

GRAIN QUEEN UNIT

UNIT AGREEMENT  
UNIT OPERATING AGREEMENT

BEFORE EXAMINER UTZ	
OIL CONSERVATION COMMISSION	
<u>Appl.</u>	EXHIBIT NO. <u>1</u>
CASE NO.	<u>2293</u>

UNIT AGREEMENT  
GRAIN QUEEN UNIT  
LEA COUNTY, NEW MEXICO

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Exhibit "A" (Map of Unit Area)

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UNIT AGREEMENT  
FOR THE DEVELOPMENT AND OPERATION OF THE  
GRAIN QUEEN UNIT  
LEA COUNTY, NEW MEXICO

THIS AGREEMENT, entered into as of the 1st day of June, 1961, by and between the parties subscribing, ratifying or consenting hereto, and herein referred to as "parties hereto",

WITNESSETH: That,

WHEREAS, the parties hereto are the owners of working, royalty or other oil or gas interests in the Unit subject to this Agreement; and

WHEREAS, the Commissioner of Public Lands of the State of New Mexico is authorized by an Act of the Legislature (Sec. 3, Chap. 88, Laws of 1943 as amended by Sec. 1 of Chap. 162, Laws of 1951, Chap. 7, Art. 11, Sec. 39, N.M.S. 1953 anno) to consent to or approve this Agreement on behalf of the State of New Mexico, insofar as it covers and includes lands and mineral interests of the State of New Mexico; and

WHEREAS, the Commissioner of Public Lands of the State of New Mexico is authorized by an Act of the Legislature (Sec. 3, Chap. 88, Laws of 1943, as amended by Sec. 1, Chap. 162, Laws of 1951, Chap. 7, Art. 11, Sec. 41, N.M.S. 1953 anno) to amend with the approval of the lessee, any oil and gas lease embracing State lands so that the length of the term of said lease may coincide with the term of such unitized development and operation of State lands; and

WHEREAS, the Oil Conservation Commission of the State of New Mexico is authorized by law (Chap. 72, Laws of 1935, as amended by Chap. 193, Laws of 1937, Chap. 166, Laws of 1941, and Chap. 168, Laws of 1949) to approve this Agreement, and the conservation provisions hereof; and

WHEREAS, the parties hereto hold sufficient interests in the Grain Queen Unit covering the land hereinafter described to give reasonably effective control of operation therein; and

WHEREAS, it is the purpose of the parties hereto, to enable institution and consummation of secondary recovery operations, conserve natural

resources, prevent waste and secure the other benefits obtainable through development and operation of the area subject to this Agreement under the terms, conditions and limitations herein set forth.

NOW, THEREFORE, in consideration of the premises and the promises herein contained, the parties hereto commit to this Agreement their entire respective interests in the below defined Unit Area, and agree severally among themselves as follows:

SECTION 1. DEFINITIONS: For the purpose of this Agreement, the following terms and expressions as used herein shall mean:

(a) "Unit Area" is defined as those lands specified on Exhibit "A" hereof, and such land is hereby designated and recognized as constituting the Unit Area; the lands described in said Exhibit "A" are described as:

NEW MEXICO PRINCIPAL MERIDIAN, NEW MEXICO

LEA COUNTY, NEW MEXICO

Township 13-South, Range 32-East,

Section 5: SE/4 NW/4, NE/4 SW/4, S/2 SW/4  
Section 8: NE/4 NW/4

and containing 200 acres, more or less.

(b) "Commissioner" is defined as the Commissioner of Public Lands of the State of New Mexico.

(c) "Commission" is defined as the Oil Conservation Commission of the State of New Mexico.

(d) "Queen Sand" or "Formation" is defined as and shall mean that heretofore established underground reservoir, a member of the Queen Formation of the Guadalupe Series, a part of the Permian System, which is found at 3050 to 3061 feet, in the Great Western Drilling Company, State of New Mexico, "S" No. 2 Well, located in the SW $\frac{1}{4}$  of the SW $\frac{1}{4}$  of Section 5, Township 13 South, Range 32 East, N.M.P.M., insofar as the same lies within the Unit Area.

(e) "Unitized Formation" is defined as that portion of the Queen Sand committed to this Agreement.

(f) "Unitized Substances" is defined as and shall mean all of the oil and gas contained in or produced from the Unitized Formation.

(g) "Unitized Land" or "Land Subject to this Agreement" is defined as and shall mean all of the hereinabove described and subsequently admitted land committed to this Agreement.

(h) "Recoverable Oil" is defined as that amount of Unitized Substances which may be produced from a given area by natural means or with the assistance of forces created by the injection of outside fluids or other substances into the Formation.

(i) "Working Interest" is defined as the right to search for, produce and acquire Unitized Substances whether held as an incident of ownership or mineral fee simple title, under an oil and gas lease, or otherwise held.

(j) "Working Interest Owner" is defined as and shall mean any party hereto owning a Working Interest, including a carried Working Interest owner, holding an interest in Unitized Substances by virtue of a lease, operating agreement, fee title or otherwise, which interest is chargeable with and obligated to pay or bear, either in cash or out of production, or otherwise, all or a portion of the cost of drilling, developing and producing the Unitized Substance from the Unitized Formation and operating thereof hereunder.

(k) "Royalty Interest" or "Royalty" is defined as an interest other than a Working Interest in or right to receive a portion of the Unitized Substances or the proceeds thereof and includes the royalty interest reserved by the lessor by an oil and gas lease and any overriding royalty interest, oil payment interest, net profit contracts, or any other payment or burden which does not carry with it the right to search for and produce Unitized Substances.

(l) "Royalty Owner" is defined as and shall mean the owner of a Royalty Interest.

(m) "Unit Operating Agreement" is defined as and shall mean any agreement or agreements (whether one or more) entered into (separately or collectively) by and between the Unit Operator and the Working Interest Owners as provided in Section 9 (Accounting Provisions and Unit Operating Agreement), infra, and shall be styled "Unit Operating Agreement, Grain Queen Unit, Lea County, New Mexico".

(n) "Paying Quantities" is defined as production of Unitized Substances in quantities sufficient to pay for the cost of producing same from wells on the Unitized Land.

(o) "Unit Manager" is defined as the person or corporation appointed by the Working Interest Owners to perform the duties of the Unit Operator until the selection and qualification of a successor Unit Operator as provided for in Section 8 (Successor Unit Operator) hereof.

SECTION 2. EXHIBITS: Exhibit "A" attached hereto is a map showing, to the extent known to the Unit Operator, the Unit Area and the boundaries and identity of tracts and leases in said Unit Area. Exhibit "B" attached hereto is a schedule showing, to the extent known to the Unit Operator, the acreage comprising each tract, percentage ownership of each Working Interest Owner in each tract, and the percentage of participation each tract has in the Unit Area. However, nothing herein or in said schedule or map shall be construed as a representation by any party hereto as to the ownership of any interest other than such interest or interests as are shown in said map or schedule as owned by such party. Exhibits "A" and "B" shall be revised by the Unit Operator whenever changes render such revision necessary, and at least two (2) copies of such revision shall be filed with the Commissioner.

SECTION 3. EXPANSION: The Unit Area may when practicable be expanded to include therein any additional tract or tracts regarded as

reasonably necessary or advisable for the purposes of this Agreement to conform with the purposes of this Agreement. Such expansion shall be effected in the following manner:

(a) The Working Interest Owner or owners of a tract or tracts desiring to bring such tract or tracts into this Unit, shall file an application therefor with Unit Operator requesting such admission.

(b) Unit Operator shall circulate a notice to each Working Interest Owner of the proposed expansion, setting out the basis for admission, the Unit participation to be assigned to such tract or tracts, and other pertinent data. After negotiation (at Working Interest Owners' meeting or otherwise) if 80 percent of the Working Interest Owners (on the basis of Unit participation) have agreed to such tract or tracts being brought into the Unit, then Unit Operator shall:

(1) Prepare a notice of proposed expansion describing the contemplated changes in the boundaries of the Unit Area, the reason therefor, the basis for admission of the additional tract or tracts, the unit participation to be assigned thereto and the proposed effective date thereof, preferably the first day of a month subsequent to the date of notice; and

(2) Deliver copies of said notice to the Commissioner, the Commission, and each Working Interest Owner (mailing copy of such notice to the last known address of each such Working Interest Owner) and to the lessee and lessor whose interests are proposed to be committed, advising such parties that thirty (30) days will be allowed for submission to the Unit Operator of any objection to such proposed expansion; and

(3) File, upon the expiration of said thirty (30) day period as set out in (2) immediately above and provided that objections of not more than ten (10%) percent of the Working Interest Owners have been filed thereto, with the Commissioner and the Commission the following: (a) Comprehensive statement as to mailing said notice of expansion; (b) An application for such expansion; and (c) An instrument containing the appropriate joinders in compliance with the participation requirements of Section 13 (Tracts Qualified for Unit Participation), *infra*.

The expansion shall, after due consideration of all pertinent information and upon approval by the Commissioner and the Commission, become effective as of the date prescribed in the notice thereof or on such other date as may be agreed and set by the Commissioner and the Commission in the order or instrument approving such expansion.

SECTION 4. CONTRACTION: When practicable, the Unit Area shall be contracted to exclude Unitized Land not within any participating area or to exclude land not committed to this Agreement whenever such contraction is necessary or advisable to conform with the purposes of this Agreement. Such contraction should be effected in the following manner:

(a) Unit Operator, on demand of the Commissioner, or on its own motion after preliminary concurrence by the Commissioner, shall prepare a notice of contraction describing the contemplated changes in the boundaries of the Unit Area, the reasons therefor, and the proposed effective date thereof, preferably the first day of a month subsequent to the

date of notice.

(b) Said notice shall be delivered to the Commission and to the Commissioner, and copies thereof mailed to the last known address of each Working Interest Owner, lessee, and Royalty Owner whose interests are affected, advising that thirty (30) days will be allowed for submission to the Unit Operator of any objections.

(c) Upon expiration of the 30-day period provided in the preceding item (b) hereof, Unit Operator shall file with the Commission and the Commissioner, a comprehensive statement as to mailing of the notice of contraction and a copy of any objections thereto which have been filed with the Unit Operator, together with an application in sufficient number, for approval of such contraction.

(d) After due consideration of all pertinent information, the contraction, upon approval by the Commissioner and the Commission, shall become effective as of the date prescribed in the notice thereof.

SECTION 5. UNITIZED LAND AND UNITIZED SUBSTANCES: All oil and gas in Unitized Land, insofar only as the same may be found in the Queen Sand, together with the surface rights of ingress and egress, are unitized under the terms of this Agreement.

Nothing herein shall be construed to unitize, pool, or in any way affect the oil, gas and other minerals contained in or that may be produced from any formation other than the Queen Sand.

SECTION 6. UNIT OPERATOR: Great Western Drilling Company, a Texas corporation, is hereby designated as Unit Operator, and by signing this Agreement as Unit Operator it agrees and consents to accept the duties and obligations of Unit Operator for the operation, development and production of Unitized Substances as herein provided. Whenever reference is made herein to the Unit Operator, such reference means the Unit Operator acting in that capacity and not as an owner of interests in Unitized Substances, and the term "Working Interest Owner" when used herein shall include or refer to Unit Operator as the owner of a Working Interest when such an interest is owned by it.

SECTION 7. RESIGNATION OR REMOVAL OF UNIT OPERATOR: Unit Operator shall have the right to resign at any time, but such resignation shall not become effective so as to release Unit Operator from the duties and obligations of Unit Operator and terminate Unit Operator's rights as such for a period of six (6) months after written notice of intention to resign has been given by Unit Operator to all Working Interest Owners, the Commis-

sioner and the Commission, unless a new Unit Operator shall have taken over and assumed the duties and obligations of Unit Operator prior to the expiration of said period.

The resignation of Unit Operator shall not release Unit Operator from any liability for any default by it hereunder occurring prior to the effective date of its resignation.

The Unit Operator may, upon default or failure in the performance of its duties or obligations hereunder, be subject to removal by 75 percent of the Working Interest Owners (on the basis of Unit participation) exclusive of the Working Interest Owner who is the Unit Operator. Such removal shall be effective upon the date specified in a notice thereof to the Commissioner and the Commission.

In all such instances of effective resignation or removal, until a successor to Unit Operator is selected and approved as hereinafter provided, the Working Interest Owners shall be jointly responsible for the performance of the duties of the Unit Operator and shall, not later than thirty (30) days before such resignation or removal becomes effective, appoint a Unit Manager to represent them in any action to be taken hereunder, and notice of such appointment shall be immediately given the Commissioner and the Commission.

The resignation or removal of Unit Operator under this Agreement shall not terminate its right, title or interest as the owner of a Working Interest or other interest in Unitized Substances, but upon the resignation or removal of Unit Operator becoming effective, such Unit Operator shall deliver possession of all equipment, books, and records, materials, appurtenances and any other assets, used in conducting the Unit operations and owned by the Working Interest Owners (including any and all data and information which it might have gained or assembled by reason of its operation of the Unitized Lands) to the new duly qualified successor Unit Operator, or to the Unit Manager if no such new Unit Operator is elected, to be used for the purpose of conducting Unit operations hereunder. Nothing herein shall be construed as authorizing removal of any material, equipment and appurtenances needed for the preservation of any wells.



Nothing herein contained shall be construed to relieve or discharge any Unit Operator who resigns or is removed hereunder for any liability or duties accruing or performable by it prior to the effective date of such resignation or removal.

SECTION 8. SUCCESSOR UNIT OPERATOR: Whenever the Unit Operator shall tender its resignation as Unit Operator or shall be removed as hereinabove provided, the Working Interest Owners shall select a successor Unit Operator by a majority vote of the Working Interest Owners (on the basis of Unit participation), provided no Working Interest Owner who has been Unit Operator and who has been removed may vote for self succession. Such selection shall not become effective until (i) a Unit Operator so selected shall accept in writing the duties and responsibilities of Unit Operator, and (ii) the selection shall have been approved by the Commissioner. If no successor Unit Operator or Unit Manager is selected and qualified as herein provided, the Commissioner, at his election, may declare this Agreement terminated.

SECTION 9. ACCOUNTING PROVISIONS AND UNIT OPERATING AGREEMENT: Costs and expenses incurred by Unit Operator in conducting Unit operations hereunder shall be paid, apportioned among and borne by the Working Interest Owners in accordance with the Unit Operating Agreement. Such Unit Operating Agreement shall also provide the manner in which the Working Interest Owners shall be entitled to receive their respective proportionate and allocated share of the benefits accruing hereto in conformity with their underlying operating agreements, leases or other independent contracts and such other rights and obligations as between Unit Operator and the Working Interest Owners as may be agreed upon by the Unit Operator and the Working Interest Owners; however, no such Unit Operating Agreement shall be deemed either to modify any of the terms and conditions of this Unit Agreement or to relieve the Unit Operator of any right or obligation established under this Agreement, and in case of any inconsistency or conflict between this Agreement and the Unit Operating Agreement, this Agreement shall prevail. Two true copies of any Unit Operating Agreement executed pursuant to this Section shall be filed with the Commissioner prior to his approval of this Agreement.

SECTION 10. RIGHTS AND OBLIGATIONS OF UNIT OPERATOR: Except as otherwise specifically provided herein, the exclusive right, privilege and duty of exercising any and all rights of the parties hereto which are necessary or convenient for prospecting for, producing, storing, allocating and distributing the Unitized Substances are hereby delegated to and shall be exercised by the Unit Operator as herein provided. Acceptable evidence of title to said rights shall be deposited with said Unit Operator, and together with this Agreement, shall constitute and define the rights, privileges and obligations of Unit Operator. Nothing herein, however, shall be construed to transfer title to any land or to any lease or operating agreement, it being understood that Unit Operator shall exercise the rights of possession and use vested in the parties hereto only for the purposes herein specified.

SECTION 11. PLAN OF OPERATIONS: It is recognized and agreed by the parties hereto that all of the land subject to this Agreement is reasonably proved to be productive of Unitized Substances in paying quantities and that the object and purpose of this Agreement is to formulate and to put into effect a secondary recovery project in order to effect the greatest recovery of Unitized Substances, prevent waste and conserve natural resources. The parties hereto agree that Unit Operator may, subject to the consent and approval of a plan of operation by the Working Interest Owners and the Commissioner, inject into the Unitized Formation, through any well or wells completed therein, brine, water, air, gas, oil and any one or more other substances whether produced from the Unit Area or not, and that the location of input wells and the rates of injection therein and the rate of production shall be governed by standards of good geologic and petroleum engineering practices and conservation methods. After commencement of secondary recovery operations, Unit Operator shall furnish the Commissioner, monthly, injection and production reports for each well in the Unit. The Working Interest Owners and the Commissioner shall be furnished periodical reports on the progress of the plan of operation and any revisions or changes thereto; provided, however, that any major revisions of the plan of operation involving a basic deviation from the

initial plan of operation shall be subject to the consent and approval of the Working Interest Owners and the Commissioner.

The initial plan of operation shall be filed with the Commissioner concurrently with the filing of this Agreement for final approval. Said initial plan of operation and all revisions thereof shall be as complete and adequate as the Commissioner may determine to be necessary for timely operation consistent herewith. Reasonable diligence shall be exercised in complying with the obligations of the approved plan of operation.

Notwithstanding anything to the contrary herein contained, Unit Operator shall commence secondary recovery operations on the Unit Area within six (6) months after the effective date of this Agreement, or any extension thereof approved by the Commissioner, or this Agreement shall terminate automatically, in which latter event Unit Operator shall notify all interested parties. After such operations are commenced, Unit Operator shall carry on such operations as would a reasonably prudent operator under the same or similar circumstances.

SECTION 12. TRACT PARTICIPATION: In Exhibit "B" attached hereto, there are listed and numbered the various tracts within the Unit Area and set forth opposite each tract is a figure which represents the percentage of participation allocated to each tract in the Unit Area calculated on 100 percent commitment. The participation percentage of each tract was determined as follows:

Percentage Participation of Each Tract =

65%  $\frac{\text{Tract Recoverable Oil Minus Tract Accumulated Production}}{\text{Unit Area Recoverable Oil Minus Unit Area Accumulated Production}}$  Plus

25%  $\frac{\text{Total Tract Millidarcy Feet}}{\text{Total Unit Area Millidarcy Feet}}$  Plus 10%  $\frac{\text{Number of Wells in Tract}}{\text{Number of Wells in Unit Area}}$

However, if this Agreement is approved by the Commissioner with less than 100 percent commitment, said participation percentage shall be revised to fit the commitment status as of the effective date hereof, and thereafter as needed pursuant to Section 14 (Allocation of Unitized Substances).

SECTION 13. TRACTS QUALIFIED FOR UNIT PARTICIPATION: On and after the effective date hereof the tracts within the Unit Area which shall be entitled to participation in the production of Unitized Substances there-

from shall be those tracts within the Unit Area, and more particularly described in said Exhibit "B", that are qualified as follows:

(a) Each and all of those tracts as to which Working Interest Owners owning 100% of the Working Interest in said tract and Royalty Owners owning 100% of the Royalty Interest in said tract have subscribed, ratified or consented to this Agreement; and

(b) Each and all of those tracts as to which Working Interest Owners owning not less than 90% of the Working Interest therein and Royalty Owners owning not less than 66-2/3% of the Royalty Interest therein have executed this Agreement, and in which the Working Interest Owners in said tract who have executed this Agreement have agreed to indemnify and hold harmless all other parties hereto, in a manner satisfactory to 85% of the Working Interest Owners qualified under (a), against any and all claims and demands that may be made by the nonjoining Working Interest Owners or Royalty Owners, or both, on account of the commitment and joinder of such tract to the Unit Agreement, and operation thereof under such conditions on the basis herein provided, and as to which 85% of the Working Interest Owners qualified under (a), exclusive of the Working Interest Owner submitting such tract, have approved the commitment of such tract to this Unit Agreement.

If, on the effective date of this Agreement, there is any tract or tracts which have not been committed to or made subject to this Agreement by qualifying as above provided, then such tract or tracts shall not be entitled to participate hereunder. Unit Operator shall, when submitting this Agreement for final approval by the Commissioner, file therewith a schedule of those tracts which have been committed and made subject to this Agreement and are entitled to participate in the production from the Unit Area hereunder. Said schedule shall set forth opposite each such committed tract the lease number or assignment number, the owner of record of the lease, and the percentage participation of such tract which shall be computed according to the participation formula set out in Section 12 (Tract Participation) above. This schedule of participation shall be a part of Exhibit "B" and upon approval thereof by the Commissioner shall become a part of this Agreement and shall govern the allocation of production of Unitized Substances until a new schedule is filed and approved by the Commissioner.

SECTION 14. ALLOCATION OF UNITIZED SUBSTANCES: All Unitized Substances produced and saved (less, save and except any part of such Unitized Substances used in conformity with good operating practices on unitized land for drilling, operating, camp, and other production or development purposes and for pressure maintenance or unavoidable loss) shall be

apportioned among and allocated to the committed tracts within the Unit Area in accordance with the respective tract participation effective hereunder during the respective periods such Unitized Substances were produced, as set forth in the schedule of participation in Exhibit "B". The amount of Unitized Substances so allocated to each tract, and only that amount, (regardless of whether it be more or less than the amount of the actual production of Unitized Substances from the well or wells, if any, on such tract) shall, for all intents, uses and purposes, be deemed to have been produced from such tract.

The Unitized Substances allocated to each tract shall be distributed among, or accounted for to the parties subscribing, ratifying or consenting to this Agreement entitled to share in the production from such tract in the same manner, in the same proportions, and upon the same conditions, as they would have participated and shared in the production from such tracts, or in the proceeds thereof, had this Agreement not been entered into; and with the same legal force and effect.

No tract committed to this Agreement and qualified for participation as above provided shall be subsequently excluded from participation hereunder on account of depletion of Unitized Substances, and nothing herein contained shall be construed as requiring any retroactive adjustment for production obtained prior to the effective date of the joinder of any tract.

If the Working Interest and the Royalty Interest in any tract are divided with respect to separate parcels or portions of such tract and owned severally by different persons, the percentage participation assigned to such tract shall, in the absence of a recordable instrument executed by all owners and furnished to Unit Operator fixing the divisions of ownership, be divided among such parcels or portions in proportion to the number of surface acres in each.

The Unitized Substances allocated to each tract shall be delivered in kind to the respective Working Interest Owners and parties entitled thereto by virtue of the ownership of oil and gas rights therein or by purchase from such owners. Each Working Interest Owner and the parties entitled

thereto shall have the continuing right to receive such production in kind at a common point within the Unit Area and to sell or dispose of the same as it sees fit. Each such party shall have the right to construct, maintain and operate all necessary facilities for that purpose on Unitized Land, provided the same are so constructed, maintained and operated as not to interfere with operations carried on pursuant hereto. Subject to Section 16 (Royalty Settlement) hereof, any extra expenditure incurred by Unit Operator by reason of the delivery in kind of any portion of the Unitized Substances, shall be borne by the party receiving the same in kind. In the event any party hereto shall fail to take or otherwise adequately dispose of its proportionate share of the production from the Unitized Lands currently as and when produced, then so long as such conditions continue, Unit Operator, for the account and at the expense of such party and in order to avoid curtailing the operation of the Unit Area, may sell or otherwise dispose of such production to itself or others on a day-to-day basis at not less than the prevailing market price in the area for like production, and the account of such party shall be charged therewith as having received such production. The net proceeds, if any, of the Unitized Substances so disposed of by Unit Operator shall be paid to the party entitled thereto.

Any party receiving in kind or separately disposing of all of any part of the Unitized Substances allocated to any tract, or receiving the proceeds therefrom if the same is sold or purchased by Unit Operator, shall be responsible for the payment of all Royalty on the lease or leases and tracts committed to this Agreement, and each such party shall hold each other party hereto harmless against all claims, demands and causes of action for such Royalty on the lease or leases and tracts contributed by it and received into the Unitized Land.

If, after the effective date of this Agreement, there is any tract or tracts that are subsequently committed hereto, as provided in Section 3 (Expansion) hereof, or if there is any tract or tracts that are subsequently excluded herefrom, as provided in Section 4 (Contraction), or any tract or tracts within the Unit Area not committed hereto as of the effective date hereof but which are subsequently committed hereto under the provisions of

Section 30 (Nonjoinder and Subsequent Joinder), or if any tract is ~~excluded~~ from the Unit Area as provided for in Section 29 (Loss of Title), the schedule of participation as shown in Exhibit "B", subject to Section 12 (Tract Participation) or Section 30 (Nonjoinder and Subsequent Joinder), whichever is appropriate, shall be revised by the Unit Operator and distributed to the Working Interest Owners and the Commissioner to show the new percentage participation of all the then committed tracts; and the revised schedule, upon approval by the Commissioner, shall govern all the allocation of production from and after the effective date thereof until a new schedule is filed and approved by the Commissioner.

SECTION 15. USE OR LOSS OF UNITIZED SUBSTANCES: Unit Operator may use as much of the Unitized Substances as it may reasonably deem necessary for the operation and development of the Unit Area, including but not limited to the injection of Unitized Substances into the Formation.

No Royalty shall be payable upon or with respect to Unitized Substances used or consumed in the operation or development of the Unit Area or which may be otherwise lost or consumed in the production, handling, treating, transportation or storing of Unitized Substances.

SECTION 16. ROYALTY SETTLEMENT: The State of New Mexico and all Royalty Owners who, under an existing contract, are entitled to take in kind a share of the substances produced from any tract unitized hereunder, shall continue to be entitled to such right to take in kind their share of the Unitized Substances allocated to such tract, and Unit Operator shall make deliveries of such Royalty share taken in kind in conformity with the applicable contracts, laws and regulations. Settlement for Royalty Interest not taken in kind shall be made by the respective Working Interest Owners responsible therefor under existing contracts, laws and regulations, on or before the last day of each month for Unitized Substances produced during the preceding calendar month; provided, however, that nothing herein contained shall operate to relieve the lessees of any land from their respective lease obligations for the payment of any Royalty due under their leases, except that such Royalty shall be computed in accordance with the terms of this Agreement.

If gas obtained from lands not subject to this Agreement is introduced into the Unitized Formation, for use in repressuring, stimulation of production or increasing ultimate recovery, a like amount of gas, less appropriate deductions for loss from any cause, may be withdrawn from the Unitized Formation, Royalty free as to dry gas but not as to the products extracted therefrom.

All Royalty due the State of New Mexico and the other Royalty Owners hereunder shall be computed and paid on the basis of all Unitized Substances allocated to the respective tract or tracts committed hereto, in lieu of actual production from such tract or tracts.

Each Royalty Owner (other than the State of New Mexico) that executes this Agreement represents and warrants that it is the owner of a Royalty Interest in a tract or tracts within the Unit Area as its interest appears in Exhibit "B" attached hereto. If any Royalty Interest in a tract or tracts should be lost by title failure or otherwise, in whole or in part, during the term of this Agreement, then the Royalty Interest of the party representing himself to be the owner thereof shall be reduced proportionately and the interest of all affected parties shall be adjusted accordingly.

SECTION 17. RENTAL SETTLEMENT: Rentals due on leases committed hereto shall be paid by Working Interest Owners responsible therefor under existing contracts, laws and regulations, provided that nothing herein contained shall operate to relieve the lessees of any land from their respective lease obligations for the payment of any rental due under their leases. Rental for lands of the State of New Mexico subject to this Agreement shall be paid at the rate specified in the respective leases from the State of New Mexico.

SECTION 18. CONSERVATION: Operations hereunder and production of Unitized Substances shall be conducted to provide for the most economical and efficient recovery of said substances without waste, as defined by or pursuant to applicable State law and regulation.

SECTION 19. DRAINAGE: Unit Operator shall take appropriate and adequate measures to prevent drainage of Unitized Substances from Unitized



Land by wells on land not subject to this Agreement.

SECTION 20. LEASES AND CONTRACTS CONFORMED AND EXTENDED: The terms, conditions and provisions of all leases, subleases, operating agreements and other contracts relating to exploration, drilling, development or operation for oil or gas on lands committed to this Agreement are hereby expressly modified and amended to the extent necessary to make the same conform to the provisions hereof, but otherwise to remain in full force and effect, and the parties hereto hereby consent that the Commissioner shall and by his approval hereof does hereby establish, alter, change or revoke the drilling, producing, rental, and royalty requirements of State leases committed hereto and the regulations in respect thereto to conform said requirements to the provisions of this Agreement.

Without limiting the generality of the foregoing, all leases, subleases and contracts are particularly modified in accordance with the following:

(a) The development and operation of lands subject to this Agreement under the terms hereof shall be deemed full performance of all obligations for development and operation with respect to each and every part or separately owned tract subject to this Agreement, regardless of whether there is any development of any particular part of tract of the Unit Area, notwithstanding anything to the contrary in any lease, operating agreement or other contract by and between the parties hereto, or their respective predecessors in interest, or any of them.

(b) Drilling, producing, or secondary recovery operations performed hereunder upon any tract of Unitized Lands shall be accepted and deemed to be performed upon and for the benefit of each and every tract of Unitized Land, and no lease shall be deemed to expire by reason of failure to drill or produce wells situated on land therein embraced.

(c) Suspension of drilling or producing operations on all Unitized Lands pursuant to direction or consent of the Commissioner or his duly authorized representatives, shall be deemed to constitute such suspension pursuant to such direction or consent as to each and every tract of Unitized Lands.

(d) Each lease, sublease, or contract relating to the exploration, drilling, development or operation for oil and gas which by its terms might expire prior to the termination of this Agreement, is hereby extended beyond any such term so provided therein, so that it shall be continued in full force and effect for and during the term of this Agreement.

(e) Termination of this Agreement shall not affect any lease which, pursuant to the terms thereof or any applicable laws, shall continue in force and effect thereafter.

(f) Any lease embracing lands of the State of New Mexico, which is made subject to this Agreement, shall continue in force beyond the term provided therein as to the lands committed hereto until the termination hereof.

(g) Any lease embracing lands of the State of New Mexico having only a portion of its land committed hereto, shall be segregated as to that portion committed and that not committed, and the terms of such lease shall apply separately to such segregated portions commencing as of the effective date hereof. Provided, however, that notwithstanding any of the provisions of this Agreement to the contrary, such lease shall continue in full force and effect beyond the term provided therein as to all lands embraced in such lease if oil or gas is, or has heretofore been, discovered in paying quantities on some part of the lands embraced in such lease committed to this Agreement or, so long as a portion of the Unitized Substances produced from the Unit Area is, under this Agreement, allocated to a portion of the lands covered by such lease committed to this Agreement, or, at any time during the term hereof, as to any lease that is then valid and subsisting and upon which the lessee or the Unit Operator is then engaged in bona fide drilling, reworking, or secondary recovery operations on any part of the lands embraced in such lease, then the same as to all lands embraced therein shall remain in full force and effect so long as such operations are diligently prosecuted, and if they result in the production of oil or gas, said lease shall continue in full force and effect as to all of the lands embraced therein, so long thereafter as oil or gas in paying quantities is being produced from any portion of said lands, or so long as a portion of the Unitized Substances produced from the Unit Area is, under this Agreement, allocated to a portion of the lands covered by such lease committed to this Agreement.

SECTION 21. MATHEMATICAL ERRORS: It is hereby agreed by all parties to this Agreement that Unit Operator, upon approval of the Commissioner, is empowered to correct any mathematical errors which might exist in the pertinent Exhibits to this Agreement.

SECTION 22. COVENANTS RUN WITH LAND: The provisions of this Agreement shall be construed to be covenants running with the land with respect to the interest of the parties hereto and their successors in interest until this Agreement terminates, and any grant, transfer or conveyance of interest in land or leases subject hereto shall be and hereby is conditioned upon the assumption of all privileges and obligations hereunder by the grantee, transferee or other successor in interest. No assignment or transfer of any Working Interest subject hereto shall be binding upon Unit Operator until the first day of the calendar month after Unit Operator is furnished with the original, or acceptable photostatic or certified copy, of the recorded instrument of transfer; and no assignment or transfer of any Royalty Interest subject hereto shall be binding upon the Working Interest Owner responsible therefor until the first day of the calendar month after said Working Interest Owner is furnished with the original, or acceptable photostatic or certified copy, of the recorded instrument of transfer.

SECTION 23. EFFECTIVE DATE AND TERM: This Agreement shall become

binding upon each party who executes or ratifies it as of the date of execution or ratification by such party and shall become effective as of 7:00 o'clock a.m. of the first day of the month next following:

(a) The execution or ratification of this Agreement and the Unit Operating Agreement by Working Interest Owners owning a combined Unit participation of at least 90 percent, and the execution or ratification of this Agreement by Royalty Owners owning a combined interest of at least 66-2/3 percent of the Royalty Interest, in said Unit Area; and

(b) The approval of this Agreement by the Commissioner and the Commission; and

(c) The filing of at least one counterpart of this Agreement for record in the office of the County Clerk, Lea County, New Mexico, by the Unit Operator; provided, that if (a) (b) and (c) above are not accomplished on or before July 31, 1961, this Agreement shall ipso facto terminate on said date (hereinafter called "termination date") and thereafter be of no further force or effect, unless prior thereto this Agreement has been executed or ratified by Working Interest Owners owning a combined Unit participation of at least ninety (90%) percent, and the Working Interest Owners owning a combined Unit participation of at least ninety (90%) percent committed to this Agreement have decided to extend said termination date for a period not to exceed six (6) months (hereinafter called "extended termination date"). If said termination date is so extended, and (a) (b) and (c) are not accomplished on or before said extended termination date, this Agreement shall ipso facto terminate on said extended termination date and thereafter be of no further force or effect. For the purpose of this Section, ownership shall be computed on the basis of Unit participation as determined from Exhibit "C" attached to the Unit Operating Agreement.

(d) Unit Operator shall, within thirty (30) days after the effective date of this Agreement, file for record in the offices where a counterpart of this Agreement is recorded, a certificate to the effect that this Agreement has become effective according to its terms and stating further the effective date.

The term of this Agreement shall be for and during the time that Unitized Substances are produced in paying quantities from the Unit Area and as long thereafter as drilling, reworking or other operations (including secondary recovery operations) are prosecuted thereon without a cessation of more than ninety (90) consecutive days, unless sooner terminated by Working Interest Owners in the manner hereinafter provided.

This Agreement may be terminated with the approval of the Commissioner by Working Interest Owners owning ninety (90%) percent Unit participation whenever such Working Interest Owners determine that Unit operations are no longer profitable, feasible or in the interest of conservation. Notice of any such termination shall be given by Unit Operator to all then parties to this Agreement.

Upon termination of this Agreement, the further development and opera-

tion of the Unit Area as a Unit shall be abandoned, Unit operations shall cease, and thereafter the parties hereto shall be governed by the terms and provisions of the leases and contracts affecting the separate tracts.

If a longer period is not otherwise provided for in the leases unitized under this Agreement, Royalty Owners hereby grant Working Interest Owners a period of six (6) months after termination of this Agreement in which to salvage, sell, distribute or otherwise dispose of the personal property and facilities used in connection with Unit operations.

SECTION 24. RATE OF PROSPECTING, DEVELOPMENT AND PRODUCTION: All production and the disposal thereof shall be in conformity with allocations, allotments, and quotas made or fixed by the Commission and in conformity with all applicable laws and regulations.

SECTION 25. APPEARANCES: Unit Operator shall have the right to appear for or on behalf of any and all interests affected hereby before the Commissioner and the Commission, and to appeal from any order issued under the rules and regulations of the Commissioner and the Commission, and to apply for relief from any of said rules and regulations or in any proceedings relative to operations before the Commissioner or the Commission, or any other legally constituted authority; provided, however, that any other interested party shall also have the right at his or its own expense to be heard in any such proceeding.

SECTION 26. NOTICES: All notices, demands, objections, or statements required hereunder to be given or rendered to the parties hereto shall be deemed fully given if made in writing and personally delivered to the party or parties or sent by postpaid certified mail, addressed to such party or parties at their respective addresses set forth in connection with the signatures hereto, or to the ratification or consent hereof, or to such other address as any such party or parties may have furnished in writing to the party sending the notice, demand or statement.

SECTION 27. NO WAIVER OF CERTAIN RIGHTS: Nothing in this Agreement contained shall be construed as a waiver by any party hereto of the right to assert any legal or constitutional right or defense as to the validity or invalidity of any law of the State of New Mexico, or rules or

regulations issued thereunder in any way affecting such party, or as a waiver by any such party of any right beyond his or its authority to waive.

SECTION 28. UNAVOIDABLE DELAY: All obligations under this Agreement requiring the Unit Operator to commence or continue secondary recovery operations or to operate on or produce Unitized Substances from any of the lands covered by this Agreement shall be suspended while, but only so long as, Unit Operator, despite the exercise of due care and diligence, is prevented from complying with such obligations, in whole or in part, by strikes, acts of God, Federal, State or municipal law or agency, unavoidable accident, uncontrollable delays in transportation, inability to obtain necessary materials in open market, or other matters beyond the reasonable control of the Unit Operator whether similar to matters herein enumerated or not.

SECTION 29. LOSS OF TITLE: In the event title to any tract of Unitized Land shall fail so as to render the tract inoperable under this Agreement and the true owner cannot be induced to join this Agreement, such tract shall be automatically regarded as not committed hereto and there shall be such readjustment of future costs and benefits as may be required on account of the loss of such title. In the event of a dispute as to title as to any Royalty, Working Interest or other interest subject thereto, payment or delivery on account thereof may be withheld without liability or interest until the dispute is finally settled; provided, that no payments of funds due the State of New Mexico shall be withheld, but such funds shall be deposited as directed by the Commissioner, to be held as unearned money pending final settlement of the title dispute, and then applied as earned or returned in accordance with such final settlement.

Unit Operator is relieved from any responsibility for any defect or failure of any title hereunder.

SECTION 30. NONJOINDER AND SUBSEQUENT JOINDER: If the owner of any substantial interest in a tract within the Unit Area fails or refuses to subscribe, ratify, or consent in writing to this Agreement, the Working Interest Owner in that tract who has executed or ratified this Agreement may withdraw said tract from this Agreement by written notice to the Com-

missioner and Unit Operator prior to the effective date of this Agreement. Joinder by any Royalty Owner, at any time, must be accompanied by appropriate joinder of the corresponding Working Interest Owner in order for the interest of such Royalty Owner to be regarded as committed. Joinder to this Agreement by a Working Interest Owner, at any time, must be accompanied by appropriate joinder to the Unit Operating Agreement in order for such interest to be regarded as committed to this Agreement.

Any oil or gas interest in the Queen Sand not committed hereto prior to submission of this Agreement to the Commissioner for final approval may thereafter be committed hereto upon compliance with the applicable provisions of this Section and of Section 13 (Tracts Qualified for Unit Participation) hereof, at any time up to the effective date hereof and for a period to and including six (6) months thereafter, on the same basis of participation as provided in said Section 13, by the owner or owners thereof subscribing, ratifying, or consenting in writing to this Agreement and, if the interest is a Working Interest, by the owner of such interest subscribing also to the Unit Operating Agreement.

It is understood and agreed, however, that from and after six (6) months from the effective date hereof the right of subsequent joinder as provided in this Section shall be subject to such requirements or approvals and on such basis as may be agreed upon by ninety (90%) percent of the Working Interest Owners. Such joinder by a proposed Working Interest Owner must be evidenced by his execution or ratification of this Agreement and the Unit Operating Agreement. Such joinder by a proposed Royalty Owner must be evidenced by his execution, ratification or consent of this Agreement and must be consented to in writing by the Working Interest Owner responsible for the payment of any benefits that may accrue hereunder in behalf of such proposed Royalty Owner. Except as may be otherwise herein provided, subsequent joinder to this Agreement shall be effective at 7:00 a.m. as of the first day of the month following the filing with the Commissioner of duly executed counterparts of any and all documents necessary to establish commitment of any tract or interest to this Agreement, unless objection to such joinder by the Commissioner is duly made within thirty (30) days after such filing.

SECTION 31. COUNTERPARTS: This Agreement may be executed in any number of counterparts, no one of which need be executed by all parties, and may be ratified or consented to by separate instrument in writing specifically referring hereto, and shall be binding upon all those parties who have executed such a counterpart, ratification or consent hereto with the same force and effect as if all parties had signed the same document, and regardless of whether or not it is executed by all other parties owning or claiming an interest in the lands within the Unit Area.

SECTION 32. TAXES: Each party hereto shall, for its own account, render and pay its share of any taxes levied against or measured by the amount or value of the Unitized Substances produced from the Unitized Land; provided, however, that if it is required or if it be determined that the Unit Operator or the several Working Interest Owners must pay or advance said taxes for the account of the parties hereto, it is hereby expressly agreed that the parties so paying or advancing said taxes shall be reimbursed therefor by the parties hereto, including Royalty Owners, who may be responsible for the taxes on their respective allocated share of Unitized Substances. No such taxes shall be charged to the State of New Mexico, nor to any lessor who has a contract with a lessee which requires such lessee to pay such taxes.

SECTION 33. AMENDMENT: This Agreement may be amended from time to time as may be consistent with the object and purpose of this Agreement, as such object and purpose is set forth in Section 11 (Plan of Operations), and any such amendment shall become effective as of 7:00 A.M. of the first day of the month next following:

(a) The execution or ratification of such amendment by Working Interest Owners owning a combined Unit participation of at least ninety-five (95%) percent, and the execution or ratification of such amendment by Royalty Owners owning a combined Unit participation of at least ninety-five (95%) percent; and

(b) The approval of such amendment by the Commissioner and the Commission; and

(c) The filing of at least one counterpart of such amendment for record in the office of the County Clerk of Lea County, New Mexico by Unit Operator.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed and have set opposite their respective names the date of execution.

ATTEST:

GREAT WESTERN DRILLING COMPANY

\_\_\_\_\_  
Assistant Secretary

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

Date: \_\_\_\_\_

UNIT OPERATOR & WORKING INTEREST  
OWNER

ATTEST:

GRARIDGE CORPORATION

\_\_\_\_\_  
Assistant Secretary

By: \_\_\_\_\_  
Vice-President

Date: \_\_\_\_\_

WORKING INTEREST OWNER

\* \* \* \* \*

STATE OF TEXAS            )  
                              (  
COUNTY OF MIDLAND        )

The foregoing instrument was acknowledged before me this \_\_\_\_\_ day of \_\_\_\_\_, 1961, by R. C. Tucker, President of GREAT WESTERN DRILLING COMPANY, a Texas corporation on behalf of said corporation.

My Commission Expires

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

\* \* \* \* \*

STATE OF TEXAS            )  
                              (  
COUNTY OF STEPHENS        )

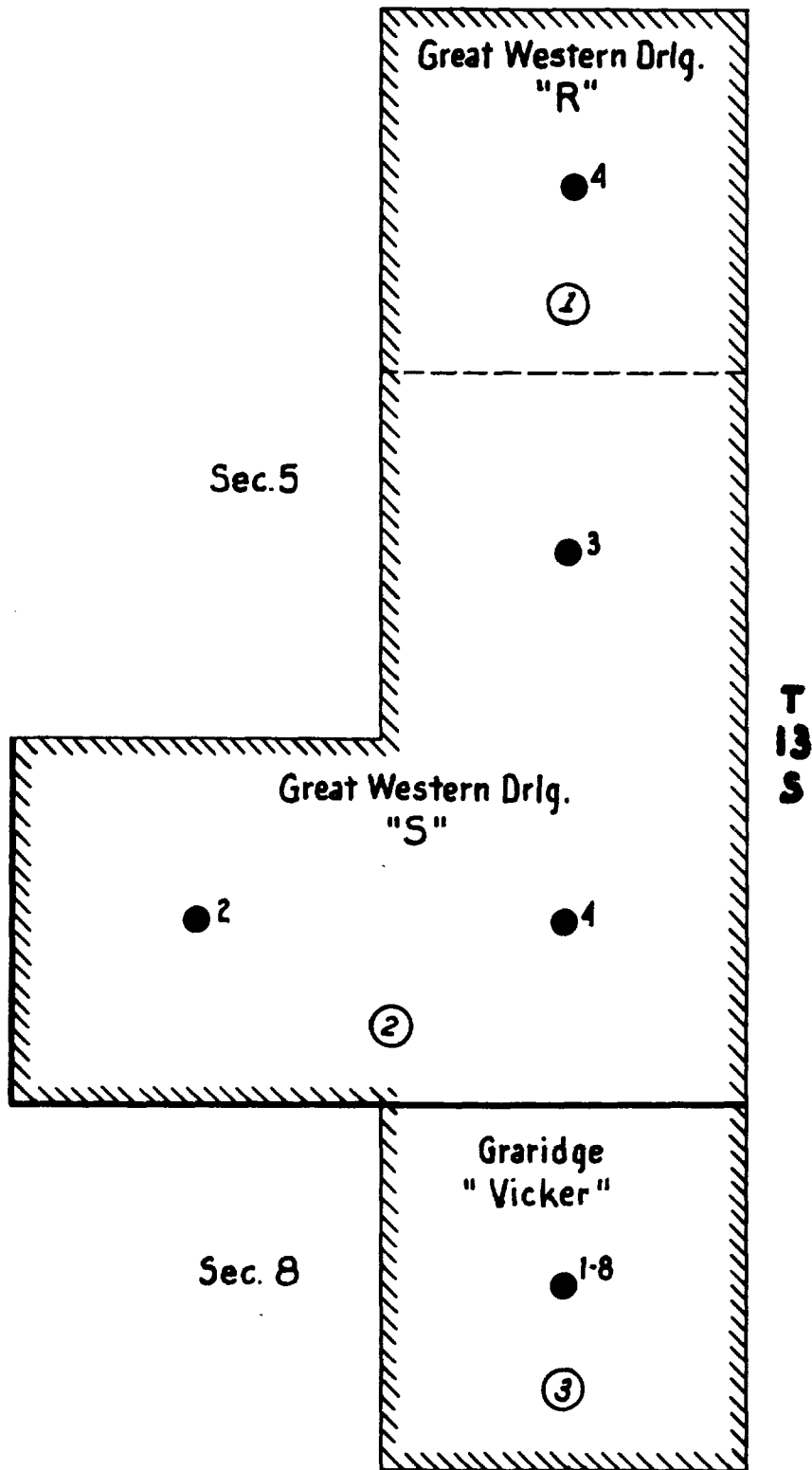
The foregoing instrument was acknowledged before me this \_\_\_\_\_ day of \_\_\_\_\_, 1961, by \_\_\_\_\_ of GRARIDGE CORPORATION, a Delaware corporation on behalf of said corporation.

My Commission Expires

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



**R-32-E**



Scale 8" = 1 Mile



*Exhibit "A"*  
*Grain Queen Unit*  
*Lea County, New Mexico*  
 *Unit Area Boundary*  
 *Tract Number*

EXHIBIT "B"

GRAIN QUEEN UNIT

WELL INFORMATION

TRACT NO.	DESCRIPTION	NUMBER OF ACRES	LEASE AND/OR ASSIGNMENT NO.	BASIC ROYALTY	LESSEE OF RECORD	OVERRIDING ROYALTY OWNER AND AMOUNT	WORKING INTEREST OWNER AND AMOUNT	PER CENT PARTICIPATION OF TRACT IN UNIT
1	SE/4 NW/4 Sec. 5, T-13-S, R-32-E	40	B-9171	12.5%	Great Western	None	Great Western Drlg. - 100%	12.361047
2	S/2 SW/4, NE/4 SW/4 Sec. 5, T-13-S, R-32-E	120	B-10907	12.5%	Great Western	None	Great Western Drlg. - 100%	65.156945
3	NE/4 NW/4 Sec. 8, T-13-S, R-32-E	40	Estelle Williams	12.5%	Graridge	The Vickers Petroleum Co., Inc. - 5% of 7/8 Subject to Agreement dated 8-16-60	Graridge Corp. - 100%	22.482008

UNIT OPERATING AGREEMENT  
GRAIN QUEEN UNIT  
LEA COUNTY, NEW MEXICO

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23.1

SUCCESSORS AND ASSIGNS  
Successors and Assigns

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Exhibit "C" (Schedule of Unit Participation)

Exhibit "D" (Accounting Procedure)

Exhibit "E" (Insurance Provisions)

UNIT OPERATING AGREEMENT  
GRAIN QUEEN UNIT  
LEA COUNTY, NEW MEXICO

THIS AGREEMENT, entered into as of the 1st day of June, 1961, by and between the parties who execute or ratify this Agreement.

WITNESSETH: That,

WHEREAS, the parties hereto as Working Interest Owners have executed as of the date hereof, that certain Unit Agreement For The Development and Operation of the GRAIN QUEEN UNIT, Lea County, New Mexico (hereinafter referred to as "Unit Agreement"), and which, among other things, provides for a separate agreement to be made and entered into by and between Working Interest Owners pertaining to the development and operation of the Unit Area therein defined;

NOW, THEREFORE, in consideration of the mutual agreements herein set forth, it is agreed as follows:

ARTICLE 1

CONFIRMATION OF UNIT AGREEMENT

1.1 Confirmation of Unit Agreement. The Unit Agreement is hereby confirmed and incorporated herein by reference and made a part of this Agreement. The definitions in the Unit Agreement are adopted for all purposes of this Agreement. In the event of any conflict between the Unit Agreement and this Agreement, the Unit Agreement shall prevail.

ARTICLE 2

EXHIBITS

2.1 Exhibits. The following exhibits are incorporated herein by reference:

2.1.1 Exhibits A and B of the Unit Agreement.

2.1.2 Exhibit C, attached hereto, is a schedule showing the total Unit Participation of each Working Interest Owner.

2.1.3 Exhibit D, attached hereto, is the Accounting Procedure applicable to development and operation of the Unit Area. In the

event of conflict between this Agreement and Exhibit D, this Agreement shall prevail.

2.1.4 Exhibit E, attached hereto, contains insurance provisions applicable to the development and operation of the Unit Area.

2.2 Revision of Exhibits. Whenever Exhibits "A" and "B" are revised, Exhibit "C" shall be revised according to such revision to be effective as of the effective date of revised Exhibits "A" and "B".

### ARTICLE 3

#### SUPERVISION OF OPERATIONS BY WORKING INTEREST OWNERS

3.1 Overall Supervision. Working Interest Owners shall exercise overall supervision and control of all matters pertaining to the development and operation of the Unit Area pursuant to this Agreement and the Unit Agreement. In the exercise of such power each Working Interest Owner shall act solely in its own behalf in the capacity of an individual owner and not on behalf of the owners as an entirety.

3.2 Particular Powers and Duties. The matters to be passed upon and decided by Working Interest Owners shall include, but not be limited to, the following:

3.2.1 Method of Operation. The kind, character and method of operation, including any type of secondary recovery program to be employed.

3.2.2 Drilling of Wells. The drilling of any well within the Unit Area either for production of Unitized Substances, for use as an injection well, or for other purposes.

3.2.3 Well Workovers and Change of Status. The workover, re-completion, repair, abandonment, or change of status of any well in the Unit Area or use of any such well for injection or other purposes.

3.2.4 Expenditures. Making of any single expenditure in excess of Five Thousand and No/100 (\$5,000.00) Dollars; provided that approval by Working Interest Owners of the drilling, reworking, drilling deeper, or plugging back of any well shall include approval of all necessary expenditures required therefor and for completing,

testing and equipping the same, including necessary flow lines, separators and lease tankage.

3.2.5 Disposition of Surplus Facilities. Selling or otherwise disposing of any major item of surplus material or equipment, the current list price of new equipment similar thereto being One Thousand and Five Hundred and No/100 (\$1,500.00) Dollars or more.

3.2.6 Appearance Before a Court or Regulatory Body. The designation of a representative to appear before any court or regulatory body in all matters pertaining to Unit operations; provided, however, such designation by Working Interest Owners shall not prevent any Working Interest Owner from appearing in person or from designating another representative in its own behalf; and provided further, that in the absence of such designation Unit Operator shall appear as such representative.

3.2.7 Audits. The making of proper audits of the accounts of Unit Operator pertaining to operations hereunder; provided that such audits shall:

- (a) not be conducted more than once each year except upon the resignation or removal of Unit Operator;
- and shall:
- (b) be made at the expense of all Working Interest Owners other than the Working Interest Owner designated as Unit Operator, unless such audit is conducted at the specific instance and request of Unit Operator, in which latter event the same shall be made at the expense of all Working Interest Owners including the Working Interest Owner designated as Unit Operator; and
  - (c) be upon not less than thirty (30) days' written notice to Unit Operator.

3.2.8 Inventories. The taking of periodic inventories under the terms of Exhibit "D".

3.2.9 Technical Services. Any direct charges to the joint account for the services by consultants of Unit Operator's technical personnel not covered by the overhead charges provided by Exhibit "D".



3.2.10 Appointment of Committees. The appointment or designation of committees or subcommittees necessary for the study of any problem in connection with Unit Operations.

3.2.11 Subject to Article 6.2, the removal of Unit Operator and the selection of a successor.

3.2.12 The enlargement of the Unit Area.

3.2.13 The readjustment of investments as required.

3.2.14 The termination of the Unit Agreement.

#### ARTICLE 4

##### MANNER OF EXERCISING SUPERVISION

4.1 Designation of Representatives. Each Working Interest Owner shall advise Unit Operator in writing the names and addresses of its representative and alternate representative authorized to represent and bind it in respect to any matter pertaining to the development and operation of the Unit Area. Such representative or alternate representative may be changed from time to time by written notice to Unit Operator.

4.2 Meetings. All meetings of Working Interest Owners for the purpose of considering and acting upon any matter pertaining to the development and operation of the Unit Area shall be called by Unit Operator upon its own motion or at the request of one (1) or more Working Interest Owners. Except for emergency meetings which may be called on two days notice, no meeting shall be called on less than fourteen (14) days' advance written notice, with agenda for the meeting attached. In the absence of protest by any qualified member of the meeting, the Working Interest Owners attending such meeting shall not be prevented from amending items included in the agenda or from deciding on such amended item or from deciding other items presented at such meeting. The representative of Unit Operator shall be chairman of each meeting.

4.3 Voting Procedure. Working Interest Owners shall act upon and determine all matters coming before them as follows:

4.3.1 Voting Interest. In voting on any matter each Working Interest Owner shall have a voting interest equal to its then percentage in Unit participation, as shown in Exhibit "C", and such revisions thereof as may hereafter be made in accordance with the

terms of this Agreement.

4.3.2 Vote Required. Except as may otherwise be provided herein or in the Unit Agreement, Working Interest Owners shall act upon and determine all matters coming before them including but not limited to:

- (a) an expenditure of more than Five Thousand and No/100 (\$5,000.00) Dollars; or
- (b) drilling of any wells and method of reconditioning for injection and/or producing wells

by the affirmative vote of a majority of the voting interest; provided, that should any one Working Interest Owner own more than fifty (50%) percent voting interest, its vote must be supported by the vote of one or more Working Interest Owners having a combined voting interest of at least ten (10%) percent.

4.3.3 Vote at Meeting by Nonattending Working Interest Owner.

Any Working Interest Owner not represented at a meeting may vote on any item included in the agenda of the meeting by letter or telegram addressed to the chairman of the meeting, provided such vote is received prior to the submission of such item to vote. Such vote shall not be counted with respect to any item on the agenda which is amended at the meeting.

4.3.4 Poll Votes. Working Interest Owners may decide any matter by vote taken by letter or telegram, provided the matter is first submitted in writing to each Working Interest Owner and no meeting on the matter is called as provided in Article 4.2, within seven (7) days after such proposal is served on Working Interest Owners. Unit Operator will give prompt notice of the results of such voting to all Working Interest Owners.

ARTICLE 5

INDIVIDUAL RIGHTS AND PRIVILEGES  
OF WORKING INTEREST OWNERS

5.1 Reservation of Rights. Working Interest Owners severally reserve to themselves all their rights, power, authority and privileges,

except as expressly provided in this Agreement and the Unit Agreement.

5.2 Specific Rights. Each Working Interest Owner shall have, among others, the following specific rights and privileges:

5.2.1 Access to Unit Area. Access to the Unit Area at all reasonable times to inspect the operation hereunder and all wells and records and data pertaining thereto.

5.2.2 Reports by Request. The right to receive from Unit Operator, upon written request, copies of all reports to any governmental agency, reports of crude oil runs and stocks, inventory reports and all other data not ordinarily furnished by Unit Operator to all Working Interest Owners; the cost of preparing copies of said reports shall be charged solely to the Working Interest Owners requesting the same.

## ARTICLE 6

### UNIT OPERATOR

6.1 Initial Unit Operator. Great Western Drilling Company, a Texas corporation, is hereby designated as Unit Operator.

6.2 Resignation or Removal - - Selection of Successor. The resignation or removal of Unit Operator, and the selection of a successor shall be governed by the provisions of the Unit Agreement.

## ARTICLE 7

### POWERS AND DUTIES OF UNIT OPERATOR

7.1 Exclusive Right to Operate Unit. Subject to the provisions of this Agreement and to the orders, directions and limitations rightfully given or imposed by Working Interest Owners, Unit Operator shall have the exclusive right and duty to develop and operate the Unit Area for the production of Unitized Substances.

7.2 Workmanlike Conduct. Unit Operator shall conduct all operations hereunder in a good and workmanlike manner, and, in the absence of specific instructions from Working Interest Owners, shall have the right and duty to conduct such operations in the same manner as would a prudent operator under the same or similar circumstances. Unit Operator shall freely consult with Working Interest Owners and keep them advised of all

matters arising in connection with such operations which Unit Operator, in the exercise of its best judgment, considers important. Unit Operator shall not be liable for damages unless such damages result from the gross negligence or willful misconduct of Unit Operator.

7.3 Liens and Encumbrances. Unit Operator shall keep the lands and leases in the Unit Area free from all liens and encumbrances occasioned by its operations hereunder, except the lien of Unit Operator granted hereunder.

7.4 Employees. The number of employees used by Unit Operator in conducting operations hereunder, the selection of such employees, the hours of labor, and the compensation for services to be paid any and all such employees shall be determined by Unit Operator. Such employees shall be the employees of Unit Operator.

7.5 Records. Unit Operator shall keep true and correct books, accounts and records of its operations hereunder.

7.6 Reports to Working Interest Owners. Unit Operator shall furnish to each Working Interest Owner monthly, injection and production reports for each well in the Unit, as well as periodic reports of the development and operation of the Unit Area.

7.7 Reports to Governmental Authorities. Unit Operator shall make all necessary reports to governmental authorities.

7.8 Engineering and Geological Information. Unit Operator shall furnish to each Working Interest Owner, upon written request, a copy of the log of, and copies of engineering and geological data pertaining to, wells drilled by Unit Operator.

7.9 Expenditures. Unit Operator is authorized to make single expenditures not in excess of Five Thousand and No/100 (\$5,000.00) Dollars without prior approval of Working Interest Owners; provided, however, that nothing in this Article (nor in Article 3.2.4) shall be deemed to prevent Unit Operator from making an expenditure in excess of said amount if such expenditure becomes necessary because of a sudden emergency which may otherwise cause loss of life or extensive damage to property.

7.10 Settlements. Unit Operator may settle any single damage

claim not involving an expenditure in excess of One Thousand and No/100 (\$1,000.00) Dollars, provided such payment is a complete settlement of such claim. All claims in excess of \$1,000.00 must be approved by the Working Interest Owners.

7.11 Mathematical Errors. It is hereby agreed by all parties to this Agreement that Unit Operator is empowered to correct any mathematical errors which might exist in the pertinent exhibits to this Agreement upon approval of the Commissioner.

## ARTICLE 8

### TAXES

8.1 Ad Valorem Taxes. Unit Operator, after consulting with Working Interest Owners, shall make and file for ad valorem tax purposes all necessary renditions and returns with the proper taxing authorities or governmental subdivisions covering all real and personal property of each Working Interest Owner within the Unit Area and used in connection with the development and operation of the Unit Area. Any Working Interest Owner dissatisfied with any proposed rendition or assessment of its interest in real or personal property shall have the right, at its own expense, to protest and resist the same. All such ad valorem taxes due and payable on account of real and personal property of each Working Interest Owner located within the Unit Area and used in connection with Unit operations shall be paid by Unit Operator for the joint account in the same manner as other costs and expenses of Unit operations.

8.2 Direct Taxes and Assessments. Each Working Interest Owner shall pay or cause to be paid all production, severance, gathering and other direct taxes and assessments imposed upon or on account of the production or handling of its share of Unitized Substances.

## ARTICLE 9

### INSURANCE

9.1 Insurance. Unit Operator shall carry, with respect to Unit operation subject to this Agreement:

9.1.1 Insurance as set forth in Exhibit "E".

## ARTICLE 10

### ADJUSTMENT OF INVESTMENTS

10.1 Personal Property Taken Over. Upon the effective date hereof, Working Interest Owners shall deliver to Unit Operator possession of:

10.1.1 Wells and Casing. All wells completed in the Unitized Formation together with the casing therein;

10.1.2 Well and Lease Equipment. The tubing and rods in each such well, together with the wellhead connections thereon, and all other lease and operating equipment used in the operation of such wells which Working Interest Owners determine is necessary or desirable for conducting Unit operations; and

10.1.3 Records. A copy of all production and well records pertaining to such wells.

10.2 Inventory and Evaluation of Personal Property. Working Interest Owners shall (at Unit expense) inventory and evaluate (i) all controllable material in accordance with provisions of Exhibit "D" and (ii) all personal property so taken over under Article 10.1.2 above, and Working Interest Owners shall appoint a committee for such purpose. Such inventory and evaluation shall, with the exception of sucker rods, be limited to items considered controllable, as recommended in the Material Classification Manual published by the Petroleum Accountants Society of Oklahoma in 1953. In this connection, Working Interest Owners agree to furnish such committee a list of their underground equipment prior to the effective date of this Agreement. The inventory as taken by the committee shall be as of the effective date of the Unit Agreement.

10.3 Investment Adjustment. Upon approval by Working Interest Owners of such inventory and evaluation, each Working Interest Owner shall be credited with the value of its interest in all personal property so taken over by Unit Operator under Article 10.1.2, and charged with an amount equal to that obtained by multiplying the total value of all such personal property so taken over by Unit Operator under Article 10.1.2 by such Working Interest Owner's Unit participation, as shown on Exhibit "C". If the charge against any Working Interest Owner is greater than the

amount credited to such Working Interest Owner, the resulting net charge shall be paid and in all other respects be treated as any other item of Unit expense chargeable against such Working Interest Owner. If the credit to any Working Interest Owner is greater than the amount charged against such Working Interest Owner, the resulting net credit shall be paid to such Working Interest Owner by Unit Operator out of funds received by it in settlement of the net charges described above. Pricing of inventory will be in accordance with Article V of Exhibit "D" hereof.

10.4 General Facilities. The acquisition of warehouses, warehouse stocks, lease houses, camps, facility systems, and office buildings necessary for operations hereunder shall be by negotiation by and between the owners thereof and Unit Operator, subject to the approval of Working Interest Owners.

10.5 Ownership of Personal Property and Facilities. Each Working Interest Owner, individually, shall by virtue hereof own an undivided interest in all personal property and facilities taken over or otherwise acquired by Unit Operator pursuant to this Agreement in an amount equal to its Unit participation, shown on Exhibit "C".

## ARTICLE 11

### DEVELOPMENT AND OPERATING COSTS

11.1 Basis of Charge to Working Interest Owners. Unit Operator initially shall pay and discharge all costs and expenses incurred in the development and operation of the Unit Area. Working Interest Owners shall reimburse Unit Operator for all such costs and expenses, in proportion to their respective Unit participation, shown on Exhibit "C". All charges, credits and accounting for costs and expenses shall be in accordance with Exhibit "D".

11.2 Budgets. Before or as soon as practical after the effective date hereof, Unit Operator shall prepare a budget of estimated costs and expenses for the remainder of the calendar year, and on or before the first day of each October thereafter shall prepare a budget of estimated costs and expenses for the ensuing calendar year. Such budgets shall set forth the estimated costs and expenses by quarterly periods. Unless

otherwise specified in the budget, it shall be presumed for the purpose of advance billings that the estimated costs and expenses for each month of a quarterly period shall be one-third (1/3) of the estimate for the quarterly period. Budgets so prepared shall be estimates only and shall be subject to adjustment and correction by Working Interest Owners and Unit Operator from time to time whenever it shall appear that an adjustment or correction is proper. A copy of each such budget and adjusted budget shall be promptly furnished each Working Interest Owner.

11.3 Advance Billing. Unit Operator shall have the right at its option to require Working Interest Owners to advance their respective proportion of such costs and expenses by submitting to Working Interest Owners, on or before the 15th day of any month, an itemized estimate of such costs and expenses for the succeeding month with a request for payment in advance. Within fifteen (15) days thereafter, each Working Interest Owner shall pay to Unit Operator its proportionate part of such estimate. Adjustment between estimates and the actual costs shall be made by Unit Operator at the close of each calendar month, and the accounts of the Working Interest Owners shall be adjusted accordingly. Where such estimates include materials to be acquired, Working Interest Owners may have the option of furnishing such material in kind, subject to acceptance of such material by Unit Operator.

11.4 Commingling of Funds. No funds received by Unit Operator under this Agreement need be segregated by Unit Operator or maintained by it as a joint fund, but may be commingled with its own funds.

11.5 Lien of Unit Operator. Each Working Interest Owner grants to Unit Operator a lien upon such Working Interest Owner's (i) leasehold and other mineral interests in each tract, (ii) its interest in all jointly-owned materials, equipment and other property, and (iii) its interest in all Unitized Substances, as security for payment of the costs and expenses chargeable to it, together with interest thereon at the rate of six (6%) percent per annum. Unit Operator shall have the right to bring any action at law or in equity to enforce collection of such costs and expenses, with or without foreclosure of such lien. In addition, upon



default by any Working Interest Owner in the payment of costs and expenses chargeable to it, Unit Operator shall have the right to collect and receive from the purchaser or purchasers all proceeds of such Working Interest Owner's share of Unitized Substances up to the amount owing by such Working Interest Owner plus interest, as aforesaid, until paid. Each such purchaser shall be entitled to rely upon Unit Operator's statement concerning the existence and amount of any such default.

11.6 Wells Drilled by Unit Operator. All wells drilled by Unit Operator shall be drilled on a competitive basis at the usual rates prevailing in the area. Unit Operator may employ its own tools and equipment in the drilling of wells, but in such event, the charge therefor shall not exceed the prevailing rate in the area, and such work shall be performed by Unit Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors doing work of a similar nature.

11.7 Burden of Unsigned One-eighth (1/8) Royalty Interest. Should the owner of a Royalty Interest fail or refuse to execute or become bound by the Unit Agreement and as a result thereof the Royalty payments with respect to such tract are more or less than a basic one-eighth (1/8) royalty computed on the basis of the Unitized Substances allocated to such tract under the Unit Agreement said differences shall be borne by or inure to the benefit of Working Interest Owners in proportion to their respective Unit participations, as shown in Exhibit "C".

11.8 Burden of Excess Royalty and Other Interests. If any interest contributed by a Working Interest Owner is burdened with a Royalty in excess of one-eighth (1/8), such excess burden shall be borne solely by the Working Interest Owner contributing such interest.

## ARTICLE 12

### OIL IN LEASE TANKAGE ON EFFECTIVE DATE

12.1 Gauge of Merchantable Oil. Unit Operator shall make a proper and timely gauge of all lease and other tanks within the Unit Area in order to ascertain the amount of merchantable oil above the pipe line connection in such tanks as of 7:00 a.m. on the effective date hereof.

All such oil which has then been produced legally shall be and remain the property of the Working Interest Owner entitled thereto the same as if the Unit had not been formed; and such Working Interest Owner shall promptly remove said oil from the Unit Area. Any such oil not so removed shall be sold by Unit Operator for the account of such Working Interest Owner, subject to the payment of all Royalty to Royalty Owners under the terms and provisions of the Unit Agreement and any applicable lease or leases and other contracts.

### ARTICLE 13

#### OPERATION OF NON-UNITIZED FORMATIONS

13.1 Right to Operate in Non-Unitized Formations. Any Working Interest Owner now having, or hereafter acquiring, the right to drill for and produce oil, gas or other minerals, other than Unitized Substances, within the Unit Area shall have the full right to do so notwithstanding this Agreement. In exercising said right, however, such Working Interest Owner shall exercise every reasonable precaution to prevent unreasonable interference with operations hereunder. No Working Interest Owner, other than Unit Operator, shall produce Unitized Substances through any well drilled or operated by it. If any such other Working Interest Owner drills any well into or through the Unitized Formation, the Unitized Formation shall be cased or otherwise protected in such a manner that the Unitized Formation and the production of Unitized Substances will not be adversely affected. No dual completions in the Unitized Formation and some other formation shall be permitted.

13.2 Appropriated Water Rights. Any Working Interest Owner who has appropriated water rights in the Lea County Underground Water Basin within the Unit Area agrees to the allocation of such amount of water as is required for the operation of the Unit up to limit appropriated to such owner by Lea County Underground Water Basin. This Agreement shall not be deemed as an assignment of the appropriated water rights to the Unit, but is a covenant to allow the Unit so much of the appropriated water as is required for efficient operations of the secondary recovery operations contemplated by the Unit Agreement, subject to the limitations and

requirements of the State Engineer's Office of the State of New Mexico.

#### ARTICLE 14

##### TITLES

14.1 Warranty and Indemnity. Each Working Interest Owner represents and warrants that it is the owner of the respective Working Interest set forth opposite its name in Exhibit "B" of the Unit Agreement and hereby indemnifies and agrees to hold the other Working Interest Owners harmless from any loss and liability for damages due to failure (in whole or in part) of its title to any such interest, except failure of title arising out of operations hereunder. Each failure of title shall be effective, insofar as this Agreement is concerned, as of the first day of the calendar month in which such failure is finally determined and there shall be no retroactive adjustment of development and operating expenses, Unitized Substances or the proceeds therefrom, as a result of title failure.

14.2 Failure Because of Unit Operations. The failure of title to any Working Interest in any tract by reason of Unit operations, including nonproduction from such tract, shall not operate to reduce or otherwise affect the percentage of said Unit participation of the Working Interest Owner whose title has so failed.

#### ARTICLE 15

##### LIABILITY, CLAIMS AND SUITS

15.1 Individual Liability. The duties, obligations and liabilities of Working Interest Owners shall be several and not joint or collective; and nothing contained herein shall ever be construed as creating a partnership of any kind, joint venture, or an association or trust between or among Working Interest Owners.

15.2 Settlements. In the event claim is made against a Working Interest Owner, or any Working Interest Owner is sued on account of any matter or thing arising from the development and operation of the Unit Area and over which such Working Interest Owner individually has no control because of the rights, powers and duties granted by this Agreement

and the Unit Agreement, said Working Interest Owner shall immediately notify the Unit Operator of such claim or suit. Unit Operator shall assume and take over the further handling of such claim or suit and all costs and expenses of handling, settling or otherwise discharging such claim or suit shall be borne by Working Interest Owners as any other cost or expense of operating the Unit Area.

#### ARTICLE 16

##### INTERNAL REVENUE PROVISION

16.1 Internal Revenue Provision. Each party hereto hereby irrevocably elects that it and the operations covered by this Agreement be excluded from the application of Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code of 1954 as permitted and authorized by Section 761 of said Code and the regulations promulgated thereunder. Unit Operator is hereby irrevocably authorized and directed to execute on behalf of each party hereto such additional or further evidence of said election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service and regulations issued under said Subchapter K, including all of the returns, statements and data required, and Unit Operator shall furnish each party hereto with a copy thereof. Should said regulations require each party to execute such further evidence, each party hereto irrevocably agrees to execute or join in the execution thereof. Each party hereto irrevocably agrees not to give any notices or take any action inconsistent with the elections hereby made and each hereby states that the income derived by it from the operations under this Agreement can be adequately determined without the computation of partnership taxable income.

#### ARTICLE 17

##### NOTICES

17.1 Notices. All notices required hereunder shall be in writing and shall be deemed to have been properly served when sent by mail or telegram to the address of the representative of each Working Interest Owner as furnished to Unit Operator in accordance with Article 4 hereof.

## ARTICLE 18

### WITHDRAWAL OF WORKING INTEREST OWNER

18.1 Withdrawal. If any Working Interest Owner so desires, it may withdraw from this Agreement by conveying, assigning and transferring, without warranty of title (either expressed or implied) to the other Working Interest Owners who do not desire to withdraw herefrom, all of the former's present rights, title and interest in and to its lease or leases, or other operating rights in the Unit Area, insofar as said lease, leases or rights pertain to the Unitized Formation, together with the withdrawing Working Interest Owner's interest in all wells, pipelines, casing, injection equipment facilities and other personal property used in conjunction with the development and operation of the Unit Area; provided, that such transfer, assignment or conveyance shall not relieve said Working Interest Owner from any obligation or liability incurred prior to the date of the execution and delivery thereof. The interest so transferred, assigned and conveyed shall be taken and owned by the other Working Interest Owners in proportion to their respective Unit participations, and the Unit Operator shall recompute the percentage of participation to include this change and furnish the remaining Working Interest Owners with a corrected interest sheet. After the execution and delivery of such transfer, assignment or conveyance, the withdrawing Working Interest Owner shall be relieved from all further obligations and liability hereunder and under said Unit Agreement; and the right of such Working Interest Owner to any benefits subsequently accruing hereunder and under said Unit Agreement shall cease; provided, that upon delivery of said transfer, assignment or conveyance, the assignees, in the ratio of the respective interests so acquired, shall pay to the assignor for its interest in all jointly-owned equipment, casing and other personal property, the fair salvage value thereof, as estimated and fixed by the remaining Working Interest Owners.

## ARTICLE 19

### ABANDONMENT OF WELLS

19.1 Rights of Former Owners. If Working Interest Owners decide to permanently abandon any well within the Unit Area prior to termination of

the Unit Agreement, Unit Operator shall give written notice of such fact to the former Working Interest Owner of the tract on which such well is located, together with the amount (as estimated and fixed by the Working Interest Owners) to be the net salvage value of the casing and equipment in and on said well; said former Working Interest Owner shall have the right and option for a period of ninety (90) days after receipt of such notice to notify Unit Operator of its election to take over and own said well and to deepen or plug back said well to a formation other than the Unitized Formation. Within ten (10) days after said former Working Interest Owner of the tract has so notified Unit Operator of its desire to take over such well, it shall pay to Unit Operator, for credit to the joint account of the Working Interest Owners, the amount of the net salvage value above described. At the same time the former Working Interest Owner taking over the well shall agree, by letter addressed to Unit Operator, to effectively seal off and protect the Unitized Formation and (at such time as the well is ready for abandonment) to plug and abandon the well in a workmanlike manner in accordance with applicable laws and regulations.

19.2 Plugging. In the event the former Working Interest Owner of a tract does not elect to take over a well located thereon which is proposed for abandonment, Unit Operator shall plug and abandon the well in accordance with applicable laws and regulations.

## ARTICLE 20

### EFFECTIVE DATE AND TERM

20.1 Effective Date. This Agreement shall become effective on the date and at the time the Unit Agreement becomes effective.

20.2 Term. This Agreement shall continue in full force and effect so long as the Unit Agreement remains in force and effect and thereafter until all Unit wells have been plugged and abandoned or turned over to Working Interest Owners in accordance with Article 21 hereof, and all personal and real property acquired for the joint account of Working Interest Owners has been disposed of by Unit Operator in accordance with instructions of Working Interest Owners.

20.3 Amendment. This Agreement may be amended from time to time as may be consistent with the object and purpose of the Unit Agreement, as such object and purpose is set forth in Section 11 (Plan of Operations) thereof, and any such amendment to this Agreement shall become effective as of 7:00 A.M. of the date specified in such amendment next following the execution or ratification of such amendment by Working Interest Owners having a combined voting interest of at least ninety-five (95%) percent.

## ARTICLE 21

### TERMINATION OF UNIT AGREEMENT

21.1 Termination. Upon termination of the Unit Agreement, the following shall occur:

21.1.1 Oil and Gas Rights. Possession of all oil and gas rights in and to the several separate tracts shall revert to the Working Interest Owners thereof.

21.1.2 Right to Operate. Working Interest Owners of any such tract desiring to take over and continue to operate a well or wells located thereon may do so by paying Unit Operator, for the credit of the joint account, the net salvage value of the casing and equipment in and on the well and by agreeing in writing to properly plug the well at such time as it is abandoned.

21.1.3 Salvaging Wells. With respect to all wells not taken over by Working Interest Owners, Unit Operator shall at the joint expense of Working Interest Owners salvage as much of the casing and equipment in or on such wells as can economically and reasonably be salvaged, and shall cause such wells to be properly plugged and abandoned.

21.1.4 Cost of Salvaging. Working Interest Owners shall share the cost of salvaging, liquidation or other distribution of assets and properties used in the development and operation of the Unit Area in proportion to their respective Unit participation, as shown on Exhibit "C".

ARTICLE 22

COUNTERPART EXECUTION

22.1 Execution by Separate Counterparts or Ratifications. This Agreement may be executed in any number of counterparts and each counterpart so executed shall have the same force and effect as an original instrument and as if all of the parties to the aggregate counterparts had signed the same instrument; or may be ratified by a separate instrument in writing referring to this Agreement. Each such ratification shall have the force and effect of an executed counterpart and of adopting by reference all of the provisions hereof.

ARTICLE 23

SUCCESSORS AND ASSIGNS

23.1 Successors and Assigns. The terms and provisions hereof shall be covenants running with the lands and unitized leases covered hereby and shall be binding upon and inure to the benefit of the respective heirs, successors and assigns of the parties hereto.

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

ATTEST:

GREAT WESTERN DRILLING COMPANY

\_\_\_\_\_  
Assistant Secretary

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

Date: \_\_\_\_\_

UNIT OPERATOR & WORKING INTEREST  
OWNER

ATTEST:

GRARIDGE CORPORATION

\_\_\_\_\_  
Assistant Secretary

By: \_\_\_\_\_  
Vice-President

Date: \_\_\_\_\_

WORKING INTEREST OWNER



STATE OF TEXAS       )  
                          (  
COUNTY OF MIDLAND    )

The foregoing instrument was acknowledged before me this \_\_\_\_\_ day  
of \_\_\_\_\_, 1961, by R. C. Tucker, President of GREAT WESTERN  
DRILLING COMPANY, a Texas corporation on behalf of said corporation.

My Commission Expires:

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

\* \* \* \* \*

STATE OF TEXAS       )  
                          (  
COUNTY OF STEPHENS    )

The foregoing instrument was acknowledged before me this \_\_\_\_\_ day  
of \_\_\_\_\_, 1961, by \_\_\_\_\_ of GRARIDGE  
CORPORATION, a Delaware corporation on behalf of said corporation.

My Commission Expires:

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

EXHIBIT "C"  
GRAIN QUEEN UNIT

UNIT PARTICIPATION

<u>WORKING INTEREST OWNERS</u>	<u>TOTAL UNIT PARTICIPATION</u>
Graridge Corporation	22.482008
Great Western Drilling Company	<u>77.517992</u>
Total	100.000000

EXHIBIT "E"

INSURANCE PROCEDURE

(A) Unit Operator agrees that it will require its contractors or sub-contractors to carry insurance as follows to cover drilling operations for the production of Unitized Substances on all lands subject to this Agreement:

- (1) Workmen's Compensation and Employer's Liability Insurance as required by the laws of the State of New Mexico, but in an amount not less than \$100,000.00;
- (2) Contractor's Public Liability Insurance in amounts of \$100,000.00 for injuries to one person, and \$200,000.00 for injuries in one accident and property damage covering premise operations with \$100,000.00 aggregate limit;
- (3) Automobile Public Liability and Property Damage Insurance in amounts of \$100,000.00 for injuries to one person; \$200,000.00 for injuries in one accident; and \$100,000.00 for property damage.

(B) With respect to Unit operations (other than drilling operations) on all lands subject to this Agreement, Unit Operator shall carry Workmen's Compensation Insurance as required by the laws of the State of New Mexico, and Employer's Liability Insurance with minimum limits of \$100,000.00; Public Liability and Property Damage Insurance in amounts of \$100,000.00 for injury or death to one person; \$300,000.00 for one accident, and \$100,000.00 Property Damage; Automobile Public Liability and Property Damage Insurance in amounts of \$100,000.00 for injury or death to one person, \$250,000.00 for one accident, and \$100,000.00 for property damage.

(C) All insurance coverage required hereby shall be carried at the joint expense and for the benefit of the parties hereto. However, premiums for Automobile, Public Liability and Property Damage Insurance on Unit Operator's fully owned equipment shall not be charged directly to the joint account, but will be covered by the flat rate charges assessed for use of such equipment. Unit Operator will not carry fire, windstorm and explosion insurance covering operations hereunder. Unit Operator agrees to promptly furnish Working Interest Owners with written reports

of damage to Unit property resulting from hazards not covered by insurance carried for the joint account.

(D) The insurance program provided for in this paragraph shall be made effective by Unit Operator upon the effective date hereof. Changes in such insurance program may, however, thereafter be made by Working Interest Owners.

# EXHIBIT " D "

PASO-T-1955-2

Attached to and made a part of Unit Operating Agreement  
GRAIN QUEEN UNIT  
Lea County, New Mexico

## ACCOUNTING PROCEDURE

(UNIT AND JOINT LEASE OPERATIONS)

### I. GENERAL PROVISIONS

#### 1. Definitions

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

"Operator" as herein used shall be construed to mean the party designated to conduct the development and operation of the subject area for the joint account of the parties hereto.

"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 Subparagraph C below:

- Statement in detail of all charges and credits to the joint account.
- Statement of all charges and credits to the joint account, summarized by appropriate classifications indicative of the nature thereof.
- Statements as follows: (See Sec.10.6 Operating Agreement)
  - Detailed statement of material ordinarily considered controllable by operators of oil and gas properties;
  - Statement of ordinary charges and credits to the joint account summarized by appropriate classifications indicative of the nature thereof; and
  - Detailed statement of any other charges and credits.

#### 3. Payments by Non-Operator

Each party shall pay its proportion of all such bills within ~~thirty~~ thirty (30) 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. Adjustments

Payment of any such bills shall not prejudice the right of Non-Operator to protest or question the correctness thereof. Subject to the exception noted in Paragraph 5 of this section I, all statements rendered to Non-Operator 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 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 making of claims for adjustment thereon. The provisions of this paragraph shall not prevent adjustments resulting from physical inventory of property as provided for in Section VI, Inventories, hereof.

#### 5. Audits

A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the accounting hereunder for any calendar year within the twenty-four (24) month period following the end of such calendar year, provided, however, that Non-Operator must take written exception to and make claim upon the Operator for all discrepancies disclosed by said audit within said twenty-four (24) month period. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct joint or simultaneous audits in a manner which will result in a minimum of inconvenience to the Operator.

### II. 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 directly to royalty owners by the purchaser of the oil, gas, casinghead gas, or other products.

#### 2. Labor

- Salaries and wages of Operator's employees directly engaged on the joint property in the development, maintenance, and operation thereof, including salaries or wages paid to geologists and other employees who are temporarily assigned to and directly employed on a drilling well.
- Operator's cost of holiday, vacation, sickness and disability benefits, and other customary allowances applicable to the salaries and wages chargeable under Subparagraph 2 A and Paragraph 11 of this Section II. Costs under this Subparagraph 2 B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable under Subparagraph 2 A and Paragraph 11 of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.
- Costs of expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's labor cost of salaries and wages as provided under Subparagraphs 2 A, 2 B, and Paragraph 11 of this Section II.

#### 3. Employee Benefits

Operator's current cost of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost, provided that the total of such charges shall not exceed ten per cent (10%) of Operator's labor costs as provided in Subparagraphs A and B of Paragraph 2 of this Section II and in Paragraph 11 of this Section II.

#### 4. 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 may be required for immediate use; and the accumulation of surplus stocks shall be avoided.

#### 5. Transportation

Transportation of employees, equipment, material, and supplies necessary for the development, maintenance, and operation of the joint property subject to the following limitations:

- If material is moved to the joint property from vendor's or from the Operator's warehouse or other properties, no charge shall be made to the joint account for a distance greater than the distance from the nearest reliable supply store or railway receiving point where such material is available, except by special agreement with Non-Operator.

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 from the nearest reliable supply store or railway receiving point, except by special agreement with Non-Operator. 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. Service

- A. Outside Services:  
The cost of contract services and utilities procured from outside sources.
- B. Use of Operator's Equipment and Facilities:  
Use of and service by Operator's exclusively owned equipment and facilities as provided in Paragraph 5 of Section III entitled "Operator's Exclusively Owned Facilities."

7. Damages and Losses to Joint Property and Equipment

All costs or expenses necessary to replace or repair damages or losses incurred by fire, flood, storm, theft, accident, or any other cause not controllable by Operator through the exercise of reasonable diligence. Operator shall furnish Non-Operator written notice of damages or losses incurred as soon as practicable after report of the same has been received by Operator.

8. Litigation Expense

- All costs and expenses of litigation, or legal services otherwise necessary or expedient for the protection of the joint interests, including attorneys' fees and expenses as hereinafter provided, together with all judgments obtained against the parties or any of them on account of the joint operations under this agreement, and 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 cost of providing and furnishing such services rendered may be made against the joint account; but no such charge shall be made until approved by the legal departments 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 or levied 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. As to ad valorem taxes for the year in which this agreement becomes effective, only the pro-ratio part thereof shall be chargeable hereunder.

11. District and Camp Expense (Field Supervision and Camp Expense)

A pro rata portion of the salaries and expenses of Operator's production superintendent and other employees serving the joint property and other properties of the Operator in the same operating area, whose time is not allocated directly to the properties, and a pro rata portion of the cost of maintaining and operating a production office known as Operator's Caprock District office located at or near Caprock, New Mexico (or a comparable office if location changed), and necessary suboffices (if any), maintained for the convenience of the above-described office, and all necessary camps, including housing facilities for employees if required, used in the conduct of the operations on the joint property and other properties operated in the same locality. The expense of, less any revenue from, these facilities should be inclusive of depreciation or a fair monthly rental in lieu of depreciation on the investment. Such charges shall be apportioned to all properties served on some equitable basis consistent with Operator's accounting practice.

Distribution of charges to be made on a per well basis. Drilling well to be considered as equivalent of five producing wells.

12. Administrative Overhead

Operator shall have the right to assess against the joint property covered hereby the following management and administrative overhead charges, which shall be in lieu of all expenses of all offices of the Operator not covered by Section II, Paragraph 11, above, including salaries and expenses of personnel assigned to such offices, except that salaries of geologists and other employees of Operator who are temporarily assigned to and directly serving on the joint property will be charged as provided in Section II, Paragraph 2, above. Salaries and expenses of other technical employees assigned to such offices will be considered as covered by overhead charges in this paragraph unless charges for such salaries and expenses are agreed upon between Operator and Non-Operator as a direct charge to the joint property.

WELL BASIS (Rate Per Well Per Month)

Well Depth	DRILLING WELL RATE	PRODUCING WELL RATE (Use Completion Depth)		
	Each Well	<del>First Five</del>	<del>Next Five</del>	<del>All Wells Over Ten</del>
	\$175.00		\$35.00	

- A. Overhead charges for drilling wells shall begin on the date each well is spudded and terminate 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. In connection with overhead charges, the status of wells shall be as follows:
- (1) Injection wells for recovery operations, such as for repressure or water flood, shall be included in the overhead schedule the same as producing oil wells.
- (2) Water supply wells utilized for water flooding operations shall be included in the overhead schedule the same as producing oil wells.
- (3) Producing gas wells shall be included in the overhead schedule the same as producing oil wells.

- (4) Wells permanently shut down but on which plugging operations are deferred shall be dropped from the 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.
- (5) Wells being plugged back, drilled deeper, or converted to a source or input well shall be included in the overhead schedule the same as drilling wells.
- (6) Temporarily shut-down wells (other than by governmental regulatory body) which are not produced or worked upon for a period of a full calendar month shall not be included in the overhead schedule; however, wells shut in by governmental regulatory body shall be included in the overhead schedule only in the event the allowable production is transferred to other wells on the same property. In the event of a unit allowable, all wells capable of producing will be counted in determining the overhead charge.
- (7) Wells completed in dual or multiple horizons shall be considered as two wells in the producing overhead schedule.
- (8) Lease salt water disposal wells shall not be included in the overhead schedule unless such wells are used in a secondary recovery program on the joint property.

(9) Each water injection plant shall be included in the overhead schedule the same as two (2) producing wells.

C. The above schedule for producing wells shall be applied to the total number of wells operated under the Operating Agreement to which this accounting procedure is attached, irrespective of individual leases.

D. It is specifically understood that the above overhead rates apply only to drilling and producing operations and are not intended to cover the construction or operation of additional facilities such as, but not limited to, gasoline plants, compressor plants, repressuring projects, salt water disposal facilities, and similar installations. If at any time any or all of these become necessary to the operation, a separate agreement will be reached relative to an overhead charge and allocation of district expense.

E. 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.

#### 14. Other Expenditures

Any expenditure, other than expenditures which are covered and dealt with by the foregoing provisions of this Section II, incurred by the 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, pumping units, sucker rods, engines, and other major equipment. Tubular goods, two-inch (2") and over, shall be priced on car-load 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 seventy-five per cent (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 secondhand 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 fifty per cent (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, buildings, and other equipment involving erection costs shall be charged at applicable percentage of knocked-down new price.

#### 3. Premium Prices

Whenever materials and equipment are not readily obtainable at the customary supply point and at prices specified in Paragraphs 1 and 2 of this Section III 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 materials on the basis of the Operator's direct cost and expense incurred in procuring such materials, in making it suitable for use, and in moving it to the location, provided, however, that notice in writing is furnished to Non-Operator of the proposed charge prior to billing the Non-Operator for the material and/or equipment acquired pursuant to this provision, whereupon Non-Operator shall have the right, by so electing and notifying Operator within 10 days after receiving notice from the Operator, to furnish in kind, or in tonnage as the parties may agree, at the location, nearest railway receiving point, or Operator's storage point within a comparable distance, all or part of his share of material and/or equipment suitable for use and acceptable to the Operator. Transportation costs on any such material furnished by Non-Operator, at any point other than at the location, shall be borne by such Non-Operator. If, pursuant to the provisions of this paragraph, any Non-Operator furnishes material and/or equipment in kind, the Operator shall make appropriate credits therefor to the account of said Non-Operator.

#### 4. 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.

#### 5. 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, fuel, power, compressor and other auxiliary services 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 at rates commensurate with cost of ownership and operation. Such rates should generally be in line with the schedule of rates adopted by the Petroleum Motor Transport Association, or some other recognized organization, as recommended uniform charges against joint 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 and tractor rates may 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. Pulling units shall be charged at hourly rates commensurate with the cost of ownership and operation, which shall include repairs and maintenance, operating supplies, insurance, depreciation, and taxes. Pulling unit rates may include wages and expenses of the operator.
- D. A fair rate shall be charged for laboratory services performed by Operator for the benefit of the joint account, such as gas, water, core, and any other analyses and tests; provided such charges shall not exceed those currently prevailing if performed by outside service laboratories.
- E. Whenever requested, Operator shall inform Non-Operator in advance of the rates it proposes to charge.
- F. 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. The disposition of major items of surplus material, such as derricks, tanks, engines, pumping units, and tubular goods, shall be subject to mutual determination by the parties hereto; provided Operator shall have the right to dispose of normal accumulations of junk and scrap material either by transfer or sale from the joint property.

##### **1. Material Purchased by the Operator or Non-Operator**

Material purchased by either the Operator or Non-Operator shall be credited by the Operator to the joint account for the month in which the material is removed by the purchaser.

##### **2. Division in Kind**

Division of material in kind, if made between Operator and Non-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. Such credits shall appear in the monthly statement of operations.

##### **3. Sales to Outsiders**

Sales to outsiders of material from the joint property shall be credited by Operator to the joint account at the net amount collected by Operator from vendee. Any 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 one hundred per cent (100%) of current new price (plus sales tax if any).

##### **3. Good Used Material**

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

- A. At seventy-five per cent (75%) of current new price if material was charged to joint account as new, or
- B. At sixty-five per cent (65%) of current new price if material was originally charged to the joint property as secondhand at seventy-five per cent (75%) of new price.

##### **4. Other Used Material**

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

- A. 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.

##### **5. Bad-Order Material**

Material and equipment (Condition "D"), which is no longer usable for its original purpose without excessive repair cost but is further usable for some other purpose, shall be priced on a basis comparable with that of items normally used for that purpose.

##### **6. Junk**

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

#### **7. TEMPORARILY USED MATERIAL (In service 60 days or less)**

**When the use of material is temporary and its service to the joint account does not justify the reduction in price as provided in Paragraph 3 above, such material shall be priced on a basis that will leave a net charge to the joint account of 10% of price charged if material charged out as new and 5% if material charged out as second-hand.**

#### **VI. Inventories**

##### **1. PERIODIC INVENTORIES, NOTICE AND REPRESENTATION**

**At reasonable intervals, inventories shall be taken by Operator of the joint account material, which shall include all such material as is ordinarily considered controllable. (See Sec. 10.2, Operating Agreement).**

Inventory adjustments shall be made by Operator with the joint account for shortages, Operator only for shortages due to lack of reasonable diligence.

##### **3. 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.