Mid-Continent Region
Production United States

Marathon Oil Company

P.O. Box 552
Midland, TX 79702-0552
Telephone 915/682-1626

Case 11152

January 2, 1996

Oil Conservation Division
2040 So. Pacheco
Santa Fe, NM 87505

Re: OCD Order - R-10307
Cooperative Water Injection Well

Gentlemen:

Pursuant to the above referenced order, dated February 3, 1995, enclosed is a fully executed copy of the Cooperative Water Injection Agreement between Marathon Oil Company and Shell Western E&P, INC. This agreement provides for Marathon to operate the Warn State A/C#25 injection well which will be located in Section 6, T-18-S, R-35-E, N.M.P.M., Lea County, New Mexico.

Please advise if anything further is needed. Thank you.

Yours very truly,

J. F. Rusnak

J. F. Rusnak
Landman

JFR;mmc'
Encl.

COOPERATIVE WATER INJECTION AGREEMENT

STATE OF NEW MEXICO §
§ KNOW ALL MEN BY THESE PRESENTS THAT:
COUNTY OF LEA §

THIS AGREEMENT, entered into and effective as of the date of the last execution hereof, by and between **MARATHON OIL COMPANY**, whose mailing address is P. O. Box 552, Midland, Texas 79702, hereafter referred to as "Marathon", and **SHELL WESTERN E & P, INC.**, whose mailing address is P. O. Box 576, Houston, Texas 77001, hereafter referred to as "Shell". Hereinafter, Marathon and Shell may sometimes be individually referred to as a "party" or collectively as the "parties".

WITNESSETH:

WHEREAS, Marathon is the owner and operator of the Warn State A/C 2 Lease, covering the west half (W/2) of Section 6, T-18-S, R-35-E, NMPM, Lea County, New Mexico; and

WHEREAS, Shell is the owner and operator of the State "D" Lease, covering the SW/4 SW/4 of Section 31, T-17-S, R-35-E, NMPM, and the State "E" Lease, covering the SE/4 SW/4 of Section 31, T-17-S, R-35-E, NMPM, all being located in Lea County, New Mexico, and hereafter collectively referred to as the "Shell Leases"; and

WHEREAS, Marathon and Shell desire to provide for the drilling and operation of one (1) water injection well on or near the common boundary of the Marathon - Warn State A/C 2 Lease and the Shell Leases to provide for the injection of water into the underlying Drinkard Formation so that the leases and lands mentioned above will be benefited by an increase in the production of crude oil and in order to protect the correlative rights of the owners of said leases.

NOW, THEREFORE, in consideration of the premises and the mutual covenants and agreements hereinafter set forth, the adequacy and sufficiency of which are hereby acknowledged, it is agreed by the parties hereto as follows:

1. Marathon is hereby designated as Operator of said water injection well being described, as follows:

Warn State A/C 2 #25 located 113' FNL and
1429' FWL, Section 6, T-18-S, R-35-E, NMPM

The above-described well will be drilled to an approximate depth of 8,150 feet into the Drinkard Formation and will hereinafter be referred to as "said well". Marathon agrees to commence drilling operations for said well within sixty (60) days from the execution date of this agreement. Marathon will make every effort to complete and begin injection into the well within 60 days from the spud date. Perforation depths for said well shall be mutually agreed upon by both parties hereto.

Injection of water into the said well shall be at such rates and at such pressures that will comply with the rules and regulations of the Oil Conservation Division of the Department of Energy and Minerals of the State of New Mexico. The maximum injection rate shall be determined by parting pressures and by mutual consent of the parties hereto, in accordance with prudent oil field operating practices. In no event, however, shall the injection pressure exceed the fracture pressure or the injection rate exceed 1,000 barrels of water per day, unless mutually agreed upon by the parties. Within 90 days from the start of injection, the parties agree to meet to review injection and production performance to determine if the 1,000 barrels of water per day injection rate is sufficient to replace the fluids being withdrawn from the reservoir by the four wells immediately offsetting said well. In the event channeling or other damage to any well, on any of the above-described leases, where the cause can be reasonably traced to said well listed above, injection shall be ceased into the well, at the request of either party, pending remedial work.

The parties hereto agree with each other that the creation of an artificial water drive by the injection of water through the said injection well into the Drinkard Formation is a reasonable producing and engineering practice. Each of the parties hereby indemnifies and releases the other party hereto from any liability for damages or losses of any kind arising from or growing out of the injection of water or operation of said well pursuant to the terms and conditions of this agreement. Each party shall also hold the other party harmless from all claims, demands, actions, causes of action, and damages relating to or arising out of the separate operation of each party's respective leases; all to the end that each party shall assume and discharge any and all claims from its own mineral, royalty and surface owners for money damages arising out of the flooding operations conducted pursuant to this agreement, and shall hold the other party harmless from any and all such claims. However, it is understood that Marathon and Shell agree to be jointly liable (50% each) for all damages, claims, actions, penalties, expenses, including attorney fees, related to any claim or action for environmental damages, pollution or contamination arising out of the operation of said well or injection of water pursuant to this agreement unless such environmental damages, pollution or contamination is a result of Marathon's gross negligence or willful misconduct, in which event Marathon will be solely liable and responsible therefor.

2. It is understood and agreed that the above-described injection well shall be operated by Marathon and jointly owned (50% each) by Marathon and Shell.

3. It is understood and agreed that the costs and expenses incurred for drilling, casing, cementing, completing, and equipping the aforesaid injection well (subject to a mutually acceptable AFE), plus costs associated with capital workovers of said well performed after receiving the consent of each party shall be borne by and paid 50% by Marathon and 50% by Shell. It is expressly understood and agreed that Marathon and Shell will each be responsible for 50% of all costs associated with operating said well during the terms hereof, subject to the takeover provisions contained hereinbelow. If said well cannot be completed as an injector and Marathon desires to put said well to alternative use, Marathon will remit to Shell, within thirty (30) days of its election to takeover said well, Shell's full costs incurred in connection with the drilling and attempted completion of said well as an injector.

4. Marathon has secured access to water suitable for injection purposes. The water volume injected shall be measured by standard type water metering equipment. The initial cost for said water will be $.10 per barrel, which will be paid 50% by Marathon and 50% by Shell. Such cost of water has been negotiated for an initial term of three (3) years and may be redetermined on an annual basis after the initial three year-period. Marathon shall pay and discharge expenses incurred in the operations of the injection well pursuant to this agreement and shall charge Shell with its proportionate share according to the provisions of the accounting procedure attached hereto as Exhibit "A". Shell will be billed monthly and will make payments within thirty (30) days of receipt of said bill. After the initial term of the above referenced water supply agreement has expired and in the event that a less costly injection water source alternative becomes available, the parties hereto may mutually agree to modify and/or terminate the above referenced water supply agreement.

5. Shell shall have the right to audit the accounts and records of Marathon that relate to said well for any calendar year for a two-year period following the end of any calendar year. This shall include the right to audit those related entities of Marathon which provide materials or services for the operation of said well. Such materials and services must be reasonably necessary and of the same or better quality as those available for unrelated vendors in the same general area.

6. The term of this agreement shall commence as of the effective date hereof and shall continue for a period of five (5) years from the date of initial injection into said well. At the end of said five (5) year period or thereafter, either of the parties hereto shall have the right to terminate its participation in the water injection operations upon giving sixty (60) days advance written notice to the other party of its intention to terminate participation. The other party shall then have the option, but

not the obligation, at its sole risk and expense, to take over and operate said well. In such event, the party taking over said well is to be granted the right of ingress and egress to said injection well, together with rights-of-way and easements necessary to continue operations of said well, but this grant is made without representation or warranty whatsoever and only insofar as the terminating party can legally make such grant. The parties further agree to execute and deliver such additional instruments as may be required to accomplish the foregoing. The party taking over operations of said well shall pay the other party for 50% of the equipment therein on the basis of the current net salvage value thereof in place, and when said party wishes to discontinue the water injection operations, such party shall plug and abandon said well, including any applicable surface clean-up, in compliance with all contractual obligations and rules and regulations of each governmental body having jurisdiction, at its sole cost, risk and expense. The net salvage value is defined as the value of all recoverable equipment less cost to recover and abandon said well. The party taking over said well hereby agrees to indemnify and hold the other party harmless from and against all claims, charges, suits and any liabilities arising out of or in any way associated with subsequent operations. It is the intention hereof that the party taking over said well shall thereafter be responsible for 100% of any and all costs associated therewith after the effective date of such assignment. However, any liability, environmental or otherwise, which existed before the effective date of such assignment, shall remain the joint responsibility of the parties as outlined in Article 1.

7. In the event any party hereto is rendered unable, wholly or in part, by *force majeure* to carry out its obligations under this Agreement, upon such party's giving notice and reasonably full particulars of such *force majeure* in writing to the other party hereto within a reasonable time after the occurrence of the case relied upon, the obligations of the party giving such notice, insofar as they are affected by such *force majeure*, shall be suspended during the continuance of any inability so caused, but for no longer period; and the cause of the *force majeure* so far as possible shall be remedied with all possible dispatch.

The term "*force majeure*", as employed herein, shall mean an act of God, strike, lockout or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, earthquake, storm, flood, fire, explosion, governmental restraint, unavailability of equipment, failure of water supply and any other cause, whether or not of the character above enumerated, which is not reasonably within the control of the party claiming suspension. It is understood that the settlement of strikes, lockouts or other labor difficulties shall be entirely within the discretion of the party having the difficulty. The above 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 acceding to the demands of opponents therein when such course is inadvisable in the discretion of the party having the difficulty.

8. The rights, duties, obligations and liabilities of the parties hereto shall be several, and not joint or collective, and nothing herein contained shall ever be construed as creating a partnership of any kind, joint venture, and association or a trust or as imposing upon any of the parties hereto a partnership duty, obligation or liability. Each party hereto shall be individually responsible only for its obligations as set out in this Agreement.

9. Each party hereto agrees that this Agreement shall not constitute a partnership, as defined in the Internal Revenue Code, and specifically elects to be excluded from the application of all of Subchapter K of the Internal Revenue Code of 1986 pursuant to Section 761 thereof.

10. Any sale, assignment, unitization or transfer of any interest of any party hereto in the lease and lands covered hereby shall be made expressly subject to obtaining the consent of the other party hereto, which consent shall not be unreasonably withheld. Any sale, assignment, unitization or transfer of any interest of any party hereto in the lease and lands covered hereby shall be made expressly subject to this Agreement, and any party acquiring any such interest shall assume the obligations hereof and be entitled to the benefits accruing hereunder. In the event any

party not a signatory party to this contract thereafter shall acquire any interest subject to this contract by assignment, operation of law, or otherwise, such party shall forthwith furnish to the other party having an interest subject to this contract, evidence of the acquisition of such interest. Failure to comply herewith shall constitute a waiver by such party as to any notice required or permitted hereunder, and said party shall be deemed to have received any such notice where such notice was given to such party's predecessor in title and any action taken or any notice received by such party's predecessor in title shall be binding upon any such party.

11. Marathon shall provide Shell monthly reports of the daily injection volumes and surface injection pressures from said well. Each such month's reports shall be provided within thirty (30) days of actual water injection operations. Additionally, Marathon shall run an initial injection profile survey within thirty (30) days of initial water injection and thereafter, annual injection profile surveys and furnish all such information to Shell on a timely basis. Any indicated profile modification work may be requested by either party hereto, however, such parties must mutually agree upon any remedial activities to be pursued.

12. Either party hereto may call a meeting concerning issues and/or operations associated with this Agreement by providing the other party no less than fourteen (14) days advance written notice, with the agenda for the meeting attached.

13. All terms and provisions herein shall be subject to all valid orders, rules and regulations of the Oil Conservation Division of the Department of Energy and Minerals of the State of New Mexico and all other applicable state and federal laws, rules and regulations.

14. This Agreement and all terms, covenants and conditions hereof shall extend to, be binding upon, and inure to the parties hereto and their respective successors and assigns.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the dates opposite their respective signatures.

MARATHON OIL COMPANY

Date: 12/14/95

By: _____
A. R. Kukla
Production Manager

APPROVED AS TO FORM MC

SHELL WESTERN E & P, INC.

Date: 12/19/95

By: _____
G. S. Nady
Attorney-In-Fact

C:\WP51\NM\CWIA

ACKNOWLEDGEMENTS

STATE OF TEXAS §
§
COUNTY OF MIDLAND §

The foregoing instrument was acknowledged before me on the 13th day of December, 1995, by A. R. Kukla, as Production Manager, of Marathon Oil Company, an Ohio corporation, on behalf of said corporation.

DIXIE A. HERTEL
MY COMMISSION EXPIRES
April 27, 1997

Dixie A. Hertel
Notary Public in and for the State of Texas

My commission expires:_____

STATE OF TEXAS §
§
COUNTY OF HARRIS §

The foregoing instrument was acknowledged before me on the 19th day of December, 1995, by G. S. Nady, as Attorney-In-Fact, of Shell Western E & P, Inc., a Delaware corporation, on behalf of said corporation.

Joyce M. Bowen
Notary Public in and for the State of Texas

My commission expires: Jan. 13, 2000

JOYCE M. BOWEN
Notary Public
STATE OF TEXAS
My Commission Expires
01/13/2000

EXHIBIT "A"

Attached to and made a part of that certain "COOPERATIVE WATER INJECTION AGREEMENT" by and between Marathon Oil Company and Shell Western Exploration & Production, Inc. for the Warn State A/C 2 Lease, the State "D" Lease, and the State "E" Lease in Lea County, New Mexico.

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 Chase Manhattan Bank 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 Opera tor's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) monti period following the end of such calendar year; provided, however, the making of an audit shall not extend the tim for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Sectio I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct joint audit in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no por tion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator. The audit shall not be conducted more than once each year without prior approval of Operator, except upon the resignation o 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 th Accounting Procedure and if the agreement to which this Accounting Procedure is attached contains no contrary provisio in regard thereto, Operator shall notify all Non-Operators of the Operator's proposal, and the agreement or approval 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 enviro mental considerations applicable to the Joint Operations. Such costs may include surveys of an ecological or archaeologic 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 Joi 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 exclud from the overhead rates.

(4) Salaries and wages of Technical Employees either temporarily or permanently assigned to and directly employ 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 employe whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II. Such costs unc this Paragraph 3B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount salaries and wages chargeable to the Joint Account under Paragraph 3A of this Section II. If percentage assessm 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 applica 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 Paragra 3A of this Section II.

4. Employee Benefits

Operator's current costs of established plans for employees' group life insurance, hospitalization, pension, retirement, st purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Jc Account under Paragraphs 3A and 3B of this Section II shall be Operator's actual cost not to exceed the percent most rec ly 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 Mate shall be purchased for or transferred to the Joint Property as may be required for immediate use and is reasonably pract 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 m to the Joint Account for a distance greater than the distance from the nearest reliable supply store where like mat 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 Prime rate percent (_____%) 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

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:

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

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, 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:

(X) shall be covered by the overhead rates, or
( ) 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 $ 4,500
(Prorated for less than a full month)

Producing Well Rate $ 450

(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 provide 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 unde Paragraphs 2 and 10 of Section II, all salvage credits, the value of injected substances purchased for secondar recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in an 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, developmen shall include all costs in connection with drilling, redrilling, deepening, or any remedial operations on any or al wells involving the use of drilling rig and crew capable of drilling to the producing interval on the Joint Prop erty; also, preliminary expenditures necessary in preparation for drilling and expenditures incurred in abandonin when the well is not completed as a producer, and original cost of construction or installation of fixed assets, th expansion of fixed assets and any other project clearly discernible as a fixed asset, except Major Construction a 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 o fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of th Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Join 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 sing project shall not be treated separately and the cost of drilling and workover wells and artificial lift equipment shall l excluded.

3. Catastrophe Overhead

To compensate Operator for overhead costs incurred in the event of expenditures resulting from a single occurrence du to oil spill, blowout, explosion, fire, storm, hurricane, or other catastrophes as agreed to by the Parties, which are necessar to restore the Joint Property to the equivalent condition that existed prior to the event causing the expenditures, Operat shall either negotiate a rate prior to charging the Joint Account or shall charge the Joint Account for overhead based o 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 pro sions 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 betwe the Parties hereto if, in practice, the rates are found to be insufficient or excessive.

5. See Page 5a attached.

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 mo ments affecting the Joint Property. Operator shall provide all Material for use on the Joint Property; however, at Operat option, such Material may be supplied by the Non-Operator. Operator shall make timely disposition of idle and/or surp Material, such disposal being made either through sale to Operator or Non-Operator, division in kind, or sale to outside Operator may purchase, but shall be under no obligation to purchase, interest of Non-Operators in surplus condition A o 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 Material found to be defective or returned to vendor for any other reasons, credit shall be passed to the Joint Acco 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 Opera unless otherwise agreed to by the Parties, shall be priced on the following basis exclusive of cash discounts:

III.5 Overhead - Environmental Response

To compensate Operator for overhead costs incurred in responding to any Environmental Claim or any Environmental Condition with regard to or arising from the Joint Property. The term "Environmental Claim" means any action, suit, investigation, proceeding, demand, claim or written notice by any person alleging or inquiring as to potential liability arising out of any Environmental Law with respect to the Joint Property; and the term "Environmental Condition" means any existing or threatened condition with respect to the soil, subsurface, surface waters, groundwaters, atmosphere or other environmental media, whether or not the Environmental Condition is yet discovered, which could result in any damage, loss, cost, expense, claim, demand, order, lien or liability to or against the Joint Property or against the Parties with respect to the Joint Property under any Environmental Law. The term "Environmental Law" means all local, state and federal treaties, laws, rules, regulations and permits in effect during the term of this agreement relating to pollution or protection of the environment, including without limitation, the Comprehensive Environmental Response, Compensation and Liability Act of 1980 as amended ("CERCLA"), the Resource Conservation and Recovery Act of 1976 as amended ("RCRA"), the Toxic Substances Control Act ("TSCA"). The overhead rate applied should be determined when executing the operating agreement as follows:

1) 5% of total costs through $100,000; plus
2) 3% of total costs in excess of $100,000 but less than $1,000,000; plus
3) 2% of total costs in excess of $1,000,000.

A. New Material (Condition A)

(1) Tubular Goods Other than Line Pipe

(a) Tubular goods, sized 2⅜ 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 2⅜ 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 ¾ 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 ¾ 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 ¾ 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.