
SERIAL NO. VB-0455  
RECORDING DATA: Not Available

DESCRIPTION: The NW/4NE/4 and the SE/4NE/4 of Section 9, T19S-R29E, N.M.P.M. limited to depths below 5000', Eddy County, New Mexico.

Exhibit "B"

ASSIGNMENT OF OIL AND GAS LEASE(S)

KNOW ALL MEN BY THESE PRESENTS that Threshold Development Company, a Texas corporation, Broad Street Financial Company, a Texas corporation, Leland A. Hodges and his wife, (Mrs. Hodges), and Herbert F. Boles, a single man dealing in his sole and separate property, hereinafter individually and collectively called "Assignor" all of whose address for the purposes of this document shall be C/O Threshold Development Company, Fort Worth Club Tower, Penthouse II, Suite D, 777 Taylor Street, Fort Worth, Texas 76102, for and in consideration of Ten Dollars (\$10.00) and other valuable consideration paid, does hereby, subject to the exceptions and reservations hereinafter contained, grant, convey, sell, assign and transfer unto OXY USA Inc., a Delaware corporation, whose address is P. O. Box 50250 Midland, Texas 79710, herein called "Assignee",

herein called "Assignee",

[all][fifty percent (50%)] of its right, title and interest in and to the following described lease(s), insofar only as said lease(s) cover(s) and grant(s) rights from below (insert 3,000' or 5,000' subsurface, as appropriate) down to and including all greater depths, under the lands described below, to-wit:

Lessor:

Lessee:

Dated:

Recording Data:

Description:                   INSOFAR AND ONLY INSOFAR as said lease shall concern

1. Assignor excepts and reserves from the lease(s) and lands assigned herein (1) all rights granted by said lease(s) above the depth to which this Assignment is made, together with the right to drill wells for and produce and market any and all minerals appearing in said lands above and below said depth. All interests set forth above are subject to proportionate reduction as provided in Paragraph 3. below.

2. Assignor grants Assignee, insofar as Assignor has the right to do so and subject always to the terms and conditions of the lease(s) herein assigned, the right to pool or combine said lease(s) with other leases or lands, and in the event any lease assigned herein is pooled or unitized with other leases or lands for production, the overriding royalty reserved herein shall, as to the lands covered by this Assignment and so unitized, be paid to Assignor in the proportion that the number of acres assigned herein and so unitized bears to the total number of acres in such unit and the Assignor's after payout working interest in the well shall be in the proportion that the number of acres assigned herein and so unitized bears to the total number of acres in such unit.

3. If a lease described herein covers less than a full oil and gas leasehold estate in any lands described herein under such lease, or if Assignor's interest in such lease covering any lands described herein under such lease is less than the full oil and gas leasehold estate (excluding and disregarding any applicable royalty, overriding royalty, production payment or other burden to which such leasehold estate is subject), then the overriding royalty reserved out of the production from the lands in which Assignor's interest is less than the full oil and gas leasehold estate in such lands herein described under such lease shall be payable in the proportion that Assignor's interest in the oil and gas lease bears to the full oil and gas leasehold estate in such lands, and the interest in the well in which Assignor may elect to receive a working interest shall be in the proportion that the oil and gas leasehold estate in such lease conveying the lands described herein bears to the full oil and gas leasehold estate in said lands.

4. As to each well in which the Assignor is not participating with a working interest that Assignee drills on the said lands, or on lands within a unit for production which includes any lands described herein, Assignee shall notify Assignor in writing of the following items:

- (1) The exact legal description of the location.
- (2) The date actual drilling is commenced.
- (3) The total depth drilled.
- (4) The date of completion.
- (5) Whether completed as a producer of oil and/or gas or as a dry hole.
- (6) The date any production commences.
- (7) The date the well is shut-in.
- (8) The date and amount of payment of any shut-in royalty.

Assignment of  
Oil and Gas Lease

1 STATE OF )  
2 ) SS.  
3 COUNTY OF )  
4

5 The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 1997,  
6 by Leland A. Hodges, an individual.

7  
8 Witness my hand and official seal.  
9

10 My commission expires:  
11  
12 \_\_\_\_\_

13 \_\_\_\_\_  
14 Notary Public

15 STATE OF )  
16 ) SS.  
17 COUNTY OF )  
18

19 The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 1997,  
20 by Marjorie Ann Hodges, an individual.

21  
22 Witness my hand and official seal.  
23

24 My commission expires:  
25  
26 \_\_\_\_\_

27 \_\_\_\_\_  
28 Notary Public

29  
30 STATE OF )  
31 ) SS.  
32 COUNTY OF )  
33

34 The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 1997,  
35 by Herbert F. Boles, an individual.

36  
37 Witness my hand and official seal.  
38

39 My commission expires:  
40  
41 \_\_\_\_\_

42 \_\_\_\_\_  
43 Notary Public  
44  
45  
46  
47  
48

Assignment of  
Oil and Gas Lease

Such written notice shall be given to Assignor within thirty (30) days after the occurrence of each of said items.

5. The Assignee shall deliver to Assignor in the pipeline to which Assignee's wells may be connected the fraction of the minerals reserved herein, all free and clear of cost and expense of production, Assignor's overriding royalty interest shall bear its proportionate part of any third party transportation charge necessary to deliver the product to market, severance taxes, production taxes, ad valorem taxes, or excise taxes measured or assessed on production, and shall execute any contract or division order which may be necessary in connection with payment of proceeds of said reserved minerals to Assignor or appropriate to effectuate such payments.

6. Within one hundred twenty (120) days following the first sale of oil and/or gas from the lands or leases described herein or lands pooled therewith, Assignee shall pay, or cause to be paid, to Assignor such sums as shall have accrued to Assignor as overriding royalties under this lease and thereafter such payments shall be made monthly without the necessity of the execution by Assignor, or any other party, of a division or transfer order. Notwithstanding anything herein to the contrary, in the event such amounts accruing to Assignor as overriding royalty total less than twenty-five dollars (\$25.00) such amounts may be remitted the earlier of annually or when such amounts shall exceed twenty-five dollars (\$25.00). Subject to the usury laws of the State of New Mexico, all sums not paid timely shall bear interest at the prime rate as fixed by the Bank of America at San Francisco on the date such sums become due and payable, to accrue from the date they are due until the date payment is received by the Assignor.

7. This Assignment is made subject to, and Assignee shall comply with, all applicable rules, regulations, laws and orders issued or promulgated by any court or governmental agency having jurisdiction over operation, production or marketing on and from the lands covered hereby.

8. Assignor agrees to execute such other and further documents as may be required to convey and deliver to Assignee good and merchantable title in and to the lands and leases described herein and to properly reflect said title and interest in the county records and any applicable state or federal records.

TO HAVE AND TO HOLD the same unto the said Assignee, its successors and assigns, according to the terms and conditions of said lease(s), the said Assignee to perform all of such conditions and covenants thereof as to the portion of lands herein assigned, but subject however to the provisions and conditions of said Agreement hereinbefore mentioned. This Assignment is made without warranty of title either express or implied.

The reservations herein made and the provisions and covenants contained herein shall attach to and run with the lease or leases assigned and the land herein described or referred to and shall be binding upon and inure to the benefit of Assignor and Assignee and their respective successors and assigns.

This instrument may be executed in any number of counterparts, no one of which need bear the signature of all the parties, but any one of which may serve as an original for all purposes. Should any Assignor named herein fail for any reason to execute and/or deliver this instrument the instrument shall never the less be effective to convey to the Assignee the interest of the Assignor(s) actually executing and delivering the same to the Assignee.

IN WITNESS WHEREOF, the undersigned parties, Assignor, have executed this instrument or caused this instrument to be executed on their behalf as of this \_\_\_\_\_ day of \_\_\_\_\_, 199\_\_\_\_, but effective as of the earlier of such date or the date of first production of the \_\_\_\_\_ Well.

\_\_\_\_\_  
Threshold Development Company

\_\_\_\_\_  
Broad Street Financial Company

\_\_\_\_\_  
Leland A. Hodges

Assignment of  
Oil and Gas Lease

\_\_\_\_\_  
Marjorie Ann Hodges

\_\_\_\_\_  
Herbert F. Boles

STATE OF )  
                  ) SS.  
COUNTY OF )

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 1997,  
by \_\_\_\_\_, as \_\_\_\_\_, on behalf of Threshold  
Development Company, a Texas corporation.

Witness my hand and official seal.

My commission expires:

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

STATE OF )  
                  ) SS.  
COUNTY OF )

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 1997,  
by \_\_\_\_\_, as \_\_\_\_\_, on behalf of Broad Street  
Financial Company, a Texas corporation.

Witness my hand and official seal.

My commission expires:

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

STATE OF )  
                  ) SS.  
COUNTY OF )

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 1997,  
by Leland A. Hodges, an individual.

Witness my hand and official seal.

My commission expires:

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



Assignment of  
Oil and Gas Lease

1 STATE OF )  
2 ) SS.  
3 COUNTY OF )  
4

5 The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 1997,  
6 by Marjorie Ann Hodges, an individual.

7  
8 Witness my hand and official seal.  
9

10 My commission expires:  
11  
12 \_\_\_\_\_

13 \_\_\_\_\_  
14 Notary Public  
15

16 STATE OF )  
17 ) SS.  
18 COUNTY OF )  
19

20 The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 1997,  
21 by Herbert F. Boles, an individual.

22  
23 Witness my hand and official seal.  
24

25 My commission expires:  
26  
27 \_\_\_\_\_

28 \_\_\_\_\_  
29 Notary Public  
30  
31  
32  
33  
34

STUBBEMAN, McRAE, SEALY, LAUGHLIN & BROWDER, INC.

ATTORNEYS AT LAW

MIDLAND, TEXAS

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550 WEST TEXAS AVENUE, SUITE 800 • 79701

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432/682-1616

FACSIMILE 432/682-4884

DAVID A. SUTTER

LICENSED IN TEXAS, NEW MEXICO AND NEBRASKA  
DIRECT DIAL 688-0270

dsutter@stubbemanlawfirm.com

April 23, 2007

**LETTER OPINION**

OXY USA WTP Limited Partnership  
6 Desta Drive, Suite 6000  
P. O. Box 50250  
Midland, Texas 79710

Attn: Mr. David Evans

Re: Threshold Development Company Letter Agreement  
dated March 27, 1997  
Sections 8 and 9, Township 19 South, Range 29 East  
Eddy County, New Mexico

Gentlemen::

At your request, we have examined a copy of the captioned letter agreement. You have asked whether Bold Energy, LP ("Bold"), successor in interest to Threshold Development Company, may participate as a 46.5% working interest owner in the drilling of in-fill wells on Sections 8 and 9, Township 19 South, Range 29 East, NMPM, Eddy County, New Mexico. You have also indicated that Bold believes the March 27, 1997 Letter Agreement terminated. It is our opinion that the March 27, 1997 Letter Agreement is still in full force and effect and that Bold does not have the right to propose an in-fill well on units earned by OXY, because all such wells "shall be drilled at the sole risk, cost and expense of OXY".

According to the information you have provided, OXY drilled four wells on Sections 8 and 9 which were completed below the base of the Bone Springs formation in various formations which were spaced on 320-acre spacing. Upon reaching the objective depth in the wells, OXY earned all of Threshold Development Company's interest in the spacing unit established for each well. Upon "payout", Threshold Development Company was entitled to a 46.5% working interest in each well and the earned unit for those zones below the base of the Bone Springs formation. You have stated that payout has occurred on all four wells. Bold, as the successor in interest to Threshold Development Company, has now proposed the drilling of an additional in-fill well on Section 8 and has requested that OXY either elect to go non-consent or participate as a 53.5% working interest owner in such well.

While the March 27, 1997 Letter Agreement does not include a term, we believe that this letter agreement is to remain in full force and effect so long as oil and/or gas is produced from the contract area

covered by the letter agreement, plus an additional period of ninety (90) days. Under Paragraph 14 of the letter agreement, if there is a cessation of production from an earned unit, OXY's rights in such unit shall terminate unless OXY commences further operations for reworking or drilling an additional well on the earned unit within ninety (90) days after cessation of all production. Attached to the letter agreement is an operating agreement in which OXY USA Inc. is named as operator. This operating agreement covers the same lands covered by the letter agreement. The term of the operating agreement is for so long as oil and/or gas is produced in paying quantities from the contract area, plus an additional period of ninety (90) days from cessation of all production. The term of the operating agreement and the term of the letter agreement are consistent and clearly indicate an intention of the parties for both agreements to remain in effect for so long as oil and/or gas is produced in paying quantities from the contract area, plus an additional period of ninety (90) days. Absent the cessation of production on any of the units earned by OXY or absent the existence of a written document in which OXY and Bold's predecessors effectively agreed to terminate the March 27, 1997 Letter Agreement, it is our opinion that the March 27, 1997 Letter Agreement is still in full force and effect.

Because the March 27, 1997 Letter Agreement remains in full force and effect, it is our opinion that the well proposal submitted by Bold is governed by Paragraph No. 9 of the letter agreement which provides as follows:

- “9. With regard to any well to be drilled on the Subject Lands below the base of the Bone Springs formation whether such well is an Option Well or a well proposed to be drilled on an Earned Unit, all such wells shall be drilled at the sole risk, cost and expense of OXY and Fairmors shall be entitled to receive an undivided forty-six and one half percent (46.5%) working interest in such well upon the occurrence of payout (as hereinafter defined), it being the expressed intention hereof that, any and all wells drilled on the Subject Lands below the base of the Bone Springs formation shall be subject to the Farmor's right to back-in for a full forty-six and one half percent (46.5%) working interest upon the occurrence of payout (as hereinafter defined).”

As previously mentioned, Paragraph 14 of the letter agreement further provides that upon cessation of production from an earned unit, all of OXY's right, title and interest in such unit shall terminate unless OXY commences further operations for reworking an existing well or for drilling an additional well on the subject earned unit within ninety (90) days after completion of operations. While further drilling below the base of the Bone Springs formation is contemplated in the letter agreement, such additional drilling is to be conducted and paid for by OXY and not Bold.

When read with Paragraph 14, Paragraph 9 is intended to relieve Threshold Development Company, or its successors and assigns, from paying for any wells drilled on an earned unit below the base of the Bone Springs formation, including any additional drilling that may be required by OXY in order to maintain its rights under this agreement in Paragraph 14. Consequently, Bold, as successor in interest to Threshold Development Company, would own no interest in any in-fill wells drilled on earned units under this agreement until payout has occurred on each in-fill well. Obviously, payout cannot occur until an actual in-fill well is drilled by OXY. While Bold owns an interest in the existing wells drilled on Section 8, it owns no interest in any additional wells drilled on earned units, until such wells are drilled by OXY and payout has occurred.

While Paragraph 9 relieves Threshold Development Company from paying for any wells drilled on an earned unit below the base of the Bone Springs formation, we also believe that Paragraph 9 is intended

Page 3

You have indicated that the parties to this letter agreement never executed an operating agreement, even though Paragraph 18 of the letter agreement required the parties to do so. By executing the letter agreement, we believe that the parties effectively adopted the operating agreement, even though the operating agreement was never separately executed by the parties. Nevertheless, under Paragraph 18 of the letter agreement, if there is an inconsistency between the letter agreement and the operating agreement, then the terms of the letter agreement shall control. Given the foregoing, we believe that the failure of the parties to execute the operating agreement attached as Exhibit "C" to the letter agreement would have no effect on the proposal submitted by Bold, since such a proposal is governed by Paragraph 9 of the letter agreement.

Based upon our examination of the foregoing letter agreement, it is our opinion that this letter agreement is still in full force and effect so long as there is production in paying quantities from each of the earned units in Sections 8 and 9, and that Bold Energy, LP may not propose or drill wells below the base of the Bone Springs formation on Sections 8 and 9, because Sections 8 and 9 encompass all of the units earned by OXY under the March 27, 1997 Letter Agreement. In each earned unit, Bold Energy, LP owns only an after payout interest in the existing wells that were drilled on Sections 8 and 9 and a possible future interest in any in-fill wells drilled by OXY, assuming such wells are drilled by OXY and payout on these wells does in fact occur.

STUBBEMAN, McRAE, SEALY,  
LAUGHLIN & BROWDER, INC.

By:

David A. Sutter

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