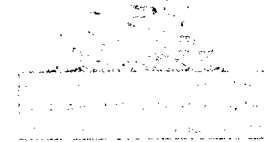


BEFORE ALBERT J. ...  
OIL CONSERVATION ...  
EXHIBIT NO. II  
CASE NO. 7363  
GULF OIL CORP

A.A.P.L. FORM 610 - 1977

## MODEL FORM OPERATING AGREEMENT



EAST WHITE RANCH  
UNIT

### OPERATING AGREEMENT

DATED

\_\_\_\_\_, 19\_\_\_\_,

OPERATOR GULF OIL CORPORATION

CONTRACT AREA T-13-S, R-30-E, N.M.P.M.  
Section 11: all  
Section 14: all  
Section 23: all

COUNTY ~~ORIGIN~~ OF CHAVES STATE OF NEW MEXICO

**GUIDANCE IN THE PREPARATION OF THIS AGREEMENT:**

1. Title Page - Fill in blank as applicable.
2. Preamble, Page 1 - Name of Operator.
3. Article II - Exhibits:
  - (a) Indicate Exhibits to be attached.
  - (b) If it is desired that no reference be made to Non-discrimination, the reference to Exhibit "F" should be deleted.
4. Article IV.A - Title Examination - Select option as agreed to by the parties.
5. Article IV.B - Loss of Title - If "Joint Loss" of Title is desired, the following changes should be made:
  - (a) Delete Articles IV.B.1 and IV.B.2.
  - (b) Article IV.B.3 - Delete phrase "other than those set forth in Articles IV.B.1 and IV.B.2 above."
  - (c) Article VII.F. - Change reference at end of the first grammatical paragraph from "Article IV.B.2" to "Article IV.B.3."
6. Article V - Operator - Enter name of Operator.
7. Article VI.A - Initial Well:
  - (a) Date of commencement of drilling.
  - (b) Location of well.
  - (c) Obligation depth.
8. Article VI.B.2.(b) - Subsequent Operations - Enter penalty percentage as agreed to by parties.
9. Article VII.D.1. - Limitation of Expenditures - Select option as agreed to by parties.
10. Article VII.D.3. - Limitation of Expenditures - Enter limitation of expenditure of Operator for single project and amount above which Operator may furnish information AFE.
11. Article VII.E. - Royalties, Overriding Royalties and Other Payments - Enter royalty fraction as agreed to by parties.
12. Article X. - Claims and Lawsuits - Enter claim limit as agreed to by parties.
13. Article XIII. - Term of Agreement:
  - (a) Select Option as agreed to by parties.
  - (b) If Option No. 2 is selected, enter agreed number of days in two (2) blanks.
14. Signature Page - Enter effective date.

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## OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between GULF OIL CORPORATION, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators". This Agreement is a companion instrument to the Unit Agreement for the development and operation of the East White Ranch Unit Area, effective as of the effective date thereof, and in the event of any conflict between this agreement and the said Unit Agreement, the terms and provisions of the Unit Agreement shall be controlling. The term "Unit Operator", and the term "Contract Area" herein is synonymous with "Unit Area" as those terms are defined and used in the said Unit Agreement.

## WITNESSETH:

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

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.  
DEFINITIONS

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

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

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

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

D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".

E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.

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

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

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

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

ARTICLE II.  
EXHIBITS

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

☒ A. Exhibit "A", shall include the following information:

(1) Identification of lands subject to agreement,

(2) Restrictions, if any, as to depths or formations,

(3) Percentages or fractional interests of parties to this agreement,

~~(4) Oil and gas leases and/or oil and gas interests subject to this agreement.~~

(5) Addresses of parties for notice purposes.

~~☐ B. Exhibit "B", Form of Lease.~~

☒ C. Exhibit "C", Accounting Procedure.

☒ D. Exhibit "D", Insurance.

☒ E. Exhibit "E", Gas Balancing Agreement.

☒ F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.

☒ G. Exhibit "G", Tax Partnership.

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

**ARTICLE III.  
INTERESTS OF PARTIES**

**A. Oil and Gas Interests:**

If any party owns an unleased oil and gas interest in the Contract Area, that interest shall be treated for the purpose of this agreement and during the term hereof as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B". As to such interest, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the lessee interest.

**B. Interest of Parties in Costs and Production:**

Exhibit "A" lists all of the parties and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and material acquired in operations on the Contract Area shall be owned by the parties as their interests are shown in Exhibit "A". All production of oil and gas from the Contract Area, subject to the payment of lessor's royalties ~~which will be borne by the Joint Account~~, shall also be owned by the parties in the same manner during the term hereof; provided, however, this shall not be deemed an assignment or cross-assignment of interests covered hereby.

**ARTICLE IV.  
TITLES**

**A. Title Examination:**

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

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

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

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

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

**B. Loss of Title:**

1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A", this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests, and

(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development

or operating costs which it may have theretofore paid, but there shall be no monetary liability on its part to the other parties hereto for drilling, development, operating or other similar costs by reason of such title failure; and

(b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the interest which has been lost, but the interests of the parties shall be revised on an acreage basis, as of the time it is determined finally that title failure has occurred, so that the interest of the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract Area by the amount of the interest lost; and

(c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled on the Contract Area is increased by reason of the title failure, the party whose title has failed shall receive the proceeds attributable to the increase in such interests (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well; and

(d) Should any person not a party to this agreement, who is determined to be the owner of any interest in the title which has failed, pay in any manner any part of the cost of operation, development, or equipment, such amount shall be paid to the party or parties who bore the costs which are so refunded; and

(e) Any liability to account to a third party for prior production of oil and gas which arises by reason of title failure shall be borne by the party or parties in the same proportions in which they shared in such prior production; and

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

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

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

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

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

**3. Other Losses:** All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall not be considered failure of title but shall be joint losses and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of the Contract Area.

## ARTICLE V. OPERATOR

### A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:

GULF OIL CORPORATION shall be the Operator of the Contract Area, and shall conduct and direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of, this agreement. It shall conduct all such operations in a good and workmanlike manner, but it shall have no liability as Operator to the other parties for losses sustained or liabilities incurred, except such as may result from gross negligence or willful misconduct.

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

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

~~2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the Parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A", and not on the number of parties remaining after excluding the voting interest of the Operator that was removed.~~

**C. Employees:**

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

**D. Drilling Contracts:**

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

**ARTICLE VI.  
DRILLING AND DEVELOPMENT**

**A. Initial Well:**

On or before six (6) months from the effective date of the Unit Agreement, Operator shall commence the drilling of a well for oil and gas at the following location: Operator's choice within the SW/4 of Section 14, T-13-S, R-30-E, N.M.P.M., Chaves County, New Mexico,

and shall thereafter continue the drilling of the well with due diligence to a depth sufficient to completely test the Atoka-Morrow formation, provided however, that the Unit Operator shall not in any event be required to drill said well to a depth in excess of 10,500 feet,

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

Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E.1. hereof.

1 **B. Subsequent Operations:**

2  
3 1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area  
4 other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled  
5 at the joint expense of all parties or a well jointly owned by all the parties and not then producing  
6 in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the  
7 other parties written notice of the proposed operation, specifying the work to be performed, the loca-  
8 tion, proposed depth, objective formation and the estimated cost of the operation. The parties receiv-  
9 ing such a notice shall have thirty (30) days after receipt of the notice within which to notify the  
10 parties wishing to do the work whether they elect to participate in the cost of the proposed operation.  
11 If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given  
12 by telephone and the response period shall be limited to ~~twenty-four~~ hours, ~~exclusive of Saturday,~~  
13 ~~Sunday or legal holidays.~~ Failure of a party receiving such notice to reply within the period above fixed  
14 shall constitute an election by that party not to participate in the cost of the proposed operation. Any  
15 notice or response given by telephone shall be promptly confirmed in writing.

16  
17 2. Operations by Less than All Parties: If any party receiving such notice as provided in Article  
18 VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to  
19 the benefits of this article, the party or parties giving the notice and such other parties as shall elect  
20 to participate in the operation shall, within sixty (60) days after the expiration of the notice period of  
21 thirty (30) days (or as promptly as possible after the expiration of the ~~twenty-four~~ hour period  
22 where the drilling rig is on location, as the case may be) actually commence work on the proposed  
23 operation and complete it with due diligence. Operator shall perform all work for the account of the  
24 Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Op-  
25 erator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform  
26 the work required by such proposed operation for the account of the Consenting Parties, or (b) desig-  
27 nate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when  
28 conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms  
29 and conditions of this agreement.

30  
31 If less than all parties approve any proposed operation, the proposing party, immediately after the  
32 expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest  
33 of the parties approving such operation, and (b) its recommendation as to whether the Consenting Par-  
34 ties should proceed with the operation as proposed. Each Consenting Party, within ~~twenty-four~~  
35 hours ~~(exclusive of Saturday, Sunday or legal holidays)~~ after receipt of such notice, shall advise the  
36 proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A",  
37 or (b) carry its proportionate part of Non-Consenting Parties' interest. The proposing party, at its  
38 election, may withdraw such proposal if there is insufficient participation, and shall promptly notify  
39 all parties of such decision.

40  
41 The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in  
42 the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting  
43 Parties shall keep the leasehold estates involved in such operations free and clear of all liens and  
44 encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such  
45 an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole  
46 cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions  
47 of this Article results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall  
48 complete and equip the well to produce at their sole cost and risk, and the well shall then be turned  
49 over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties.  
50 Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such  
51 well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party  
52 shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and  
53 be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's  
54 interest in the well and share of production therefrom until the proceeds of the sale of such share,  
55 calculated at the well, or market value thereof if such share is not sold (after deducting production  
56 taxes, royalty, overriding royalty and other interests existing on the effective date hereof, payable out of  
57 or measured by the production from such well accruing with respect to such interest until it reverts)  
58 shall equal the total of the following:

59  
60 (a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface  
61 equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators,  
62 treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the  
63 cost of operation of the well commencing with first production and continuing until each such Non-  
64 Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being  
65 agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which  
66 would have been chargeable to each Non-Consenting Party had it participated in the well from the be-  
67 ginning of the operation; and

68  
69 (b) 300 % of that portion of the costs and expenses of drilling reworking, deepening, or plugging  
70 back, testing and completing, after deducting any cash contributions received under Article VIII.C., and



1 300 % of that portion of the cost of newly acquired equipment in the well (to and including the well-  
2 head connections). which would have been chargeable to such Non-Consenting Party if it had partici-  
3 pated therein.

4 Gas production attributable to any Non-Consenting Party's relinquished  
5 interest shall be sold, at the election of the Consenting Party, consistent  
6 with the terms of the Consenting Party's gas sales contract, either to  
7 the Consenting Party's purchaser or to the Non-Consenting Party's pur-  
8 chaser, such Non-Consenting Party shall direct its purchaser to remit the  
9 proceeds receivable from such sale direct to the Consenting Party until the  
10 amounts provided for in this Article are recovered from the Non-Consenting  
11 Party's relinquished interest.  
12  
13

14 During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share  
15 of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of  
16 all production, severance, gathering and other taxes, and all royalty, overriding royalty and other  
17 burdens applicable to Non-Consenting Party's share of production.  
18

19 In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall  
20 be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of  
21 all such equipment shall remain unchanged; and upon abandonment of a well after such reworking,  
22 plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the  
23 owners thereof, with each party receiving its proportionate part in kind or in value, less cost of  
24 salvage.  
25

26 Within sixty (60) days after the completion of any operation under this Article, the party con-  
27 ducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an in-  
28 ventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling,  
29 deepening, plugging back, testing, completing, and equipping the well for production; or, at its option,  
30 the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed  
31 statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being  
32 reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furn-  
33 ish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the  
34 operation of the well, together with a statement of the quantity of oil and gas produced from it and the  
35 amount of proceeds realized from the sale of the well's working interest production during the preceding  
36 month. In determining the quantity of oil and gas produced during any month, Consenting Parties  
37 shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any  
38 amount realized from the sale or other disposition of equipment newly acquired in connection with any  
39 such operation which would have been owned by a Non-Consenting Party had it participated therein  
40 shall be credited against the total unreturned costs of the work done and of the equipment purchased,  
41 in determining when the interest of such Non-Consenting Party shall revert to it as above provided;  
42 and if there is a credit balance, it shall be paid to such Non-Consenting party.  
43

44 If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest  
45 the amounts provided for above, the relinquished interests of such Non-Consenting Party shall auto-  
46 matically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same  
47 interest in such well, the material and equipment in or pertaining thereto, and the production there-  
48 from as such Non-Consenting Party would have been entitled to had it participated in the drilling,  
49 reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be  
50 charged with and shall pay its proportionate part of the further costs of the operation of said well in  
51 accordance with the terms of this agreement and the Accounting Procedure, attached hereto.  
52

53 Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent  
54 of all parties, no wells shall be completed in or produced from a source of supply from which a well  
55 located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing  
56 well spacing pattern for such source of supply.  
57

58 The provisions of this Article shall have no application whatsoever to the drilling of the initial  
59 well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b)  
60 to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall  
61 prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article  
62 VI.A.  
63

64 **C. Right to Take Production in Kind:**

65 See Article XV. A. and C.

66 Each party shall have the right to take in kind or separately dispose of its proportionate share of  
67 all oil and gas produced from the Contract Area, exclusive of production which may be used in de-  
68 velopment and producing operations and in preparing and treating oil for marketing purposes and  
69 production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate dispo-  
70 sition by any party of its proportionate share of the production shall be borne by such party. Any

party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.

Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment direct from the purchaser thereof for its share of all production.

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate commerce, of any other party's share of gas production without first giving such other party thirty (30) days notice of such intended sale.

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

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

Each party shall have access to the Contract Area at all reasonable times, at its sole risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the information.

#### **E. Abandonment of Wells:**

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

2. Abandonment of Wells that have Produced: Except for any well which has been drilled or re-worked pursuant to Article VI.B.2. hereof for which the Consenting Parties have not been fully reimbursed as therein provided, any well which has been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment of such well, all parties do not agree to the abandonment of any well, those wishing to continue its operation shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, quality, or fitness for use of the equipment and material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or intervals of the formation or formations then open to production, for a term of one year and so long thereafter as oil and or gas is produced from the interval or inter-

vals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentages of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interest in the remaining portion of the Contract Area.

Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned well.

## ARTICLE VII. EXPENDITURES AND LIABILITY OF PARTIES

### A. Liability of Parties:

See Article XV. B.

The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.

### B. Liens and Payment Defaults:

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

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

### C. Payments and Accounting:

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

Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

**D. Limitation of Expenditures:**

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

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

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

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

3. Other Operations: Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of Twenty-Five Thousand Dollars (\$ 25,000.00 ) except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares "Authority for Expenditures" for its own use, Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project costing in excess of Fifteen Thousand Dollars (\$ 15,000.00 ).

**E. Royalties, Overriding Royalties and Other Payments:**

See Article XV. C.

~~Each party shall pay or deliver, or cause to be paid or delivered, all royalties to the extent of due on its share of production and shall hold the other parties free from any liability therefor. If the interest of any party in any oil and gas lease covered by this agreement is subject to any royalty, overriding royalty, production payment, or other charge over and above the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account for or cause to be accounted for, such interest to the owners thereof.~~

No party shall ever be responsible, on any price basis higher than the price received by such party, to any other party's lessor or royalty owner; and if any such other party's lessor or royalty owner should demand and receive settlements on a higher price basis, the party contributing such lease shall bear the royalty burden insofar as such higher price is concerned.

**F. Rentals, Shut-in Well Payments and Minimum Royalties:**

Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.2.

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

of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

**G. Taxes:**

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. Operator shall bill other parties for their proportionate share of all tax payments in the manner provided in Exhibit "C".

If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final determination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint account, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as provided in Exhibit "C".

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

**H. Insurance:**

At all times while operations are conducted hereunder, Operator shall comply with the Workmen's Compensation Law of the State where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be an amount equivalent to the premium which would have been paid had such insurance been obtained. Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the Workmen's Compensation Law of the State where the operations are being conducted and to maintain such other insurance as Operator may require.

In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's fully owned automotive equipment.

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

**A. Surrender of Leases:**

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

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

be shared by the parties assignee in the proportions that the interest of each bears to the interest of all parties assignee.

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

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

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

If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease. Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein by the acquiring party.

The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to the provisions of this agreement.

~~The provisions in this Article shall apply also and in like manner to extensions of oil and gas leases.~~

#### C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash toward the drilling of a well or any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. If all parties hereto are Drilling Parties and accept such tender, such acreage shall become a part of the Contract Area and be governed by the provisions of this agreement. If less than all parties hereto are Drilling Parties and accept such tender, such acreage shall not become a part of the Contract Area. Each party shall promptly notify all other parties of all acreage or money contributions it may obtain in support of any well or any other operation on the Contract Area.

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

#### D. Subsequently Created Interest:

Notwithstanding the provisions of Article VIII.E. and VIII.G., if any party hereto shall, subsequent to execution of this agreement, create an overriding royalty, production payment, or net proceeds interest, which such interests are hereinafter referred to as "subsequently created interest", such subsequently created interest shall be specifically made subject to all of the terms and provisions of this agreement, as follows:

1. If non-consent operations are conducted pursuant to any provision of this agreement, and the party conducting such operations becomes entitled to receive the production attributable to the interest out of which the subsequently created interest is derived, such party shall receive same free and clear of such subsequently created interest. The party creating same shall bear and pay all such subsequently created interests and shall indemnify and hold the other parties hereto free and harmless from any and all liability resulting therefrom.

2. If the owner of the interest from which the subsequently created interest is derived (1) fails to pay, when due, its share of expenses chargeable hereunder, or (2) elects to abandon a well under provisions of Article VI.E. hereof, or (3) elects to surrender a lease under provisions of Article VIII.A. hereof, the subsequently created interest shall be chargeable with the pro rata portion of all expenses hereunder in the same manner as if such interest were a working interest. For purposes of collecting such chargeable expenses, the party or parties who receive assignments as a result of (2) or (3) above shall have the right to enforce all provisions of Article VII.B. hereof against such subsequently created interest.

**E. Maintenance of Uniform Interest:**

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

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

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

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

**F. Waiver of Right to Partition:**

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

**G. Preferential Right to Purchase:**

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

**ARTICLE IX.  
INTERNAL REVENUE CODE ELECTION**

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No



such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from Operations hereunder can be adequately determined without the computation of partnership taxable income. The tax election in Exhibit "G" is exercised by the Tax Partnership described in Article XV. S. (3) as an entity and not by the members of the Tax Partnership in their individual capacities.

#### ARTICLE X. CLAIMS AND LAWSUITS

Operator may settle any single damage claim or suit arising from operations hereunder if the expenditure does not exceed Ten Thousand Dollars (\$ 10,000.00 ) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, the parties hereto shall assume and take over the further handling of the claim or suit, unless such authority is delegated to Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense of the parties. If a claim is made against any party or if any party is sued on account of any matter arising from operations hereunder over which such individual has no control because of the rights given Operator by this agreement, the party shall immediately notify Operator, and the claim or suit shall be treated as any other claim or suit involving operations hereunder.

#### ARTICLE XI. FORCE MAJEURE

If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations under this agreement, other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the force majeure with reasonably full particulars concerning it; thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure, shall be suspended during, but no longer than, the continuance of the force majeure. The affected party shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

The requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party concerned.

The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood, explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment, and any other cause, whether of the kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.

#### ARTICLE XII. NOTICES

All notices authorized or required between the parties, and required by any of the provisions of this agreement, unless otherwise specifically provided, shall be given in writing by United States mail or Western Union telegram, postage or charges prepaid, or by teletype, and addressed to the party to whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any provision hereof shall be deemed given only when received by the party to whom such notice is directed, and the time for such party to give any notice in response thereto shall run from the date the originating notice is received. The second or any responsive notice shall be deemed given when deposited in the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid, or when sent by teletype. Each party shall have the right to change its address at any time, and from time to time, by giving written notice hereof to all other parties.

#### ARTICLE XIII. TERM OF AGREEMENT

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

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



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

It is agreed, however, that the termination of this agreement shall not relieve any party hereto from any liability which has accrued or attached prior to the date of such termination.

#### ARTICLE XIV. COMPLIANCE WITH LAWS AND REGULATIONS

##### A. Laws, Regulations and Orders:

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

##### B. Governing Law: SEE ARTICLE XV. F. and XV. G.

The essential validity of this agreement and all matters pertaining thereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state where most of the land in the Contract Area is located shall govern.

#### ARTICLE XV. OTHER PROVISIONS

##### A.

Each party electing to take in kind or separately dispose of its proportionate share of the production from the Contract area shall keep accurate records of the volume, selling price, royalty and taxes relative to its share of production. Non-Operators shall, upon request, furnish Operator with true and complete copies of the records required to be kept hereunder whenever, under the terms of this agreement or any agreement executed in connection herewith, it is necessary for Operator to obtain said information. Any information furnished to Operator hereunder shall be used by Operator only to the extent necessary to carry out its duties as Operator and shall otherwise be kept confidential.

##### B.

It is not the intention of the parties that this contract is made or intended for the benefit of any third person.

##### C.

For the purpose of this agreement as between the parties hereto, the royalty interest is and shall be treated as 1/8th, and the working interest of the parties hereto shall be treated as 7/8ths, and all oil and gas, including casinghead gas and condensates produced from the contract area attributable to the working interest covered by this agreement shall be owned in the proportions shown in Exhibit "A".

It is recognized by the parties hereto that in addition to each party's share of working interest production as shown in Exhibit "A", such party shall have the right, subject to existing contracts, to market the royalty gas attributable to each lease which it contributes to the Contract Area and to receive payments due for such royalty gas produced from or allocated to such lease or leases. It is

agreed that, regardless of whether each party markets or contracts for its share of gas, including the royalty gas under the leases which it contributed to the Contract Area, such party agrees to pay or cause to be paid to the royalty owners under its lease or leases the proceeds attributable to their respective royalty interest and to hold all other parties hereto harmless for its failure to do so.

It is understood by and between the parties hereto that if any of them is obligated to pay any lessor royalties at a rate in excess of the usual 1/8th royalty or to pay to anyone any overriding royalty, payments out of production, net profit obligations, carried interests, or any other outstanding obligations now existing or hereafter coming into existence against any of the parties hereto, or their respective interests, or with respect to the respective interests in the production from the above described land, all such royalties, obligations and payments by which any of the parties hereto is now bound or may hereafter become bound shall remain the obligation of the respective party or parties, as the case may be, and shall be paid and satisfied in each instance, unless otherwise paid and satisfied, out of the interest of the obligated party in the 7/8ths working interest set forth above.

D.

~~If the Operator is required hereunder to pay ad valorem taxes based in whole or in part upon separate valuations of each party's working interest, then notwithstanding anything to the contrary herein, charges to the joint account shall be made and paid by the parties hereto in accordance with the percentage of tax value generated by each party's working interest.~~

~~E. Anything to the contrary notwithstanding, the following shall apply to the renewal or extension of leases as to the undeveloped portions of the unit:~~

(1) Renewal or Extension by Original Lease Owner

If the party who committed a lease to this agreement, which party is referred to as the "original lease owner", shall renew such lease prior to or within six (6) months after the expiration date of such lease, such party shall thereby own or retain its original interest and title in said lease and all parties' working interest in the Contract Area shall remain unchanged, unless such renewal lease covers less area or less interest than was covered by said lease at the time of its expiration, in which event the interest of the parties will be adjusted accordingly.

(2) Renewal or Extension by Other Than Original Lease Owner

If any working interest owner other than the original lease owner renews a lease committed to this agreement prior to or within six (6) months after the expiration date of such lease, whether such renewal lease is for the entire interest covered by the expiring lease or covers only a portion of its area or an interest therein, the renewing party shall furnish the original lease owner an itemized statement of the full costs and expenses of renewing such lease. The original lease owner shall have sixty (60) days after the receipt of such itemized statement within which to reimburse the renewing party in full for such costs and expenses of renewing such lease, and promptly execute an assignment of such renewal lease to the original lease owner. If such renewal lease covers the same area and the same interest as the expiring lease, then the interests of all parties' working interest in the Contract Area shall remain unchanged; otherwise, the interests of all the parties will be adjusted accordingly.

(3) Original Lease Owner Does Not Elect to Reimburse

If the original lease owner does not elect to reimburse the renewing party for such costs and expenses of renewing such lease within sixty (60) days after receipt of such statement, such lease shall then be promptly offered by the renewing party to all of the working interest owners on a pro rata basis provided each such owner agrees to pay his proportionate part of the renewal costs. Such renewal costs shall be borne in proportion to the interest held at that time by the parties in the Contract Area, and such party or parties shall receive an assignment of the renewal lease from the renewing party in proportion to their interest in the Contract Area. Such right to pay renewal costs and to share in the assignment of said lease must be exercised within sixty (60) days after receipt of such notice from the renewing party. If all parties to this agreement elect to share in the renewal costs and to receive an assignment of such renewal lease in proportion to their current interest,

~~(3) Original Lease Owner Does Not Elect to Reimburse (Continued)~~

then such lease shall again become subject to this agreement and the interest of all parties' working interest in the Contract Area shall remain unchanged.

(4) If All Parties Do Not Elect to Reimburse

If one or more parties to this agreement elect not to reimburse the renewing party and to receive an assignment of their proportionate interest in such renewal lease, then such renewal lease shall not be or become subject to this agreement unless all parties to this agreement consent in writing to such lease being subject to this agreement and all parties consent to adjusting their percentages of participation in the Contract Area.

(5) Individual Loss

If any party secures the renewal of a lease subject to this agreement, the loss of which was an individual loss, such lease shall again become subject to this agreement and to the rights of the original lease owner under Subsections XV E (1) and XV E (2) hereof, subject only to an adjustment of percentages as required. However, the provisions of Subsections XV E (3) and XV E (4) shall not be applicable hereto and shall not apply to any such individual loss.

(6) Renewal Lease Defined

A renewal lease as used in Article XV E hereof shall mean any lease taken before the expiration of its predecessor lease, or any lease taken or contracted for within six (6) months after the expiration of an existing lease. Any lease taken or contracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease.

(7) Article XV E also Applies to Extensions

The provisions of Article XV E (a) through (e) shall also apply in like manner to extensions of leases and where not in conflict or in contradiction, the terms "renewal" and the term "extension" as used in said Article XV E shall have the same meaning.

F. TERM

This agreement shall remain in force for a period of one (1) year from and after the effective date of the Unit Agreement, and as long thereafter as the Unit Agreement is in effect. In the event of termination of the Unit Agreement for any reason as to all or any part of the land now or hereafter included in the Unit Area, this agreement shall continue in full force and effect with respect to any land as to which the Unit Agreement terminates which is included in any drilling unit or proration unit for any unabandoned well which has been drilled or commenced pursuant to this agreement, and as long thereafter as oil and gas, or either of them is produced from the Unit Area, or any part thereof, or as long as producing, drilling or reworking operations are conducted thereon with no cessation of more than sixty (60) consecutive days, or as long as any lease committed to the Unit remains in effect by the payment of shut-in gas royalties on a gas well situated upon the Unit Area or any portion thereof. This agreement shall constitute a covenant running with the committed interests and shall be binding upon and insure to the benefit of the parties hereto, their successors and assigns. In the event of the termination of the Unit Agreement as to part of the land included in such Unit Agreement, the lands remaining subject to the Unit Agreement will also remain subject to this Operating Agreement.

G. It is understood that this contract may not be canceled, terminated or suspended for noncompliance with the Nondiscrimination Clause set forth in Exhibit "F" attached hereto until a final determination of noncompliance has been made by the Director, Office of Federal Contract Compliance, U. S. Department of Labor, as authorized in Executive Order No. 11246 of September 24, 1965.

H. CASING POINT ELECTION

~~It is specifically understood that consent to the drilling or deepening of a well shall not be deemed as consent to the setting of casing and a completion attempt. After any well drilled pursuant to this agreement has~~

#### H. CASING POINT ELECTION (CONTINUED)

~~reached its authorized depth, Operator shall give immediate notice to parties bearing costs of drilling to said depth. The parties receiving such notice shall have twenty-four (24) hours in which to elect whether or not they desire to set casing and to participate in a completion attempt. Failure of a party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of a completion attempt. If all of the parties election to plug and abandon the well, Operator shall plug and abandon same at the expense of said parties. If one or more, but less than all, of said parties elect to set pipe and attempt completion, the provisions of Section 9 shall apply to the operations thereafter conducted by less than all parties.~~

#### I. REQUIRED WELLS

For the purpose of this article a well shall be deemed a required well if the drilling thereof is required by the final order of an authorized representative of the Department of Interior. Such an order shall be deemed final upon expiration of the time allowed for appeal therefrom without the commencement of appropriate appeal proceedings or, if such proceedings are commenced within said time, upon the final disposition of the appeal. Whenever Unit Operator receives any such order, it shall promptly mail a copy thereof to each of the other parties; if any such order is appealed, the party appealing shall give prompt written notice thereof to each of the other parties, and upon final disposition of the appeal, Unit Operator shall give each of the other parties prompt written notice of the result thereof.

Any party desiring to drill, or participate in the drilling of, a required well shall give to Unit Operator written notice thereof within thirty (30) days after the order requiring such well becomes final or within such lesser time as may be required by such order. If such notice is given within said period, Unit Operator shall drill the required well for the account of the party or parties giving such notice, who shall bear all costs incurred therein; the rights and obligations of such party or parties with respect to the ownership of such well, the operating rights therein, the available production therefrom and the bearing of costs incurred therein shall be the same as if the well had been drilled for the account of such party or parties under Article VI B 2, "Additional Wells."

If no party elects to drill a required well within the period allowed for such election, and if any of the following alternatives are available, the first such alternative which is available shall be followed:

- a. If compensatory royalties may be paid in lieu of drilling the well and if payment thereof is authorized by the parties within said period, Unit Operator shall pay such compensatory royalties; or
- b. If the drilling of the well may be avoided, without other penalty, by contraction of the Unit Area through exclusion of lands not then within a participating area, Unit Operator shall make reasonable effort to effect such contraction with the approval of the Director; or
- c. If unitized substances have not theretofore been discovered in paying quantities within the Unit Area, the parties shall join in termination of the Unit Agreement in accordance with its provisions.

If none of the foregoing alternatives are available, Unit Operator shall drill the required well for the account of all the parties, each of whom shall bear that percentage of all costs incurred therein which is equal to its participating interest.

#### J. COMPENSATORY ROYALTIES

Whenever demand is made in accordance with the Unit Agreement for the drilling of a well for the protection of the Unit Area from drainage, or for the payment of compensatory royalties in lieu thereof, Unit Operator shall give written notice thereof to each party. If payment of such compensatory

J. COMPENSATORY ROYALTIES (CONTINUED)

royalties is approved by the parties, Unit Operator shall make payment hereof. All payments so made by Unit Operator shall be charged as costs and borne by the parties in proportion to their respective participating interests. If payment of compensatory royalties is not approved by the parties, then the rights and obligations of the parties shall be governed by Article XV I, "Required Wells."

~~K. UNCOMMITTED ROYALTY~~

~~Should an owner of a royalty interest in any tract fail to become a party to the Unit Agreement and, as a result thereof, the actual royalty interest payments with respect to such tract are more or less than the royalty interest payments computed on the basis of the unitized substances that are allocated to such tract under the Unit Agreement, to the extent provided below, the difference shall be borne by or inure to the benefit of working interest owners, in proportion to their respective unit participation.~~

~~The difference to be borne by or inure to the benefit of working interest owners shall not exceed an amount computed on the basis of 1/8th of the difference between the unitized substances allocated to the tract and the unitized substances produced from the tract. Such adjustments shall be made by charges and credits to the joint account. Any uncommitted royalty interest in excess of 1/8th shall be borne solely by the working interest owner contributing such interest.~~

L. MANNER OF EXERCISING SUPERVISION

For projects exceeding Operator's expenditure limits and for other operational procedures not covered by this Operating Agreement, the following procedures shall apply.

Each working interest owner shall in writing inform Unit Operator of the names and addresses of its representative and alternate who are authorized to represent and bind such working interest owner in all duly called meetings with respect to Unit operations. The representative or alternate may be changed from time to time by written notice to Unit Operator.

All meetings of working interest owners shall be called by Unit Operator upon its own motion or at the request of two (2) or more working interest owners having a total percentage participation in the initial well after payout and all subsequent wells of not less than ten percent (10%). No meeting shall be called on less than fourteen (14) days' advance written notice, with agenda for the meeting attached. Working interest owners who attend the meeting shall not be prevented from amending items included in the agenda or from deciding the amended item or other items presented at the meeting. The representative of Unit Operator shall be chairman of each meeting.

Working interest owners shall decide all matters coming before them as follows:

- a. Each working interest owner shall have a voting interest computed by dividing its leasehold acreage material to the issue at hand by the total committed acreage.
- b. 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 by the affirmative vote of two (2) or more working interest owners having a total of sixty percent (60%) or more of the total voting interest in the Unit; provided that, if any one working interest owner has a voting interest of more than forty percent (40%), its negative vote or failure to vote shall not defeat the matter being voted on if such matter is supported by a majority of the voting interest unless such working interest owner is supported by the vote of one or more other working interest owners having a total voting interest of at least five percent (5%), and such resulting vote shall be binding on all parties.
- c. Any working interest owner who is not represented at a meeting may vote either by written proxy or by letter or telegram addressed

L. MANNER OF EXERCISING SUPERVISION (CONTINUED)

- c. (Continued) to the representative of the Unit Operator, provided such letter or telegram is received prior to the submission of such item to vote. If the vote is by letter or telegram, such vote shall not be counted with respect to any item on the agenda which has been materially changed at the meeting.
- d. Working interest owners may vote on and decide, by letter or telegram, any matter submitted in writing to working interest owners, if no meeting is requested, as provided in this article, within seven (7) days after the proposal is received by working interest owners. Unit Operator will give prompt notice of the results of the voting to all working interest owners.
- e. Any expenditure occurring as a result of vote will be billed to joint account and paid by all parties in accordance with their respective working interest ownership in the Unit Area.

M. ESTABLISHMENT, REVISION AND CONSOLIDATION OF PARTICIPATING AREA

Unit Operator shall initiate each proposal for the establishment or revision of a participating area by submitting the proposal therefor in writing to each Working Interest Owner at least thirty (30) days before filing the same with the Supervisor and the Land Commissioner. The date of the proposed filing shall be shown on the proposal. If the proposal receives the approval of the Working Interest Owners as provided in Article L hereof, then such proposal shall be filed on the date specified in the notice.

Prior to the proposed filing date, any Working Interest Owner may submit to all other Working Interest Owners and Unit Operator written objections to such proposal. If, despite such objections, the proposal receives the approval of the Working Interest Owners, then the Working Interest Owner making such rejection may renew its objections before the Supervisor and the Land Commissioner.

If the proposal does not receive the approval of such Working Interest Owners, then the Unit Operator shall submit a revised proposal taking into account the objections made to the first proposal. If no proposal received the approval of said Working Interest Owners within thirty (30) days from the submission of the first proposal, the Unit Operator shall then file with the Supervisor and the Land Commissioner a proposal reflecting as nearly as practicable the various views expressed by the affected Working Interest Owners.

If a proposal filed by the Unit Operator as above provided is rejected by the Supervisor and/ or the Land Commissioner, the Unit Operator shall initiate a new proposal in the same manner as provided in the third paragraph of this Article M and the procedure with respect thereto shall be the same as in the case of an initial proposal.

Two (2) or more participating areas may be combined as provided in the Unit Agreement.

N. MISCELLANEOUS

It is understood that all references made herein to the respective parties shall, where applicable, include the singular or the plural, as the case may be, and use of any pronoun herein shall, where applicable, cover the masculine, feminine and neuter, as the case may be. It is further understood and agreed that the headings used in this agreement are inserted for convenience only and shall be disregarded in construing this agreement.

In the event of conflict between the Unit Agreement and this Unit Operating Agreement, the terms and conditions of the Unit Agreement shall control.

O. DEPARTMENT OF ENERGY REGULATIONS

Non-Operators agree to release Operator from any and all losses, damages, injuries, claims and causes of action arising out of, incident to or resulting directly or indirectly from Operator's interpretation or application of rules, rulings, regulations or orders of the Department of Energy or predecessor agencies to the extent Operator's interpretation or application of such rules, rulings, regulations or orders were made in good faith. Non-Operators further agree to reimburse Operator for their proportionate share of any amounts

0. DEPARTMENT OF ENERGY REGULATIONS (CONTINUED)

Operator may be required to refund, rebate or pay as a result of an incorrect interpretation or application of the above noted rules, rulings, regulations, or orders together with the Non-Operators' proportionate part of interest and penalties owing by Operator as a result of such incorrect interpretation or application of such rules, rulings, regulations or orders.

~~P. PARTICIPATION IN COST OF INITIAL TEST WELL~~

~~who presently own interests in the contract area, are contributing a portion of~~  
such interests to the drilling of the Initial Test Well, and will hereinafter  
be referred to as the "Contributing Party" whether one or more. The  
Contributing Party's share of the Initial Test Well will be paid for by  
Gulf Oil Corporation               %, and  
            %, who will be referred to as "Earning Party" whether one or more.

In consideration of payment of expenses set forth in Exhibit "A-2" hereof, performance of all the terms and provisions of this agreement, and completion of the Initial Test Well as a well capable of producing oil or gas in paying quantities (quantities sufficient to return the cost of operating the well and a reasonable profit), the Earning Party shall earn oil and gas rights in the Contract Area equal to (a) the entire present interest of the Contributing Party in the largest participating area initially assigned by the New Mexico Oil Conservation Commission to the Initial Test Well which is first completed as a producing oil or gas well, and (b) an undivided 1/2 of the present interest of the Contributing Party in the Contract Area outside of the participating area. The Contributing Party, in proportion to the interest in the Contract Area, excepts and reserves from the participating area, a total overriding royalty, subject to proportionate reduction, equal to 1/16 of 8/8ths of the oil and gas produced, saved and marketed from the participating areas. This total overriding royalty shall include and absorb all overriding royalties and other obligations payable out of production from the Participating Area. After the earning Party has earned an interest in the Contract Area as provided hereinabove, and upon request of the Earning Party, the Contributing Party shall execute and deliver assignments of operating rights, without warranties of title, confirming the oil and gas operating rights earned.

Upon payout of the initial test well, the Contributing Party's overriding royalty interest shall terminate, the the Contributing Party shall be entitled to a forty percent (40%) working interest, proportionately reduced, in the contract area. Payout of the initial test well shall be deemed to have occurred when proceeds of all production from the initial test well (after deducting the gross production taxes, royalty, overriding royalty, and other interests payable out of or measured by such share of the production) shall equal 100% of the cost incurred in drilling, deepening, plugging back, reworking; completing and equipping (excluding any costs beyond the wellhead connection) such well, and 100% of the cost beyond the wellhead connection, such as tanks, separators and flow lines, together with 100% of the cost of operation thereof during such time, such cost to be determined in accordance with the provisions of the Accounting Procedure (Exhibit "C") of the Operating Agreement referred to above.

Within thirty (30) days after Operator has recovered all drilling and completion costs attributable to the initial test well and said well has paid out, Operator shall notify the Contributing Party of such fact. The Contributing Party's working interest shall become effective at 7:00 A.M. on the first day following the day the well pays out, and all operations on any subsequent well on the contract area shall be governed by the provisions of the Operating Agreement of even date herewith.

~~P. PARTICIPATION IN COST OF INITIAL TEST WELL~~

~~hereinafter referred to as Contributing Party,~~  
own leasehold estate rights in the following described land:

Such land is situated in the contract area. Contributing Party is farming out its interest in the above described land to Gulf Oil Corporation.

In consideration of payment of expenses as set forth in Exhibit "A" hereof, performance of all the terms and provisions of this agreement, and completion of the initial test well as a well capable of producing oil or gas in paying quantities (quantities sufficient to return the cost of operating the well and a reasonable profit), the Earning Party shall earn from Contributing Party the following described rights in the proportions described above:

1. 100% of Contributing Party's leasehold estate rights in the initial test well proration unit.
2. 60% of Contributing Party's leasehold estate rights in the contract area located outside of the initial test well proration unit.
3. 100% of any right Contributing Party may have to share in production from the initial test well.

Notwithstanding the foregoing, the Contributing Party shall receive out of the initial test well a cost free interest in production equal to  $1/16$  of  $8/8$ ths of all oil and gas produced, saved and marketed from the initial test well, proportionately reduced by the percentage of the Contract Area which was committed by contributing parties (determined on an acreage basis) as further set forth in Exhibit "A" hereto. After the Earning Party has earned an interest in the Contract Area as provided herein above, and upon request of the Earning Party, the Contributing Party shall execute and deliver assignments of such rights without warranties of title, confirming that such rights were earned.

Upon payout of the initial test well, as described below, the Contributing Party shall have the option, to be exercised within 30 days of the receipt of the notice described below, to terminate its  $1/16$  of  $8/8$ ths, proportionately reduced, cost free interest in production from the initial test well, and fully participate in the initial test well, receiving its share of production and paying its share of costs, as set out in Exhibit "A" hereto. In the event Contributing Party owned leasehold estate rights in the proration unit of the initial test well, and pursuant to the terms of this agreement assigned 100% of such rights in such proration unit to Earning Parties, then upon making the election to fully participate, as provided above, Earning Party shall reassign to Contributing Party an undivided 40% of the leasehold estate rights which were previously assigned by the contributing party to earning party.



~~P. PARTICIPATION IN COST OF INITIAL TEST WELL (CONTINUED)~~

~~Payout of the initial test well shall be deemed to have occurred when proceeds of all production from the initial test well (after deducting gross production taxes, royalty, overriding royalty, and other interests payable out of or measured by such share of production) shall equal 100% of the costs incurred in drilling, deepening, plugging back, reworking, completing and equipping such well (including any costs beyond the well head connection such as tanks, separators and flow lines), together with 100% of the costs of operation thereof during such time, such cost to be determined in accordance with the provisions of the accounting procedures (Exhibit "C") of this Operating Agreement.~~

~~Within 30 days after operator has recovered all drilling and completion costs attributable to the initial test well and said well has paid out, operator shall notify the contributing party of such fact. If the contributing party makes the election provided for above, such election shall become effective at 7 a.m. on the first day following the day the well pays out.~~

Q. PLANS OF DEVELOPMENT

Each plan for the development and operation of the Contract Area which is submitted by Operator to the Supervisor in accordance with the Unit Agreement shall make provision only for such drilling, deepening and plugging back operations and such other projects as Operator has been authorized to conduct by the parties chargeable with the costs incurred therein.

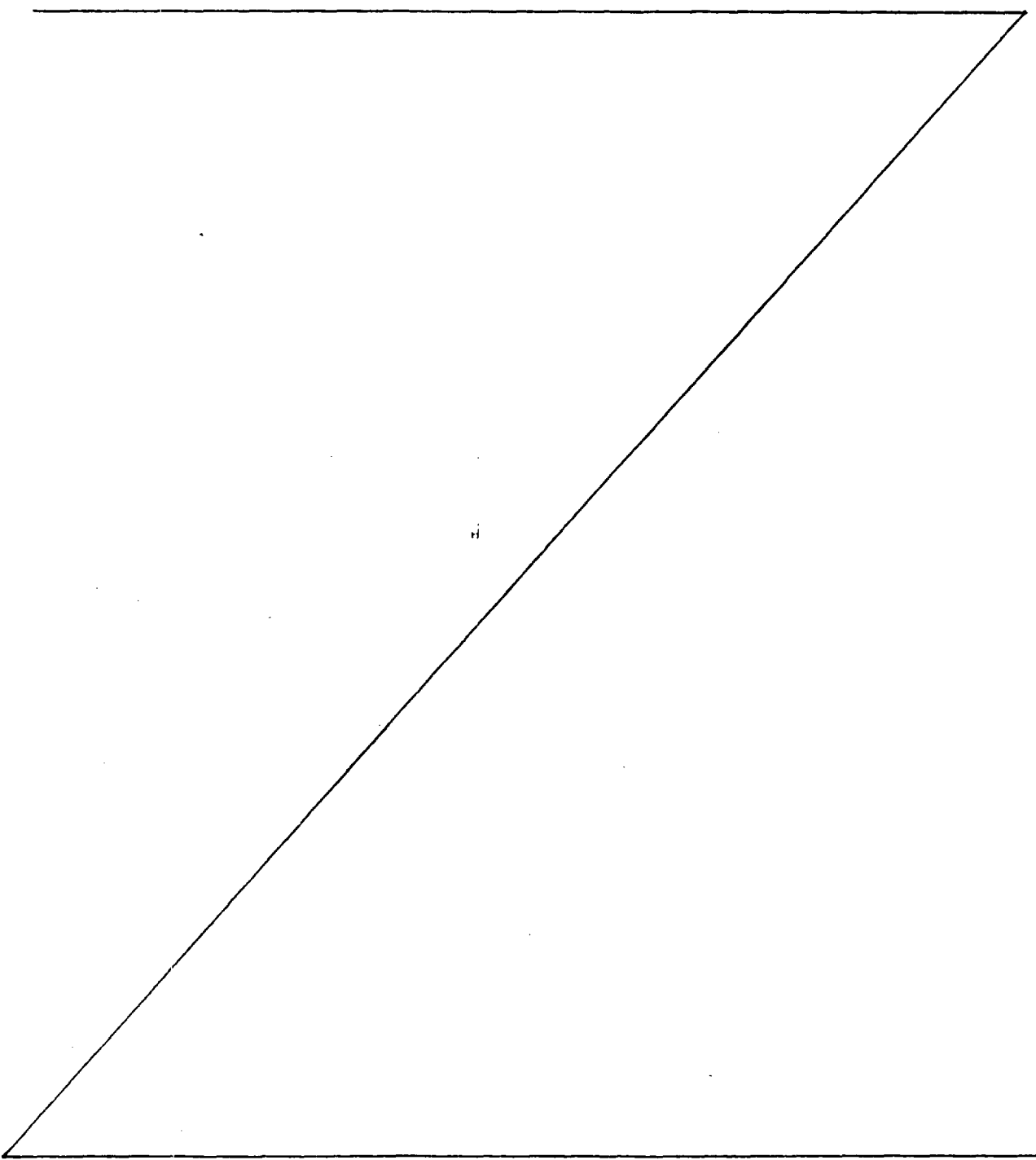
At least ten days before submitting any such proposed plan to the Supervisor, Unit Operator shall give each party a written notice thereof, together with a copy of the proposed plan.

If and when a proposed plan has been approved or disapproved by the Supervisor, Unit Operator shall give prompt written notice thereof to each party. In case of disapproval, Operator shall state in such notice the reasons therefor.

If a drilling, deepening, or plugging back operation which is authorized by all the parties of which any of the parties have elected to perform in accordance with article VI B is not provided for in the then current plan of development as approved by the Supervisor, Operator shall either (a) request the Supervisor to approve an amendment to such plan which will provide for the conduct of such operation, or (b) request the Supervisor to consent to such operation if his consent is sufficient.

If any such plan as approved by the Supervisor provides for the cessation of any drilling or other operations therein provided for on the happening of a contingency and if such contingency occurs, Operator shall promptly cease such drilling or other operations and shall not incur any additional costs in connection therewith unless and until such drilling or other operations are again authorized in accordance with this agreement by the parties chargeable with such costs.

R.

- ~~1. Operator agrees to comply with all laws and lawful regulations applicable to any activities carried out in the name of or on behalf of any one or more of the parties to this agreement under the provisions of this agreement and/or any amendments to it.~~
  2. Operator agrees that all financial settlements, billings and reports rendered to any one or more of the parties to this agreement, as provided for in this agreement and/or any amendments to it, will, to the best of its knowledge and belief, reflect properly the facts about all activities and transactions handled for the account of such party or parties, which data may be relied upon as being complete and accurate in any further recording and reporting made by such party or parties for whatever purpose.
  3. Operator agrees to notify the other parties to this agreement promptly upon discovery of any instance where the Operator fails to comply with the provision (1) above or where Operator has reason to believe ~~data covered by (2) above is no longer accurate and complete.~~
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F A R M O U T   A G R E E M E N T

This Article XV. S. shall constitute an agreement between \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_, hereinafter referred to as "Earning Party or Parties", as the case may be, and \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_, hereinafter referred to as "Contributing Party or Parties", as the case may be. In consideration for the Earning Parties' bearing the entire costs attributable to the Contributing Parties' share of the costs of drilling, testing, completing, and operating the Initial Well in the respective proportions of \_\_\_\_\_ and \_\_\_\_\_; it is agreed as follows:

(1) When and if the Initial Well has been completed as a Commercially Productive Well, the Contributing Parties shall execute and deliver to the Earning Parties the following described assignment:

An assignment covering all rights, title and interest of the Contributing Parties in and to that portion of the Contract Area included within the drilling unit around the Initial Well

\_\_\_\_\_ to the Earning Parties in the respective shares as shown above, but reserving to the Contributing Parties \_\_\_\_\_

\_\_\_\_\_ an overriding royalty interest of \_\_\_\_\_, proportionately reduced, said overriding royalty interest being each Earning Party's proportionate share of \_\_\_\_\_ of all production from the Initial Well which is attributable to the interest in the Contract Area initially owned by the Contributing Parties. Said assignment shall provide that each Contributing Party shall have an option after payout to convert its said overriding royalty interest to a proportionate share of \_\_\_\_\_, said working interest being share of \_\_\_\_\_ of all production from the Initial Well which is attributable to the interest in the Contract Area initially owned by each Contributing Party.

Payout of the Initial Well shall be deemed to have occurred when proceeds of production from the Initial Well (after deducting the gross production taxes, royalty, overriding royalty, and other interests payable out of or measured by such share of the production which on the date of this assignment burden the leasehold estate assigned) shall equal 100% of the costs incurred in drilling, deepening, plugging back, reworking, completing and equipping such well, including all costs beyond the wellhead connection, such as tanks, separators and flow lines, together with the costs of operation thereof during such time of payout, all of such costs to be determined in accordance with the provisions of the Accounting Procedure (Exhibit "C") of the Operating Agreement referred to above.

If, in the drilling of the Initial Well, Earning Parties encounter a drilling condition or substance before reaching the depth or formation specified in Article VI herein, which cannot be overcome by means or methods customarily used by prudent Operators in the area, then and in such event, the Initial Well may be plugged and abandoned at the depth at which the substance or condition is encountered and Earning Parties are hereby granted and given an option to commence and drill a substitute well for the Initial Well. The actual drilling of any such substitute well shall be commenced within 45 days from the date the Initial Well is plugged and abandoned and shall be staked at a location of Earning Parties' choice on the Contract Area. Any such substitute well shall be drilled to the same depth and under the same terms and conditions as are applicable to the Initial Well, and when so drilled, shall be considered for all purposes to be the Initial Well.

Within thirty (30) days after payout of the Initial Well the Operator shall notify all Earning and Contributing Parties of such fact. The Contributing Parties shall have 60 days from receipt of such notice to notify the Earning Parties in writing whether or not they have elected to convert their respective overriding royalty interests into the said working interests.

If any Contributing Party fails to so notify the Earning Parties within said 60-day period, it will be conclusively presumed that the Contributing Party has elected to retain its overriding royalty interest in that portion of the Contract Area included within the drilling unit around the Initial Well and in the production from the Initial Well, rather than to convert same to a working interest. Upon Contributing Parties' election to convert its overriding royalty interest to a working interest, the Contributing Parties' working interest shall become effective at 7:00 A.M. on the first day following the day the well pays out. If any or all of the Contributing Parties elect to convert to a working interest, the Earning and Contributing Parties shall execute such instruments as are appropriate to effectuate such conversion of record with such conversion becoming effective the first day after payout of the Initial Well.

(2) When and if the Initial Well has been completed as a Commercially Productive Well, the Contributing Parties shall also execute and deliver to the Earning Parties the following described assignment:

An assignment conveying \_\_\_\_\_ of the rights, title and interest of the Contributing Parties \_\_\_\_\_

\_\_\_\_\_ in the Initial Well in and to all of the Contract Area, except for that portion which is included within the drilling unit around the Initial Well, to \_\_\_\_\_

(3) "Tax Partnership": The Contributing and Earning Parties hereby agree that they are tax partners and will be bound by the Tax Partnership Agreement attached hereto as Exhibit "G" and incorporated herein by reference for all purposes.

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ARTICLE XVI.  
MISCELLANEOUS

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

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

IN WITNESS WHEREOF, this agreement shall be effective as of \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

OPERATOR

GULF OIL CORPORATION

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

NON-OPERATORS

ATTEST: HANAGAN PETROLEUM COMPANY

By \_\_\_\_\_  
Secretary Title:

IRA L. ELLIOT

Signature Page to Unit Operating Agreement covering all of Sections 11, 14, and 23, T-13-S, R-30-E, N.M.P.M., Chaves County, New Mexico.

ATTEST:

HOLLY ENERGY, INC.

\_\_\_\_\_  
Secretary

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

READ AND STEVENS, A PARTNERSHIP

\_\_\_\_\_  
CHARLES B. READ

READ AND STEVENS, A PARTNERSHIP

\_\_\_\_\_  
NORMAN L. STEVENS

EXHIBIT "A"

Attached to and made a part of the Operating Agreement  
between GULF OIL CORPORATION  
as "Operator", and HANAGAN PETROLEUM COMPANY, et al  
\_\_\_\_\_, as "Non-Operator".

Chaves County, New Mexico

- (1) Identification of lands subject to agreement:

- (2) Restrictions, if any, as to depths or formations:  
Restricted from 3,000 feet beneath the surface to all depths below.

- (3) Percentages or fractional interests of parties to this agreement:

- ~~(4) Oil and gas leases and/or oil and gas interests subject to this agreement:~~

- (5) Addresses of parties for notice purposes:

## EXHIBIT "C"

Attached to and made a part of Operating Agreement between  
GULF OIL CORPORATION as "Operator", and HANAGAN PETROLEUM  
COMPANY, et al, as "Non-Operator", Chaves County, New Mexico.

# ACCOUNTING PROCEDURE JOINT OPERATIONS

## I. GENERAL PROVISIONS

### 1. Definitions

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

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

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

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

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

"Parties" shall mean Operator and Non-Operators.

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

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

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

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

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

### 2. Statement and Billings

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

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

Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the rate of twelve percent (12%) per annum or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts.

### 4. Adjustments

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

### 5. Audits

A. Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct joint or simultaneous audits in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator.

### 6. Approval by Non-Operators

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



## II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

### 1. Rentals and Royalties

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

### 2. Labor

- A. (1) Salaries and wages of Operator's field employees directly employed on the Joint Property in the conduct of Joint Operations.
- (2) Salaries and related expenses of Supervisors in the field below Area Superintendent.
- (3) Salaries and wages of Technical Employees directly employed on the Joint Property if such charges are excluded from the Overhead rates.
- B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II. Such costs under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 2A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.
- C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II.
- D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II.

### 3. Employee Benefits

Operator's current costs of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II shall be Operator's actual cost not to exceed twenty-six percent (26%), or percent most recently recommended by the Council of Petroleum Accounts Societies of North America.

### 4. Material

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

### 5. Transportation

Transportation of employees and Material necessary for the Joint Operations but subject to the following limitations:

- A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by the Parties.
- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.
- C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking cost of \$200 or less excluding accessorial charges.

### 6. Services

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 9 of Section II and Paragraph 1. ii of Section III. The cost of professional consultant services and contract services of technical personnel directly engaged on the Joint Property if such charges are excluded from the Overhead rates. The cost of professional consultant services or contract services of technical personnel not directly engaged on the Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.

### 7. Equipment and Facilities Furnished by Operator

- A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on investment not to exceed eight per cent (8%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.
- B. In lieu of charges in Paragraph 7A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

### 8. Damages and Losses to Joint Property

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

### 9. Legal Expense

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

**10. Taxes**

All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof, or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties.

**11. Insurance**

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

**12. Other Expenditures**

Any other expenditure not covered or dealt with in the foregoing provisions of this Section II, or in Section III, and which is incurred by the Operator in the necessary and proper conduct of the Joint Operations.

**III. OVERHEAD**

**1. Overhead - Drilling and Producing Operations**

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

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

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 2A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the Overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property shall ( ) shall not ( X ) be covered by the Overhead rates.

**A. Overhead - Fixed Rate Basis**

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

Drilling Well Rate \$ 3,950.00  
 Producing Well Rate \$ 395.00

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

**(a) Drilling Well Rate**

- [1] Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.
- [2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days
- [3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

**(b) Producing Well Rates**

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

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

**B. Overhead - Percentage Basis**

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

**(a) Development**

\_\_\_\_\_ Percent ( %) of the cost of Development of the Joint Property exclusive of costs provided under Paragraph 9 of Section II and all salvage credits.

**(b) Operating**

\_\_\_\_\_ Percent ( %) of the cost of Operating the Joint Property exclusive of costs provided under Paragraphs 1 and 9 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.

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

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

**2. Overhead - Major Construction**

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess of \$25,000 :

- A. \_\_\_\_\_ 5 % of total costs if such costs are more than \$ 25,000 \_\_\_\_\_ but less than \$ 100,000 \_\_\_\_\_; plus
- B. \_\_\_\_\_ 3 % of total costs in excess of \$100,000 \_\_\_\_\_ but less than \$1,000,000; plus
- C. \_\_\_\_\_ 2 % of total costs in excess of \$1,000,000.

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

**3. Amendment of Rates**

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

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

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

**1. Purchases**

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

**2. Transfers and Dispositions**

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

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

- (1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.
- (2) Line Pipe
  - (a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.
  - (b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

**B. Good Used Material (Condition B)**

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

- (1) Material moved to the Joint Property
  - (a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV.
- (2) Material moved from the Joint Property
  - (a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged to the Joint Account as new Material, or

- (b) at sixty-five percent (65%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged to the Joint Account as good used Material at seventy-five percent (75%) of current new price.

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

**C. Other Used Material (Condition C and D)**

**(1) Condition C**

Material which is not in sound and serviceable condition and not suitable for its original function until after reconditioning shall be priced at fifty percent (50%) of current new price as determined by Paragraph 2A of this Section IV. The cost of reconditioning shall be charged to the receiving property, provided Condition C value plus cost of reconditioning does not exceed Condition B value.

**(2) Condition D**

All other Material, including junk, shall be priced at a value commensurate with its use or at prevailing prices. Material no longer suitable for its original purpose but usable for some other purpose, shall be priced on a basis comparable with that of items normally used for such other purpose. Operator may dispose of Condition D Material under procedures normally utilized by the Operator without prior approval of Non-Operators.

**D. Obsolete Material**

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

**E. Pricing Conditions**

- (1) Loading and unloading costs may be charged to the Joint Account at the rate of fifteen cents (15¢) per hundred weight on all tubular goods movements, in lieu of loading and unloading costs sustained, when actual hauling cost of such tubular goods are equalized under provisions of Paragraph 5 of Section II.
- (2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

**3. Premium Prices**

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

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

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

## V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

**1. Periodic Inventories, Notice and Representation**

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

**2. Reconciliation and Adjustment of Inventories**

Reconciliation of a physical inventory with the Joint Account shall be made, and a list of overages and shortages shall be furnished to the Non-Operators within six months following the taking of the inventory. Inventory adjustments shall be made by Operator with the Joint Account for overages and shortages, but Operator shall be held accountable only for shortages due to lack of reasonable diligence.

**3. Special Inventories**

Special Inventories may be taken whenever there is any sale or change of interest in the Joint Property. It shall be the duty of the party selling to notify all other Parties as quickly as possible after the transfer of interest takes place. In such cases, both the seller and the purchaser shall be governed by such inventory.

**4. Expense of Conducting Periodic Inventories**

The expense of conducting periodic Inventories shall not be charged to the Joint Account unless agreed to by the Parties.

EXHIBIT "D"

Attached to and made a part of the Operating Agreement  
between GULF OIL CORPORATION  
, as "Operator",  
and HANAGAN PETROLEUM COMPANY, et al  
, as "Non-Operator".

INSURANCE COVERAGE

- (a) Workmen's Compensation Insurance and Employers'  
Liability Insurance in accordance with the laws of  
the state in which the Contract Area is situated;

and,

- (b) Comprehensive General Public Liability in the  
following amounts:

Bodily Injury:	\$150,000.00 each person \$300,000.00 each accident
Property Damage:	\$100,000.00 each accident, with the exception of the first \$5,000.00 loss which is self-insured \$200,000.00 aggregate

The \$5,000.00 self-insured property damage loss incident  
to each accident shall be charged to the Joint Account.

EXHIBIT "E"

Attached to and made a part of Operating Agreement  
between GULF OIL CORPORATION, as "Operator",  
and HANAGAN PETROLEUM COMPANY, et al, as "Non-Operator".

GAS STORAGE AND BALANCING AGREEMENT

The parties to the Operating Agreement to which this agreement is attached owned the working interest in the gas rights underlying the Contract Area covered by such agreement in accordance with the percentages of participation as set forth in Exhibit "A" to the Operating Agreement.

In accordance with the terms of the Operating Agreement, each party thereto has the right, subject to existing contracts, to take its share of gas produced from the Contract Area and market the same. In the event any of the parties hereto is not at any time taking or marketing its share of gas or has contracted to sell its share of gas produced from the Contract Area to a purchaser which does not at any time while this agreement is in effect take the full share of gas attributable to the interest of such party, the terms of this agreement shall automatically become effective.

During the period or periods when any party hereto has no market or fails to take its share of gas produced from any proration unit within the Contract Area, or its purchaser does not take its full share of gas produced from such proration unit, the other parties shall be entitled to produce each month one hundred percent (100%) of the allowable gas production assigned to such proration unit by the State regulatory body having jurisdiction and shall be entitled to take and deliver to its or their purchaser all of such gas production. All parties hereto shall share in and own the liquid hydrocarbons recovered from such gas by lease equipment in accordance with their respective interests and subject to the Operating Agreement to which this agreement is attached, but the party or parties taking such gas shall own all of the gas delivered to its or their purchaser.

On a cumulative basis, each party not taking or marketing its full share of the gas produced shall be credited with gas in storage equal to its full share of the gas produced under this agreement, less its share of gas used in lease operations, vented or lost, and less that portion such party took or delivered to its purchaser. The Operator will maintain a current account of the gas balance between the parties and will furnish all parties hereto monthly statements showing the total quantity of gas produced, the amount used in lease operations, vented or lost, the total quantity of liquid hydrocarbons recovered therefrom, and the monthly and cumulative over and under account of each party.

At all times while gas is produced from the Contract Area, each party hereto will make settlement with the respective royalty owners to whom they are each accountable, just as if each party were taking or delivering to a purchaser its share, and its share only, of total gas production exclusive of gas used in lease operations, vented or lost. Each party hereto agrees to hold each other party harmless from any and all claims for royalty payments asserted by royalty owners to whom each party is accountable. The term "royalty owner" shall include owners of royalty, overriding royalties, production payments and similar interests.

After notice to the Operator, any party at any time may begin taking or delivering to its purchaser its full share of the gas produced from a proration unit under which it has gas in storage less such party's share of gas used in operations, vented or lost. In addition to such share, each party, including the Operator, until it has recovered its gas in storage and balanced the gas account as to its interest, shall be entitled to take or deliver to its purchaser a share of gas determined by multiplying fifty percent (50%) of the interest in the current gas production of the party or parties without gas in storage by a fraction, the numerator of which is the interest in the proration unit of such

party with gas in storage and the denominator of which is the total percentage interest in such proration unit of all parties with gas in storage currently taking or delivering to a purchaser.

Each party producing and taking or delivering gas to its purchaser shall pay any and all production taxes due on such gas.

Nothing herein shall be construed to deny any party the right, from time to time, to produce and take or deliver to its purchaser its full share of the allowable gas production to meet the deliverability tests required by its purchaser.

Should production of gas from a proration unit be permanently discontinued before the gas account is balanced, settlement will be made between the underproduced and overproduced parties. In making such settlement, the underproduced party or parties will be paid a sum of money by the overproduced party or parties attributable to the overproduction which said overproduced party received, less applicable taxes theretofore paid, at the applicable price defined below for the latest delivery of a volume of gas equal to that for which settlement is made. For gas, the price of which is not regulated by federal, state, or other governmental authorities, the price basis shall be the price received for the sale of the gas. For gas, the price of which is subject to regulation by federal, state, or other governmental authorities, the price basis shall be the rate collected, from time to time, which is not subject to possible refund, as provided by the Federal Energy Regulatory Commission or any other governmental authority pursuant to final order or settlement applicable to gas sold from such well, plus any additional collected amount which is not ultimately required to be refunded by such authority, such additional collected amount to be accounted for at such time as final determination is made with respect thereto.

Nothing herein shall change or affect each party's obligation to pay its proportionate share of all costs and liabilities incurred, as its share thereof is set forth in the Operating Agreement.

This agreement shall constitute a separate agreement as to each proration unit with the Contract Area and shall become effective in accordance with its terms and shall remain in force and effect as long as the Operating Agreement to which it is attached remains in effect, and shall inure to the benefit of and be binding upon the parties hereto, their successors, legal representatives and assigns.

## EXHIBIT "F"

Attached to and made a part of the Operating Agreement  
between GULF OIL CORPORATION, as "Operator",  
and HANAGAN PETROLEUM COMPANY, et al, as "Non-Operator".

### CERTIFICATE OF COMPLIANCE

Contractor agrees that, as to all current contracts and purchase orders, as defined below, heretofore issued or entered into by Gulf, as purchaser, for the furnishing of supplies or services by Contractor, and as to each such contract and purchase order, which may hereafter be issued or entered into by Gulf in favor of the Contractor during one year from the date of execution of this Certificate, the Contractor will comply with the Federal Government's Requirements as identified below, and agrees that without further reference thereto the provisions contained in this Certificate shall be a part of each such contract and purchase order.

For the purpose of this Certificate, the words "contract" and "purchase order" shall mean any nonexempt agreement or arrangement between Gulf and the Contractor for the furnishing of supplies or services or for the use of real or personal property, including lease arrangements which, in whole or in part, are necessary to the performance of any one or more contracts between Gulf and the United States of America or under which any portion of the Gulf's obligation under any one or more such contracts is performed, undertaken, or assumed.

Gulf understands and agrees that Contractor's assent to the incorporation of the provisions in this Certificate into every nonexempt contract and purchase order between Gulf and Contractor during the periods specified herein is intended to satisfy Gulf's requirements under the governing executive orders and statutes (reference to which includes amendments and orders superseding in whole or in part) and the rules and regulations issued thereunder. Gulf further understands and agrees that this Certification is not meant to create, nor shall it be construed as creating, any enforceable rights hereunder for any firm, organization or individual who is not a party to any such contract or purchase order between Gulf and Contractor.

### NONSEGREGATED FACILITIES

The undersigned bidder, offerer, applicant, seller, contractor, or subcontractor, hereinafter referred to as Contractor, certifies to Gulf and the Federal Government agencies with which it contracts that he does not maintain or provide for his employees any segregated facilities at any of his establishments, and that he does not permit his employees to perform their services at any location, under his control, where segregated facilities are maintained. As used in this certification, the term "segregated facilities" means any waiting rooms, work areas, rest rooms and wash rooms, restaurants and other eating areas, time clocks, locker rooms and other storage or dressing areas, parking lots, drinking fountains, recreation or entertainment areas, transportation, and housing facilities provided for employees which are segregated by explicit directive or are in fact segregated on the basis of race, creed, color, or national origin, because of habit, local custom, or otherwise.

### EMPLOYMENT OF THE HANDICAPPED

Applicable to all contracts and purchase orders exceeding \$2,500, not otherwise exempted: Contractor agrees to comply with Rehabilitation Act of 1973 and all orders, rules, and regulations issued thereunder and amendments thereto.

### EQUAL OPPORTUNITY, VETERANS, AND MINORITY BUSINESS ENTERPRISES

Applicable to all contracts and purchase orders exceeding \$10,000, not otherwise exempted: Contractor agrees to comply with Executive Order 11246 regarding



Equal Opportunity and all orders, rules and regulations issued thereunder or amendments thereto. Contractor agrees to comply with Executive Order 11701 and Vietnam Veteran's Readjustment Act of 1974 and orders, rules, and regulations issued thereunder or amendments thereto. Contractor agrees to comply with Executive Orders 11458 and 11625 regarding Minority Business Enterprises and all orders, rules, and regulations issued thereunder or amendments thereto.

MINORITY BUSINESS ENTERPRISES AND  
UTILIZATION OF SMALL BUSINESS CONCERNS  
AND SMALL BUSINESS CONCERNS OWNED AND CONTROLLED  
BY SOCIALLY AND ECONOMICALLY DISADVANTAGED INDIVIDUALS

Contractor agrees to comply with Executive Order 11625 regarding Minority Business Enterprises and all orders, rules and regulations issued thereunder or amendments thereto.

Applicable to all contracts of over \$10,000 not otherwise exempted:

(A) It is the policy of the United States that small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in the performance of contracts let by any Federal agency.

(B) The Contractor hereby agrees to carry out this policy in the awarding of subcontracts to the fullest extent consistent with the efficient performance of this contract. The Contractor further agrees to cooperate in any studies or surveys that may be conducted by the Small Business Administration or the contracting agency which may be necessary to determine the extent of the Contractor's compliance with this clause.

(C) (1) The terms "small business concern" shall mean a small business as defined pursuant to Section 3 of the Small Business Act and in relevant regulations promulgated pursuant thereto.

(2) The term "small business concern owned and controlled by socially and economically disadvantaged individuals" shall mean a small business concern--

(i) which is at least 51 per centum owned by one or more socially and economically disadvantaged individuals; or in the case of any publicly owned business, at least 51 per centum of the stock of which is owned by one or more socially and economically disadvantaged individuals; and

(ii) whose management and daily business operations are controlled by one or more of such individuals.

The contractor shall presume that socially and economically disadvantaged individuals include Black Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and other minorities, or any other individual found to be disadvantaged by the Small Business Administration pursuant to section 8(a) of the Small Business Act.

(D) Contractors acting in good faith may rely on written representations by their subcontractors as either a small business concern or a small business concern owned and controlled by socially and economically disadvantaged individuals.

SMALL BUSINESS AND SMALL DISADVANTAGED  
BUSINESS SUBCONTRACTING (OVER \$500,000 OR  
\$1,000,000 FOR CONSTRUCTION OF ANY PUBLIC FACILITY)

Applicable to all contracts over \$500,000 or \$1,000,000 for construction of any public facility not otherwise exempted:

Pursuant to Temporary Regulation 50, Supplement 2(c) where applicable the contractor agrees to negotiate detailed subcontracting plan.

UTILIZATION OF WOMEN-OWNED BUSINESS CONCERNS

Applicable to all contracts over \$10,000 not otherwise exempted:

(A) It is the policy of the United States Government that women-owned businesses shall have the maximum practicable opportunity to participate in the

performance of contracts awarded by any Federal agency.

(B) The Contractor agrees to use his best efforts to carry out this policy in the award of subcontracts to the fullest extent consistent with the efficient performance of this contract. As used in this contract, a "woman-owned business" concern means a business that is at least 51% owned by a woman or women who also control and operate it. "Control" in this context means exercising the power to make policy decisions. "Operate" in this context means being actively involved in the day-to-day management. "Women" mean all women business owners.

WOMEN-OWNED BUSINESS CONCERNS SUBCONTRACTING PROGRAM

Applicable to all contracts over \$500,000 or \$1,000,000 for construction of any public facility not otherwise exempted:

(A) The Contractor agrees to establish and conduct a program which will enable women-owned business concerns to be considered fairly as subcontractors and suppliers under this contract. In this connection, the contractor shall:

1. Designate a liaison officer who will administer the Contractor's "Women-Owned Business Concerns Program".
2. Provide adequate and timely consideration of the potentialities of known women-owned business concerns in all "make-or-buy" decisions.
3. Develop a list of qualified bidders that are women-owned businesses and assure that known women-owned business concerns have an equitable opportunity to compete for subcontracts, particularly by making information on forthcoming opportunities available by arranging solicitations, time for preparation of bids, quantities, specifications, and delivery schedules so as to facilitate the participation of women-owned business concerns.
4. Maintain records showing (i) procedures which have been adopted to comply with the policies set forth in this clause, including the establishment of a source list of women-owned business concerns; (ii) awards to women-owned businesses on the source list by minority and non-minority women-owned business concerns; and (iii) specific efforts to identify and award contracts to women-owned business concerns.
5. Include the "Utilization of Women-Owned Business Concerns" clause in subcontracts which offer substantial subcontracting opportunities.
6. Cooperate in any studies and surveys of the Contractor's women-owned business concerns procedures and practices that the Contracting Officer may from time-to-time conduct.
7. Submit periodic reports of subcontracting to women-owned business concerns with respect to the records referred to in subparagraph 4 above, in such form and manner and at such time (not more often than quarterly) as the Contracting Officer may prescribe.

(B) The Contractor further agrees to insert, in any subcontract hereunder which may exceed \$500,000 or \$1,000,000 in the case of contracts for the construction of any public facility and which offers substantial subcontracting possibilities, provisions which shall conform substantially to the language of this clause, including this paragraph B and to notify the Contracting Officer of the names of such subcontractors.

(C) The Contractor further agrees to require written certification by its subcontractors that they are bona fide women-owned and controlled business concerns in accordance with the definition of a women-owned business concern as set forth in the Utilization Clause 1(b) above at the time of submission of bids or proposals.

The aforementioned Contractor agrees that the provisions of this Certificate of Compliance are hereby incorporated in every nonexempt contract or purchase order between us currently in force or that may be issued during one year from the date of execution of the Operating Agreement.

EXHIBIT " G "

Attached to and made a part of the Operating Agreement, executed by Gulf Oil Corporation, Operator, and HANAGAN PETROLEUM COMPANY, et al, Non-Operator, effective the \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

TAX PARTNERSHIP AGREEMENT

The parties recognize that this agreement creates a partnership for Federal and State income tax purposes and such parties do hereby agree not to elect to be excluded from the application of Subchapter K of Chapter I of Subtitle A of the United States Internal Revenue Code of 1954, as amended, or any similar State statute. All parties agree that the necessary Federal and State partnership income tax returns shall be filed covering operations under this agreement and Operator agrees to use its best efforts in the preparation and filing of the partnership tax returns and in making any appropriate elections on such returns, acting on behalf of itself and the other parties hereto, but in so doing, Operator shall incur no liability to any other party with regard to such returns or elections and shall make no charges for performance of any administrative or professional service in connection with the keeping of records or the filing of returns. Each party agrees to provide Operator with all information readily available from regularly maintained accounting records. Operator shall submit copies of all returns to the other parties forty-five (45) days before the due date to permit review and approval prior to filing. Operator is hereby granted authority to make the following elections under United States Internal Revenue laws and regulations and any similar State statutes:

- a. To elect to adopt the calendar year as the annual accounting period;
- b. To elect to adopt the accrual method of accounting;
- c. To elect to expense all intangible drilling and development costs;
- d. To elect to compute the allowance for depreciation utilizing the shortest life permissible under the Asset Depreciation Range System;
- e. To elect to deduct advance royalties from gross income for the year the advance royalties are paid or accrued; and,
- f. To make such other elections as may be approved by the parties.

The parties further agree that for United States income tax purposes, the gains and losses from sales, abandonments and other disposition of property and all classes of costs, expenses, and credits, including depreciation and depletion, shall be shared and accounted for as follows:

- a. All production and intangible drilling and development costs and other classes of costs and expenses shall be allocated as deductions to each party in accordance with its respective contributions to such costs;
- b. Depreciation on tangible equipment shall be allocated to each party in accordance with its contributions to the adjusted basis of such equipment, as such adjusted basis is defined in the Internal Revenue Code of 1954, as amended, and any similar State statute;
- c. Deductions for depletion shall be computed by the parties as follows:
  - (1) If eligible for percentage or cost depletion, the depletion deduction shall be computed by each of the parties separately. Percentage depletion shall be calculated under IRC Section 613A, (b) "Exemption for Certain Domestic Gas Wells", or IRC Section 613A, (c) "Independent Procedures and Royalty Owners", whichever is applicable.
  - (2) The partnership basis in oil or gas properties shall be allocated to each party in accordance with its respective contribution to such cost depletion base. Each partner shall maintain an individual basis account and compute its own allowance for either percentage depletion or cost depletion on all its properties. The depletion allowance deducted by the partners shall be treated as a reduction of the basis of the partnership property. In addition, each partner shall furnish its percentage or cost depletion calculation to Operator annually.
  - (3) Each party shall take into account for its depletion calculation such party's share of production, gross income, royalty obligations, expenses, contributions to the unadjusted cost basis of the joint property, all adjustments to basis and depletion allowance deductions reducing such party's basis.
- d. Such investment credit as shall be allowed by Section 38 of the Internal Revenue Code of 1954, as amended, as well as any other credits shall be allocated to the parties in accordance with their respective contributions to the cost thereof.

- e. Gains and losses from each sale, abandonment or other disposition of property (other than oil, gas or other hydrocarbon substances) will be allocated to the parties in such manner as will reflect the gains and losses that would have been includable in their respective income tax returns if such property was held by the parties outside this agreement. The computations shall take into account each party's share of the proceeds derived from each sale or other disposition of such property during the year, selling expenses and the parties' respective contributions to the unadjusted cost basis of such property, less any allowed or allowable depreciation, depletion, amortization, credits or other deductions which have been allocated to each party with respect to such property as provided in this paragraph.

It is the intent of the parties that these provisions be limited in their application to matters relating to Federal and State taxes based on income and shall not in any way change, amend or affect the substantive rights and obligations of the parties otherwise contained herein. It is not the purpose or intention of the parties hereto to create any partnership, mining partnership or association other than as above provided, and neither this agreement nor the authorizations hereunder shall be construed as creating any such relationship. Furthermore, nothing in this agreement shall be construed as providing directly or indirectly, for any joint or cooperative refining or marketing or sale of any party's interest in oil and gas or the products therefrom.

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