

R-10-W

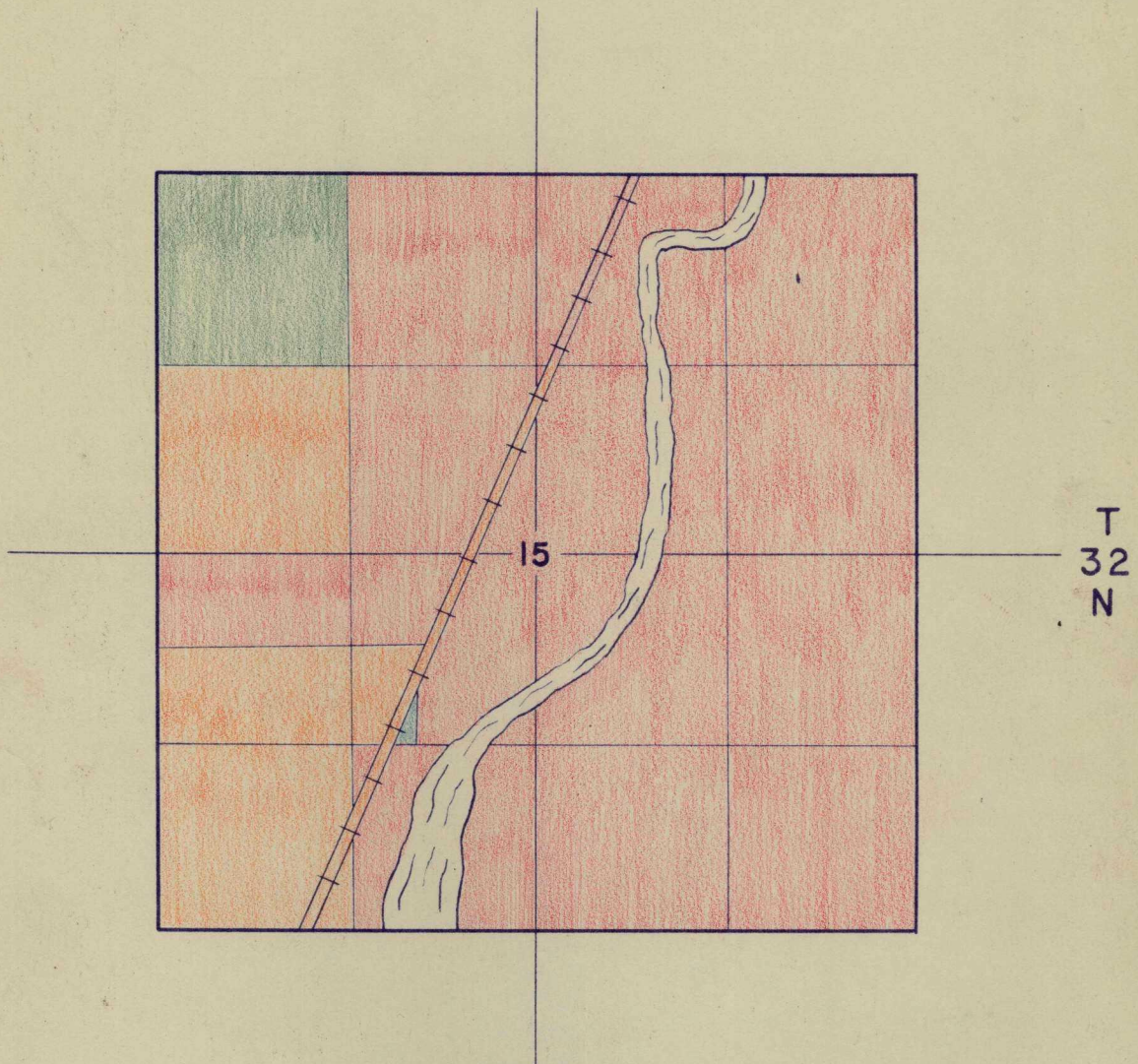






Exhibit A

To Accompany an Application for Unorthodox  
Spacing Unit W/2 Section 15 T-32-N R-10-W N.M.P.M.

	E. P. N. G.		Pacific Northwest
	Dave Clark		Saul Yager, et al

Scale: 1" = 1/4 mile





N/M 236

OPERATING AGREEMENT

THIS AGREEMENT, made and entered into this 9 day of <sup>August</sup>~~July~~, 1954, by and between GREAT WESTERN DRILLING COMPANY, a Texas corporation whose address is Post Office Box 1659, Midland Texas, hereinafter sometimes referred to as "Operator"; EL PASO NATURAL GAS COMPANY, a Delaware corporation whose address is Post Office Box 1492, El Paso, Texas, and PUBCO DEVELOPMENT, INC. (No Stockholders Liability), a New Mexico corporation whose address is Post Office Box 1360, Albuquerque, New Mexico, the two latter corporations being hereinafter referred to as "Non-Operator":

W I T N E S S E T H :

WHEREAS, the parties hereto are the owners of certain Oil and Gas Leases, which leases cover, among other lands, the following described land in San Juan County, New Mexico, to-wit:

Township 31 North, Range 11 West, N.M.P.M.  
Section 36: S $\frac{1}{2}$   
containing 320.0 acres, more or less; and

WHEREAS, it is the desire of the parties hereto to enter into an Operating Agreement covering the development and operation of the above described tract as hereinafter set out:

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements hereinafter contained to be kept and performed by the parties hereto, said parties do hereby agree as follows:

1. FORMATION OF THE UNIT:

For the purposes hereof, it is agreed that the aforementioned leases, insofar as they apply to the above described lands, are hereby pooled and communitized to form a unit covering only the Mesaverde formation in and under the land described above. It is the intention of the parties hereto in forming said unit to pool and communitize all leases which they may now own or which they may hereafter acquire covering any interest in the communitized unit. Such unit is created by the Communitization Agreement bearing the same date as this Operating Agreement, executed by the owners of leasehold interests in the land above described.

2. OPERATOR:

Great Western Drilling Company is hereby designated and shall act as Operator of such unit in accordance with the terms and provisions of this Agreement. Operator shall have full and complete management of the development and operation of the said unit for dry gas and associated liquid hydrocarbons producible from the Mesaverde formation as an entirety, but Operator agrees that no well shall be commenced upon the said unit except the well hereinafter provided for, without the consent of

Non-operator.

Operator may resign at any time by giving notice to Non-Operator in writing sixty (60) days in advance of the effective date of such resignation and, in such event, the working interest owners of said unit shall immediately select a successor. In the event Operator shall sell or otherwise dispose of all its interest in said unit, the right of operation herein conferred shall not run with the transfer or assignment of such interest or inure to the benefit of Operator's assignee, but Non-Operator and Operator's assignee shall immediately select a new Operator.

Notwithstanding anything to the contrary contained in this Paragraph, the parties to this Agreement hereby agree that if and when said initial test well is completed by Operator as a producing well, Public Development, Inc. (No Stockholders Liability), a New Mexico corporation, the address of which is Post Office Box 1360, Albuquerque, New Mexico, shall act as Operator of said well, and shall have full authority to act in behalf of the parties hereto in the same manner and to the same extent as Operator hereinabove designated.

3. WELL:

Operator shall, on or before one year from the date of this Agreement, and after giving Non-Operator at least ten (10) days advance notice in writing, commence or cause to be commenced drilling operations on an initial test well and shall thereafter drill said well to a depth sufficient to test the Mesaverde formation, unless salt, caprock, cavities, heaving shale, abnormal water flow, or impenetrable substances are encountered in said well at a lesser depth. The parties hereto may also mutually agree to discontinue drilling operations at a lesser depth. Upon completion of said well, if it is a commercial well, Operator shall notify Non-Operator of the date said well is tied-in to a gas gathering system.

In the event a well capable of producing gas in paying quantities is shut-in, other than on a temporary basis, Operator shall immediately notify Non-Operator thereof. All production obtained from the communitized area and all material and equipment acquired hereunder shall be owned by the parties hereto in the proportions hereinafter specified in Article 4 of this Agreement.

4. COSTS AND EXPENSES:

The entire costs and expenses involved in drilling and completing said well, if said well is a commercial well, or in plugging and abandoning if said well is a dry hole or non-commercial well, shall be borne by the parties hereto, as follows:

Great Western Drilling Company:  
El Paso Natural Gas Company:

87.500%  
12.500%

Unless Operator elects to require Non-Operator to advance its share of the costs and expenses, as hereinafter provided, Operator shall initially advance and pay all costs and expenses for the drilling of the well provided for in Article 3 hereof, as well as operation expenses of said unit, and shall charge Non-Operator with its pro rata part thereof on the basis of its proportionate interest in the unit as set out above.

All such costs, expenses, credits and related matter, and the method of handling the accounting with respect thereto, shall be in accordance with the provisions of the Accounting Procedure, attached hereto as Exhibit "A" and made a part hereof for all purposes; provided, however, that the Operator shall not apportion any part of the salaries and expenses of its District Superintendent, or other general district employees or of the district office expenses to the joint account as provided in paragraph 11 of Section II of said Exhibit "A", as attached hereto; and the monthly per well overhead rates set forth under paragraph 12 of Section II of said Exhibit "A", as attached hereto, shall be in lieu of any charges for any part of the compensation or salaries paid to Operator's District Superintendent and to other general district employees and shall be in lieu of any charges for district office expenses as well as Operator's division office and principal business office expenses and of any charge for field office and camp expenses, but shall not be in lieu of any charges on a fair and proportionate basis for any part of the compensation, salaries, and related expenses of any of Operator's field crew and direct supervision of such crew directly engaged in the operation of Operator's wells in the area.

In the event of any conflict between the provisions contained in the body of this Agreement, and those contained in said Exhibit "A", the provisions of this Agreement shall govern to the extent of such conflict.

In the event that Operator elects to require Non-Operator to advance its proportionate share of the above mentioned costs and expenses, Operator shall submit an itemized estimate of such costs and expenses for the succeeding calendar month to Non-Operator, showing therein the proportionate part of the estimated costs and expenses chargeable to Non-Operator. Within fifteen (15) days after receipt of said estimate, Non-Operator shall pay to the Operator its proportionate share of the estimated costs and expenses. If payment of the estimated costs and expenses is not made when due, the unpaid balance thereof shall bear interest at the rate of six per cent

(6%) per annum from the due date until paid. Adjustments between estimated and actual costs and expenses shall be made by Operator at the close of each calendar month and the account of the respective parties adjusted accordingly.

The well to be drilled on the communitized unit shall be drilled on a competitive contract basis at the usual rates prevailing in the field. However, Operator, if it so desires, may employ its own tools and equipment; in such event the cost of drilling shall include, but shall not be limited to, the following charges: (a) all direct material and labor costs; (b) a proportionate amount of applicable departmental overheads and undistributed field costs; (c) rental charge on company equipment employed; all such charges to be determined in accordance with Operator's accounting practice, provided, that in no event shall the total of such charges exceed the prevailing rate in the field, and such work shall be performed by Operator under the same terms and conditions as shall be customary and usual in the field in contracts of independent contractors who are doing work of a similar nature.

Operator shall make no single expenditure in excess of One Thousand Dollars (\$1,000.00) without first obtaining the consent thereof of Non-Operator. The approval of the drilling of the well provided for hereinabove, however, shall include all expenditures for the drilling, completing, testing and equipping such well.

5. RENTALS:

Each party hereto agrees to pay all rentals and/or shut-in royalty which may become due under the lease or leases which such party is contributing to such unit hereunder, and Operator shall not have any obligation to pay any such rentals and/or shut-in royalty except as to the lease contributed by Operator. Each party further agrees to use its best efforts to keep and maintain in full force and effect the oil and gas lease(s) contributed by such party to said unit.

6. INSURANCE:

Operator shall at all times while conducting operations hereunder, at its cost, carry and require its contractors and their sub-contractors to carry insurance to protect and save the parties hereto harmless, as follows:

- A. Workmen's Compensation Insurance sufficient to comply with the Workmen's Compensation Law for the State of New Mexico.
- B. Comprehensive General Public Liability Insurance with limits of not less than \$50,000 per person and \$100,000 per accident, and General Public Liability Property Damage with limits of not less than \$50,000 per accident.

- C. Automobile Public Liability Insurance with limits of not less than \$50,000 per person and \$100,000 per accident, and Automobile Property Damage Insurance with a limit of not less than \$50,000 per accident.

All costs and actual expenditures incurred and paid by Operator in settlement of any or all losses, claims, damages and judgments which are not covered by such insurance and other expenses, including legal services connected therewith, shall be charged to the joint account.

7. DISPOSAL OF PRODUCTION:

Each of the parties hereto shall own and have the right, at its own expense, to take in kind or separately dispose of its proportionate part of all dry gas and associated liquid hydrocarbons produced and saved from the acreage covered hereby, exclusive of the production which may be used by Operator in developing and continuing operations on the said tract and of production unavoidably lost, provided that each of the parties hereto shall pay or secure the payment of the royalty interests, overriding royalty interests, payments out of production or other similar interests, if any, from its proportionate part of said production. If at any time or times Non-Operator shall fail or refuse to take in kind or separately dispose of its proportionate part of said production, Operator shall have the right, revocable by Non-Operator at will, to sell such part of such production at the same price which Operator receives for its own portion of the production. All such sales by Operator of Non-Operator's production shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the circumstances, but in no event shall any such sale be for a period in excess of one (1) year.

8. DURATION OF AGREEMENT:

This Agreement shall become effective as of the date hereof upon execution by the parties hereto, notwithstanding the date of execution, and shall remain in full force and effect for a period of two (2) years and so long thereafter as dry gas and associated liquid hydrocarbons are produced from any part of said communitized unit in paying quantities, provided that prior to production in paying quantities from said communitized unit and upon fulfillment of all the requirements of the Oil Conservation Commission of the State of New Mexico, with respect to any dry hole or abandoned well, this Agreement may be terminated at any time by the mutual agreement of all the parties hereto.

9. ROYALTY INTERESTS:

It is agreed and understood that the burden of any royalty, overriding royalties, payments out of production, carried working interests, net profit obligations, or other similar payments, shall be borne and paid by the party owning the lease to which such interests apply.

10. TAXES:

The Operator shall render, for ad valorem tax purposes, the entire leasehold rights and interests covered by this Agreement and all physical property located thereon or used in connection therewith, or such part thereof as may be subject to ad valorem taxation under existing laws of the State of New Mexico, or which may be made subject to taxation under future laws, and shall pay for the benefit of the joint account all such ad valorem taxes at the time and in the manner required by law which may be assessed upon or against all or any portion of such leasehold rights and interests and the physical property located thereon or used in connection therewith. Operator shall bill Non-Operator for its proportionate share of such tax payments provided by the Accounting Procedure attached hereto as Exhibit "A".

11. RELATION OF PARTIES:

The rights, duties, obligations and liabilities of the parties hereto shall be several and not joint or collective, it being the express purpose and intention of the parties hereto that their ownership in said unit shall be as tenants in common; and nothing herein contained shall ever be construed as creating a partnership of any kind, joint venture, an association or trust or as imposing upon any one or more of the parties hereto any partnership duty, obligation or liability. Each party hereto shall be individually responsible only for his or its obligations, as set out in this Agreement.

12. ACCESS TO PREMISES, LOGS AND REPORTS:

Operator shall keep accurate logs of the well drilled on said unit, which logs shall be available at all reasonable times for inspection by Non-Operator. Upon request by Non-Operator, Operator shall furnish to Non-Operator a copy of said logs, samples of cores and cuttings of formations encountered, and electrical surveys relative to the development and operation of said unit, together with any other information which may be reasonably requested pertaining to such well. Non-Operator shall have access to said unit and to all books and records pertaining to operations hereunder for the purpose of inspection at all reasonable times.



13. SURRENDER, EXPIRATION, ABANDONMENT OR RELEASE OF LEASE:

No lease or leases subject to this Agreement shall be voluntarily surrendered, let to expire, abandoned or released, in whole or in part, unless the parties mutually consent thereto in writing. In the event that less than all parties hereto should elect to surrender, let expire, abandon or release all or any part of a lease or leases subject to this Agreement and the other party does not consent or agree, the party so electing shall notify the other party not less than sixty (60) days in advance of such surrender, expiration, abandonment or release, and, if requested so to do by the party not so electing, immediately shall assign without warranty to the latter party all of its rights, title and interest in and to said lease or leases, covering only the formation to be developed under the terms of this Agreement, the well or wells located thereon, and the casing and other physical equipment in or on said well or wells. If the party not so electing fails to request assignment within such sixty (60) day period, the party so electing shall have the right to surrender, let expire, abandon or release said lease or leases, or any part thereof. In the event such assignment is so requested, the party to whom such assignment is made, upon the delivery thereof, shall pay to the assigning party the salvage value of its interest in all the salvable casing and other physical equipment in or on the unit, such value to be determined in accordance with the provisions of the attached Exhibit "A", designated as Accounting Procedure. After the delivery of any such assignment, the party making the assignment shall be released from and discharged of all the duties and obligations thereafter accruing or arising hereunder, in connection with the operation and development of the unit, with respect to the interest assigned in said lease or leases.

14. LOSS OR FAILURE OF TITLE:

In the event of the loss or failure of the title, in whole or in part, of either party hereto, to any lease or to any interest therein, the interest of such party in and to the production obtained from the unit shall be reduced in proportion to such loss or failure of title as of the date such loss or failure of title is finally determined; provided, that such revision or ownership interest shall not be retroactive as to operating costs and expenses incurred or as to revenues or production obtained prior to such date; and provided further, that each party hereto whose title has been lost or has failed, as aforesaid, shall indemnify and hold the other parties hereto harmless from and against any and all loss, cost, damage and expense which may result from, or arise because of, the delivery to such party of production

obtained hereunder or the payment of proceeds derived from the sale of any production, prior to the date loss or failure of title is finally determined.

15. ABANDONMENT OF WELL:

No well on the unit which is capable of producing dry gas and associated liquid hydrocarbons from the formation covered by this Agreement shall be abandoned without the mutual consent of the parties hereto. If either of the parties desire to abandon such well, such party shall so notify the other party in writing and the latter shall have ten (10) days after receipt of such notice in which to elect whether to agree to such abandonment. If all parties hereto agree to such abandonment, such well shall be abandoned and plugged by the Operator at the expense of the joint account, and as much as possible of the casing and other physical equipment in and on said well shall be salvaged for the benefit of the joint account. If either party does not agree to said abandonment, such party shall purchase the interest of the party desiring to abandon said well in the physical equipment therein and thereof; and, within twenty-five (25) days after receipt of notice by the party not electing to abandon, the party desiring to abandon, shall execute and deliver to the other party an assignment, without warranty of title, of all its interest in said well and physical equipment, and in the working interest and gas leasehold estate, insofar as it covers the formation covered by this Agreement in said unit. In exchange for said assignment, the purchasing party shall pay to the assigning party the salvage value of the latter's interest in the salvable casing and other physical equipment in and on said well, such value to be determined in accordance with the provisions of the Accounting Procedure attached hereto as Exhibit "A".

16. LAWS AND REGULATIONS:

This Agreement shall be subject to all valid and applicable State and Federal laws, rules, regulations and orders, and the operations conducted hereunder shall be performed in accordance with said laws, rules, regulations and orders. In the event this Agreement or any provisions hereof, is, or the operations contemplated hereby are found to be inconsistent with or contrary to any such law, rule, regulation or order, the latter shall be deemed to control and this Agreement shall be regarded as modified accordingly, and as so modified, shall continue in full force and effect.

17. FORCE MAJEURE:

No party to this Agreement shall be liable to the other party for any delay or default in performance under this Agreement due to any cause beyond its control

and without its fault or negligence, including but not restricted to acts of God or the public enemy, act or requests of the Federal or State Government or of any Federal or State officer purporting to act under duly constituted authority, floods, fires, wars, storms, strikes, interruption of transportation, freight embargoes or failures, exhaustion or unavailability or delays in delivery of any material, equipment or service necessary to the performance of any provisions hereof, or the loss of holes, blow-outs or happening of any unforeseen accident, misfortune or casualty whereby performance hereunder is delayed or prevented.

18. OPERATOR'S LIEN:

Operator shall have an express contract lien, which is hereby granted, upon the interest of Non-Operator in said unit, in the gas and associated liquid produced hydrocarbons from such unit and in the materials and equipment located thereon, to secure the payment by said Non-Operator of its proportionate part of the costs and expenses incurred or paid by Operator hereunder. Such lien may be enforced and foreclosed as any other contract lien. Moreover, Operator may to the full extent of any indebtedness owed by it to Non-Operator, offset such debt against sums owing to Operator hereunder by Non-Operator.

19. NOTICES:

All notices, reports and other correspondence required or made necessary by the terms of this Agreement shall be deemed to have been properly served and addressed if sent by mail or telegram as follows:

El Paso Natural Gas Company  
Post Office Box 1492  
El Paso, Texas

Pubco Development, Inc.  
Post Office Box 1360  
Albuquerque, New Mexico

Great Western Drilling Company  
Post Office Box 1459  
Midland, Texas

20. ELECTION AS TO JOINDER:

Notwithstanding anything to the contrary heretofore stated, and upon receipt of the notice to the effect that Operator intends to commence drilling operations hereunder as set out in Article 3 herein, Non-Operator may, by responsive notice given to the Operator in writing within ten (10) days of receipt of the aforesaid notice, elect as to whether Non-Operator desires to join in the drilling of such well. Failure to respond within said ten (10) days shall be deemed an election not to join in the drilling of said well. In the event Non-Operator elects not to join in the drilling of said well, Operator shall nevertheless proceed with due diligence

to drill such well at the sole cost and risk of the Operator. In the event said well is a dry hole, it shall be plugged and abandoned at the sole cost of the Operator. In the event said well is a producer, it shall be tested, completed and equipped to produce at the sole cost of the Operator, and the Operator shall be entitled to receive from the proportionate share of production attributable to the lease or leases owned by such non-joining Non-Operator (after deducting therefrom all royalties, overriding royalties, and one hundred per cent. (100%) of the operating expenses attributable thereto) a sum equal to one hundred and fifty per cent. (150%) of that portion of the total cost of drilling, testing, completing, and equipping said well which is chargeable to the lease or leases owned by said non-joining Non-Operator. For the purposes of this paragraph, where a party takes its share of production in kind, the proceeds of production from such well shall be computed upon the same price basis as that employed for payment of royalties to the State of New Mexico on comparable production from the communitized area. When Operator shall have been reimbursed for one hundred and fifty per cent. (150%) of said costs as hereinabove provided, proceeds from said well shall thereafter be shared by the parties hereto as provided in Article 7 hereof. Any amounts which may be realized from sale or disposition of the well or equipment thereon, or required in connection with the drilling, testing, completing, equipping and operating thereof, shall be paid to the Operator and credited against the total unreturned portion of said one hundred and fifty per cent. (150%), with the balance thereof, if any, to be divided between the parties hereto in the same proportion as the production is shared according to Article 7.

21. HEIRS, SUCCESSORS AND ASSIGNS:

All of the provisions of this Agreement shall extend to and be binding upon the parties hereto, their heirs, successors and assigns, and such provisions shall be deemed to be covenants running with land covered hereby.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement in several counterpart originals as of the day and year first above written.

GREAT WESTERN DRILLING COMPANY

ATTEST:

By: R. C. Zucker  
President

R. W. Pearman  
Asst - Secretary

PUBCO DEVELOPMENT, INC. (No Stockholders Liability)

ATTEST:

By: Frank J. Skan  
Vice President

Jack J. Skan  
Assistant Secretary

Executed	
Witnessed	AMS
Notarized	
Filed	

EL PASO NATURAL GAS COMPANY

By [Signature]  
President

ACCTG.	<u>W</u>
INS.	
LEASE	

ATTEST:

[Signature]  
ASST. Secretary

STATE OF TEXAS

COUNTY OF Midland )  
ss

On this 9 day of August, 1954, before me appeared \_\_\_\_\_

B. C. Tucker, to me personally known, who, being by me duly sworn, did say that he is the \_\_\_\_\_ President of GREAT WESTERN DRILLING COMPANY, a Texas corporation, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said \_\_\_\_\_

B. C. Tucker acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Signature]  
Notary Public, County of Midland  
State of Texas

My commission expires:

6-1-55

STATE OF TEXAS

COUNTY OF EL PASO )  
ss

On this 27 day of August, 1954, before me appeared \_\_\_\_\_

H. F. STEEN

\_\_\_\_\_ to me personally known, who being by me duly sworn, did say that he is the VICK President of EL PASO NATURAL GAS COMPANY, a Delaware corporation, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said

corporation by authority of its Board of Directors, and said H. F. STEEN acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Signature]  
Notary Public, County of El Paso,  
State of Texas

My commission expires:

ELSE M. WIELAND

Notary Public, in and for El Paso County Texas  
My Commission expires June 1, 1955



STATE OF NEW MEXICO       )  
                                  (  
COUNTY OF BERNALILLO     )     ss

On this 31<sup>st</sup> day of August, 1954, before me appeared \_\_\_\_\_

FRANK D. GORHAM JR., to me personally known, who, being by me duly sworn, did say that he is the Vice President of PUBCO DEVELOPMENT, INC. (No Stockholders Liability), a New Mexico corporation, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and said

FRANK D. GORHAM JR. acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

Mary Beth Harkness  
Notary Public, County of Bernalillo,  
State of New Mexico

My commission expires:

My Commission Expires June 24, 1957

Attached to and made a part of Operating Agreement dated \_\_\_\_\_ day of July, 1954, between Great Western Drilling Company, El Paso Natural Gas Company and Pubco Development, Inc., covering the S/2 Section 36, T-31-N, R-11-W

## ACCOUNTING PROCEDURE

(UNIT AND JOINT LEASE OPERATIONS)

### I. GENERAL PROVISIONS

#### 1. Definitions

The term "joint property" as herein used shall be construed to mean the subject area covered by the agreement to which this "Accounting Procedure" is attached.

The term "Operator" as herein used shall be construed to mean the party designated to conduct the development and operation of the leased premises for the joint account.

The term "Non-Operator" as herein used shall be construed to mean any one or more of the non-operating parties.

#### 2. Statements and Billings

Operator shall bill Non-Operator on or before the last day of each month for its proportionate share of costs and expenditures during the preceding month. Such bills will be accompanied by statements, reflecting the total costs and charges as set forth under Sub-Paragraph A below:

A. Statement in detail of all charges and credits to the joint account.

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

C. Statements, as follows:

(1) Detailed statement of material ordinarily considered controllable by Operators of oil and gas properties;

(2) Statement of all other charges and credits to the joint account summarized by appropriate classifications indicative of the nature thereof; and

(3) Statement of any other receipts and credits.

#### 3. Payments by Non-Operator

Each party shall pay its proportion of all such bills within fifteen (15) days after receipt thereof. If payment is not made within such time, the unpaid balance shall bear interest at the rate of six per cent (6%) per annum until paid.

#### 4. Audits

Payment of any such bills shall not prejudice the right of Non-Operator to protest or question the correctness thereof. All statements rendered to Non-Operator by Operator during any calendar year shall be conclusively presumed to be true and correct after eighteen months following the close of any such calendar year, unless within said eighteen months period Non-Operator takes written exception thereto and makes claim on Operator for adjustment. Failure on the part of Non-Operator to make claim on Operator for adjustment within such period shall establish the correctness thereof and preclude the filing of exceptions thereto or the making of claims for adjustment thereon. A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the accounting hereunder, within eighteen months next following the close of any calendar year. Non-Operator shall have six months next following the examination of the Operator's records within which to take written exception to and make any and all claims on Operator. The provisions of this paragraph shall not prevent adjustments resulting from the physical inventory of property as provided for in Section VI, Inventories, hereof.

### II. DEVELOPMENT AND OPERATING CHARGES

Subject to limitations hereinafter prescribed, Operator shall charge the joint account with the following items:

#### 1. Rentals and Royalties

Delay or other rentals, when such rentals are paid by Operator for the joint account; royalties, when not paid direct to royalty owners by the purchaser of the oil, gas, casinghead gas, or other products.

#### 2. Labor, Transportation, and Services

Labor, transportation, and other services necessary for the development, maintenance, and operation of the joint property. Labor shall include (A) Operator's cost of vacation, sickness and disability benefits of employees, and expenditures or contributions imposed or assessed by governmental authority applicable to such labor, and (B) Operator's current cost of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of like nature, applicable to Operator's field payroll; provided that the charges under Part (B) of this paragraph shall not exceed five per cent (5%) of the total of such labor charged to the joint account.

#### 3. Material

Material, equipment, and supplies purchased or furnished by Operator, for use of the joint property. So far as it is reasonably practical and consistent with efficient and economical operation, only such material shall be purchased for or transferred to the joint property as required for immediate use, and the accumulation of surplus stocks shall be avoided.

#### 4. Moving Material to Joint Property

Moving material to the joint property from Vendor's or from Operator's warehouse in the district or from the other properties of Operator, but in either of the last two events no charge shall be made to the joint account for a distance greater than the distance from the nearest reliable supply store or railway receiving point where such material is available, except by special agreement with Non-Operator.

**5. Moving Surplus Material from Joint Property**

Moving surplus material from the joint property to outside vendees, if sold f.o.b. destination, or minor returns to Operator's warehouse or other storage point. No charge shall be made to the joint account for moving major surplus material to Operator's warehouse or other storage point for a distance greater than the distance to the nearest reliable supply store or railway receiving point, except by special agreement with Non-Operator; and no charge shall be made to the joint account for moving material to other properties belonging to Operator, except by special agreement with Non-Operator.

**6. Use of Operator's Equipment and Facilities**

Use of and service by Operator's exclusively owned equipment and facilities as provided in Paragraph 4, of Section III, "Basis of Charges to Joint Account."

**7. Damages and Losses**

Damages or losses incurred by fire, flood, storm, or any other cause not controllable by Operator through the exercise of reasonable diligence. Operator shall furnish Non-Operator written notice of damage or losses incurred by fire, storm, flood, or other natural or accidental causes as soon as practicable after report of the same has been received by Operator.

**8. Litigation, Judgments, and Claims**

All costs and expenses of litigation, or legal services otherwise necessary or expedient for the protection of the joint interests, including attorney's fees and expenses as hereinafter provided, together with all judgments obtained against the joint account or the subject matter of this agreement; actual expenses incurred by any party or parties hereto in securing evidence for the purpose of defending against any action or claim prosecuted or urged against the joint account or the subject matter of this agreement.

A. If a majority of the interests hereunder shall so agree, actions or claims affecting the joint interests hereunder may be handled by the legal staff of one or more of the parties hereto, and a charge commensurate with the services rendered may be made against the joint account, but no such charge shall be made until approved by the legal department of or attorneys for the respective parties hereto.

B. Fees and expenses of outside attorneys shall not be charged to the joint account unless authorized by the majority of the interests hereunder.

**9. Taxes**

All taxes of every kind and nature assessed upon or in connection with the properties which are the subject of this agreement, the production therefrom or the operation thereof, and which taxes have been paid by the Operator for the benefit of the parties hereto.

**10. Insurance**

A. Premiums paid for insurance carried for the benefit of the joint account, together with all expenditures incurred and paid in settlement of any and all losses, claims, damages, judgments, and other expenses, including legal services, not recovered from insurance carrier.

B. If no insurance is required to be carried, all actual expenditures incurred and paid by Operator in settlement of any and all losses, claims, damages, judgments, and any other expenses, including legal services, shall be charged to the joint account.

**11. District and Camp Expense**

A proportionate share of the salaries and expenses of Operator's District Superintendent and other general district or field employees serving the joint property, whose time is not allocated direct to the joint property, and a proportionate share of maintaining and operating a district office and all necessary camps, including housing facilities for employees if necessary, in conducting the operations on the joint property and other leases owned and operated by Operator in the same locality. The expense of, less any revenue from, these facilities shall include depreciation or a fair monthly rental in lieu of depreciation on the investment. Such charges shall be apportioned to all leases served on some equitable basis consistent with Operator's accounting practice.

**12. Overhead**

Overhead charges, which shall be in lieu of any charges for any part of the compensation or salaries paid to managing officers and employees of Operator, including the division superintendent, the entire staff and expenses of the division office located at Farmington, New Mexico, and any portion of the office expense of the principal business office located at Midland, Texas, but which are not in lieu of district or field office expenses incurred in operating any such properties, or any other expenses of Operator incurred in the development and operation of said properties; and Operator shall have the right to assess against the joint property covered hereby the following overhead charges:

A. \$ 250.00 per month for each drilling well, beginning on the date the well is spudded and terminating when it is on production or is plugged, as the case may be, except that no charge shall be made during the suspension of drilling operations for fifteen (15) or more consecutive days.

B. \$ 45.00 per well per month for the first five (5) producing wells.

~~Good for the first five (5) producing wells only. No charge for the remaining producing wells.~~

~~Good for the first five (5) producing wells only. No charge for the remaining producing wells.~~

E. In connection with overhead charges, the status of wells shall be as follows:

(1) In-pit or key wells shall be included in overhead schedule the same as producing oil wells.

(2) Producing gas wells shall be included in overhead schedule the same as producing oil wells.

(3) Wells permanently shut down but on which plugging operations are deferred, shall be dropped from overhead schedule at the time the shutdown is effected. When such wells are plugged, overhead shall be charged at the producing well rate during the time required for the plugging operation.

(4) Wells being plugged back or drilled deeper shall be included in overhead schedule the same as drilling wells.

(5) Various wells may be shut down temporarily and later replaced on production. If and when a well is shut down (other than for proration) and not produced or worked upon for a period of a full calendar month, it shall not be included in the overhead schedule for such month.

(6) Salt water disposal wells shall not be included in overhead schedule.

- F. The above overhead schedule on producing wells shall be applied to individual leases; provided that, whenever leases covered by this agreement are operated as a unitized project in the interest of economic development, the schedule shall be applied to the total number of wells, irrespective of individual leases.
- G. The above specific overhead rates may be amended from time to time by agreement between Operator and Non-Operator if, in practice, they are found to be insufficient or excessive.

**13. Warehouse Handling Charges**

NONE

**14. Other Expenditures**

Any other expenditure incurred by Operator for the necessary and proper development, maintenance, and operation of the joint property.

**III. BASIS OF CHARGES TO JOINT ACCOUNT**

**1. Purchases**

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

**2. Material Furnished by Operator**

Material required for operations shall be purchased for direct charge to joint account whenever practicable, except that Operator may furnish such material from Operator's stocks under the following conditions:

**A. New Material (Condition "A")**

- (1) New material transferred from Operator's warehouse or other properties shall be priced f. o. b. the nearest reputable supply store or railway receiving point, where such material is available, at current replacement cost of the same kind of material. This will include material such as tanks, rigs, pumps, sucker rods, boilers, and engines. Tubular goods (2" and over), shall be priced on carload basis effective at date of transfer and f. o. b. railway receiving point nearest the joint account operation, regardless of quantity transferred.
- (2) Other material shall be priced on basis of a reputable supply company's Preferential Price List effective at date of transfer and f. o. b. the store or railway receiving point nearest the joint account operation where such material is available.
- (3) Cash discount shall not be allowed.

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

- (1) Material which is in sound and serviceable condition and is suitable for reuse without reconditioning shall be classed as Condition "B" and priced at 75% of new price.
- (2) Material which cannot be classified as Condition "B" but which,
  - (a) After reconditioning will be further serviceable for original function as good second hand material (Condition "B"), or
  - (b) Is serviceable for original function but substantially not suitable for reconditioning, shall be classed as Condition "C" and priced at 50% of new price.
- (3) Material which cannot be classified as Condition "B" or Condition "C" shall be priced at a value commensurate with its use.
- (4) Tanks, derricks, buildings, and other equipment involving erection costs shall be charged at applicable percentage of knocked-down new price.

**3. Warranty of Material Furnished by Operator**

Operator does not warrant the material furnished beyond or back of the dealer's or manufacturer's guaranty; and, in case of defective material, credit shall not be passed until adjustment has been received by Operator from the manufacturers or their agents.

**4. Operator's Exclusively Owned Facilities**

The following rates shall apply to service rendered to the joint account by facilities owned exclusively by Operator:

- A. Water service, fuel gas, power, and compressor service: At rates commensurate with cost of providing and furnishing such service to the joint account but not exceeding rates currently prevailing in the field where the joint property is located.
- B. Automotive Equipment: Rates commensurate with cost of ownership and operation. Such rates should generally be in line with schedule of rates adopted by the Petroleum Motor Transport Association, or some other recognized organization, as recommended uniform charges against joint account operations and revised from time to time. Automotive rates shall include cost of oil, gas, repairs, insurance, and other operating expense and depreciation; and charges shall be based on use in actual service on, or in connection with, the joint account operations. Truck, tractor, and pulling unit rates shall include wages and expenses of driver.
- C. A fair rate shall be charged for the use of drilling and cleaning-out tools and any other items of Operator's fully owned machinery or equipment which shall be ample to cover maintenance, repairs, depreciation, and the service furnished the joint property; provided that such charges shall not exceed those currently prevailing in the field where the joint property is located.
- D. Whenever requested, Operator shall inform Non-Operator in advance of the rates it proposes to charge.
- E. Rates shall be revised and adjusted from time to time when found to be either excessive or insufficient.

**IV. DISPOSAL OF LEASE EQUIPMENT AND MATERIAL**

The Operator shall be under no obligation to purchase interest of Non-Operator in surplus new or secondhand material. Derricks, tanks, buildings, and other major items shall not be removed by Operator from the joint property without the approval of Non-Operator. Operator shall not sell major items of material to an outside party without giving Non-Operator an opportunity either to purchase same at the price offered or to take Non-Operator's share in kind.

1. **Material Purchased by Operator**

Material purchased by Operator shall be credited to the joint account and included in the monthly statement of operations for the month in which the material is removed from the joint property.

2. **Material Purchased by Non-Operator**

Material purchased by Non-Operator shall be invoiced by Operator and paid for by Non-Operator to Operator immediately following receipt of invoice. The Operator shall pass credit to the joint account and include the same in the monthly statement of operations.

3. **Division in Kind**

Division of material in kind, if made between Operator and Non-Operator, shall be in proportion to their respective interests in such material. Each party will thereupon be charged individually with the value of the material received or receivable by each party and corresponding credits will be made by the Operator to the joint account, and such credits shall appear in the monthly statement of operations.

4. **Sales to Outsiders**

Sales to outsiders of material from the joint property shall be credited by Operator to the joint account at the net amount collected by Operator from Vendee. Any claims by Vendee for defective material or otherwise shall be charged back to the joint account, if and when paid by Operator.

**V. BASIS OF PRICING MATERIAL TRANSFERRED FROM JOINT ACCOUNT**

Material purchased by either Operator or Non-Operator or divided in kind, unless otherwise agreed, shall be valued on the following basis:

1. **New Price Defined**

New price as used in the following paragraphs shall have the same meaning and application as that used above in Section III, "Basis of Charges to Joint Account."

2. **New Material**

New material (Condition "A"), being new material procured for the joint account but never used thereon, at 100% of current new price.

3. **Good Used Material**

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

A. At 75% of current new price if material was charged to joint account as new, or

B. At 75% of current new price less depreciation consistent with their usage on and service to the joint property, if material was originally charged to the joint property as secondhand at 75% of new price.

4. **Other Used Material**

Used Material (Condition "C"), being used material which

A. After reconditioning will be further serviceable for original function as good secondhand material (Condition "B"), or

B. Is serviceable for original function but substantially not suitable for reconditioning, at 50% of current new price.

5. **Bad-Order Material**

Used material (Condition "D"), being material which cannot be classified as Condition "B" or Condition "C", shall be priced at a value commensurate with its use.

6. **Junk**

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

7. **Temporarily Used Material**

When the use of material is of a temporary nature and its service to the joint account does not justify the reduction in price as provided in Paragraph 3B, above, such material shall be priced on a basis that will leave a net charge to the joint account consistent with the value of the service rendered.

**VI. INVENTORIES**

1. **Periodic Inventories**

Periodic inventories shall be taken by Operator of the joint account material, which shall include all such material as is ordinarily considered controllable by operators of oil and gas properties.

2. **Notice**

Notice of intention to take inventory shall be given by Operator at least ten days before any inventory is to begin, so that Non-Operator may be represented when any inventory is taken.

3. **Failure to be Represented**

Failure of Non-Operator to be represented at the physical inventory shall bind Non-Operator to accept the inventory taken by Operator, who shall in that event furnish Non-Operator with a copy thereof.

4. **Reconciliation of Inventory**

Reconciliation of inventory with charges to the joint account shall be made by each party at interest, and a list of overages and shortages shall be jointly determined by Operator and Non-Operator.

5. **Adjustment of Inventory**

Inventory adjustments shall be made by Operator with the joint account for overages and shortages, but Operator shall only be held accountable to Non-Operator for shortages due to lack of reasonable diligence.

6. **Special Inventories**

Special inventories may be taken, at the expense of the purchaser, whenever there is any sale or change of interest in the joint property, and it shall be the duty of the party selling to notify all other parties hereto as quickly as possible after the transfer of interest takes place. In such cases both the seller and the purchaser shall be represented and shall be governed by the inventory so taken.