



EXHIBIT "B"

Proposed Water Flood System

Caprock Field

Lea County, New Mexico

Scale - None

ITEM NO:

- (1) Water Supply Well No. 1 (Equipped with 22½ H.P. Reda Pump)
- (2) Water Supply Well No. 2 (Equipped with presently installed Beam Unit)
- (3) (8' X 5') National Pressure Filter
- (4) Centrifugal Backwash Pump (750 gpm at 50' Head)
- (5) Backwash Pit
- (6) 5,000 bbl Storage Tank (Presently Installed)
- (7) F & M Fig 6182 (4" x 6") Duplex Pump (Presently Installed)
- (8) Oilwell 36-P Triplex Pump with 75 H.P. Motor

## EXHIBIT "C"

### ACCOUNTING PROCEDURE

Attached to and made a part of Agreement between Gulf, Great Western, and Graridge - Caprock Field Waterflood

#### 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 project for the joint account.

The term "Nonoperator" as herein used shall be construed to mean any one or more of the nonoperating parties.

##### 2. Statements and Billings

Operator shall bill Nonoperator 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 Nonoperator

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 Nonoperator to protest or question the correctness thereof. All statements rendered to Nonoperator 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 Nonoperator takes written exception thereto and makes claim on Operator for adjustment. Failure on the part of Nonoperator 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 Nonoperator, upon notice in writing to Operator and all other Nonoperators, 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. Nonoperator 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. 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 employee's 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.

### 2. 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.

### 3. 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 Nonoperator.

### 4. 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 Nonoperator; and no charge shall be made to the joint account for moving material to other properties belonging to Operator, except by special agreement with Nonoperator.

### 5. 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."

### 6. 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 Nonoperator 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.

#### 7. 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.

#### 8. Taxes

The Operator shall render for and shall pay for the benefit of the parties hereto all taxes of every kind and nature assessed upon or in connection with the project and shall charge the same to the joint account.

#### 9. 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.

#### 10. 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 district superintendent, the entire staff and expenses of the district office located at the Caprock Field Camp, and any portion of the office expenses of the principal business office located at Breckenridge and Graham, Texas, but which are not in lieu of any other expenses of Operator incurred in the development and operation of said properties; and Operator shall have the right to assess against the project covered hereby the following overhead charges:

A. Operation of the Plant shall be \$100.00 per month.

B. The above specific overhead rate may be amended from time to time by agreement between Operator and Nonoperator if, in practice, they are found to be insufficient or excessive.

11. Warehouse Handling Charges

None

12. 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 as 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 Nonoperator 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 Nonoperator 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 Nonoperator. Operator shall not sell major items of material to an outside party without giving Nonoperator an opportunity either to purchase same at the price offered or to take Nonoperator'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 Nonoperator

Material Purchased by Nonoperator shall be invoiced by Operator and paid for by Nonoperator 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 Nonoperator 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 Nonoperator may be represented when any inventory is taken.

3. Failure to be Represented

Failure of Nonoperator to be represented at the physical inventory shall bind Nonoperator to accept the inventory taken by Operator, who shall in that event furnish Nonoperator 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 Nonoperator.

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 Nonoperator 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.