

UNIT AGREEMENT
SOUTH LOCO HILLS (GRAYBURG) UNIT
EDDY COUNTY, NEW MEXICO
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EXHIBIT "A" (MAP OF UNIT AREA)
EXHIBIT "B" (SCHEDULE OF OWNERSHIP)
EXHIBIT "C" (SCHEDULE OF TRACT PARTICIPATION)
EXHIBIT "D" (THERE IS NO EXHIBIT "D")

UNIT AGREEMENT
FOR THE DEVELOPMENT AND OPERATION OF THE
SOUTH LOCO HILLS (GRAYBURG) UNIT
EDDY COUNTY, NEW MEXICO

THIS AGREEMENT, entered into as the _____ day of _____, 1982, by and between the parties subscribing, ratifying or consenting hereto, and herein referred to as "parties hereto":

WITNESSETH:

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

WHEREAS, the Oil Conservation Division of the Energy and Minerals Department of the State of New Mexico, is authorized by law (Chap. 72, Laws of 1935, as amended by Chap. 193, Laws of 1937, Chap. 166, Laws of 1941, and Chap. 168, Laws of 1949, Chap. 65, Art. 3, Sec. 14, N.M.S., 1953 anno) to approve this Agreement, and the conservation provisions hereof; and

WHEREAS, the Mineral leasing Act of February 25, 1920, 41 Stat. 437, as amended 30 U.S.C. Sections 181 et seq., authorizes Federal lessees and their representatives to unite with each other, or jointly or separately with others, in collectively adopting and operating a cooperative or unit plan of development or operation of any oil or gas pool, field or like area, or any part thereof for the purpose of more properly conserving the natural resources thereof whenever determined and certified by the Secretary of the Interior to be necessary or advisable in the public interest; and

WHEREAS, the parties hereto hold sufficient interests in the South Loco Hills (Grayburg) Unit Area covering the land hereinafter described to give reasonably effective control of operation therein; and

WHEREAS, it is the purpose of the parties hereto, to enable institution and consummation of secondary recovery operations, conserve natural resources, prevent waste and secure the other benefits obtainable through development and operation of the area subject to this Agreement under the terms, conditions, and limitations herein set forth;

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

SECTION 1. ENABLING ACT AND REGULATIONS. The Mineral Leasing Act of February 25, 1920, as amended, supra, and all valid pertinent regulations, including operating and unit plan regulations, heretofore issued thereunder and valid, pertinent and reasonable regulations hereafter issued thereunder are accepted and made a part of this Agreement as to Federal lands, provided such regulations are not inconsistent with the terms of this Agreement.

SECTION 2. UNIT AREA AND DEFINITIONS. The area described by Tracts in Exhibit "B" and depicted on Exhibit "A" attached hereto is hereby designated and recognized as constituting the Unit Area containing 1060.07 acres, more or less, in Eddy County, New Mexico. Said land is described as follows:

Township 18 South, Range 29 East, N.M.P.M.

Section 19: E/2, NE/4 NW/4, E/2 SW/4, Lot 4

Section 20: W/2, NW/4 NE/4

Section 29: N/2 NW/4

Section 30: N/2 NE/4, NE/4 NW/4, Lot 1

For the purpose of the Agreement, the following terms and expressions as used herein shall mean:

- (a) "Commission" is defined as the Oil Conservation Division, Energy and Minerals Department, of the State of New Mexico.
- (b) "Director" is defined as the Director of the Minerals Management Service.
- (c) "Secretary" is defined as the Secretary of the Interior of the United States of America.
- (d) "Department" is defined as the Department of the Interior of the United States of America.
- (e) "Supervisor" is defined as the Oil and Gas Supervisor of the Minerals Management Service for the region in which the Unit Area is situated.
- (f) "Unitized Formation" is defined as that stratigraphic interval underlying the Unit Area extending from the top of the Grayburg formation to thirty (30) feet below the base of the Loco Hills Sand formation, said interval being more specifically the equivalent of the continuous interval occurring between the depth of 2,272 feet and 2,429 feet as shown on the Schlumberger Well Surveying Corporation Gamma Ray-Neutron log run on July 21, 1961 in S. P. and Martin Yates Alscott Federal No. 1 well located 660 feet from the north line and 660 feet from the east line of Section 30, T-18-S, R-29-E, Eddy County, New Mexico. Said log was measured from a Kelly Bushing elevation of 3,517 feet above sea level.
- (g) "Unitized Substances" is defined as all oil, gas, gaseous substances, sulphur contained in gas, condensate, distillate and all associated and constituent liquid or liquefiable hydrocarbons produced from the Unitized Formation underlying unitized land.

- (h) "Tract" is defined as each parcel of land described as such and given a Tract number in Exhibit "B".
- (i) "Tract Participation" is defined as that percentage of Unitized Substances which is allocated to a Tract under this Agreement.
- (j) "Unit Participation" is defined as the sum of the percentages obtained by multiplying each Working Interest Owner's fractional Working Interest in each Tract by the Tract Participation of each such Tract.
- (k) "Working Interest" is defined as the right to search for, produce, acquire Unitized Substances whether held as an incident of ownership of mineral fee simple title, under an oil and gas lease, or otherwise held.
- (l) "Working Interest Owner" is defined as and shall mean any party hereto owning a Working Interest, including a carried Working Interest, whether by virtue of a lease, operating agreement, fee title or otherwise, whose interest is chargeable with and obligated to pay or bear, either in cash or out of production, or otherwise, all or a portion of the cost of drilling, developing, and producing the Unitized Substances from the Unitized Formation.
- (m) "Royalty Interest" or "Royalty" is defined as an interest other than a Working Interest in or right to receive a portion of the Unitized Substances or the proceeds thereof and includes the royalty interest reserved to a lessor by an oil and gas lease and any overriding royalty interest, oil payment interest or any other payment or burden which does not carry with it the right to search for and produce Unitized Substances.
- (n) "Royalty Owner" is defined as and shall mean the owner of a Royalty Interest.
- (o) "Unit Operating Agreement" is defined as and shall mean any agreement or agreements (whether one or more) entered into (separately or collectively) by and between the Unit Operator and the Working Interest Owners as provided in Section 9 (ACCOUNTING PROVISIONS AND UNIT OPERATING AGREEMENT), infra, and shall be styled "Unit Operating Agreement, South Loco Hills (Grayburg) Unit, Eddy County, New Mexico."
- (p) "Paying Quantities" is defined as production of Unitized Substances in quantities sufficient to pay for the cost of producing same from wells on the Unitized Land.
- (q) "Unit Manager" is defined as the person or corporation appointed by the Working Interest Owners to perform the duties of the Unit Operator until the selection and qualification of a Successor Unit Operator as provided for in Section 8 hereof.
- (r) "Tract Cumulative Production" is defined as the total number of barrels of oil produced from the Unitized Formation under such tract through December 31, 1979, as officially reported to the Commission.

- (s) "Unit Cumulative Production" is defined as the total number of barrels produced through December 31, 1979, from all tracts within the unit area which are qualified under the terms of this agreeagreement, as officially reported to the Commission.

SECTION 3. EXHIBITS. Exhibit "A" attached hereto is a map showing the Unit Area and the boundaries and indentivity of tracts and leases in said Unit Area to the extent known to the Unit Operator, Exhibit "E" attached hereto is a schedule showing, to the extent known to the Unit Operator the acreage comprising each Tract, percentages and kind of ownership of oil and gas interest in all land in the Unit Area. Exhibit "C" attached hereto shows the Tract Participation of each Tract in the Unit Area. However, nothing herein or in said schedule or map shall be construed as a representation by any party hereto as to the ownership of any interest other than such interest or interests as are shown in said map or schedule as owned by such party. There is no Exhibit "D". Exhibits "A", "B" and "C" shall be revised by the Unit Operator whenever changes in the Unit Area render such revision necessary or when requested by the Supervisor, and not less than five copies shall be filed with the Supervisor.

SECTION 4. EXPANSION. The above described Unit Area may, when practicable, be expanded to include therein any additional Tract or Tracts regarded as reasonably necessary or advisable for the purposes of this Agreement. Such expansion shall be effected in the following manner:

- (a) The Working Interest Owner or Owners of a Tract or Tracts desiring to commit such Tract or Tracts hereto shall file an application therefor with Unit Operator requesting such admission.
- (b) Unit Operator shall circulate a notice of the proposed expansion to each Working Interest Owner in the Unit land in the Tract or Tracts proposed to be included in the Unit, setting out the basis for admission, the proposed participation to be assigned to each such Tract, and other pertinent data. After negotiation (at Working Interest Owner's meeting or otherwise), if 90 percent - (90%) of the Working Interest Owners (on basis of Unit Participation) have agreed to the addition of such Tract or Tracts, then Unit Operator shall, after preliminary concurrence by the Director:
 - (1) Prepare a notice of proposed expansion describing the contemplated changes in the boundaries of the Unit Area, the reason therefor, the basis for admission of the additional Tract or Tracts, the Tract participation to be assigned each such Tract and proposed effective date thereof, preferably 7:00 a.m. on the first day of a month subsequent to the date of notice; and
 - (2) Furnish copies of said notice to the Supervisor, the NMOCD Commission, and each Working Interest Owner, lessee, and lessor whose interests are affected and advising such parties that thirty (30) days will be allowed for submission to the Unit Operator of any objections to such expansion; and

(3) File, upon the expiration of said thirty (30) day period as set out in (2) immediately above, with the Director and the Commission, the following:

- (i) Evidence of mailing said notice of expansion
- (ii) An application for such expansion in sufficient number appropriate approval and distribution; and
- (iii) An instrument containing the appropriate joinders in compliance with the participation requirements of Section 14 (TRACTS QUALIFIED FOR PARTICIPATION) and Section 32 (NON-JOINDER AND SUBSEQUENT JOINDER), *infra*; and
- (iv) a copy of any objections received.

The expansion shall, after due consideration of all pertinent information and upon approval by the Supervisor and the Commission, become effective as of the date prescribed in the notice thereof or on such other appropriate date as may be set by the Supervisor and the Commission in the order or instrument approving such expansion. The revised Tract Participation of the respective Tracts committed to the Unit Agreement prior to any such enlargement shall remain in the same ratio one to the other.

SECTION 5. UNITIZED LAND AND UNITIZED SUBSTANCES. All land committed to this Agreement as to the Unitized Formation shall constitute land referred to herein as "Unitized Land" or "Land Subject to this Agreement." All oil, gas, gaseous substances, sulphur contained in gas, condensate, distillate, and all associated and constituent liquid or liquefiable hydrocarbons produced from the Unitized Formation underlying Unitized Land are unitized under the term of this Agreement and herein are called "Unitized Substances."

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

Unit Operator shall have a lien upon the interest of the owners of Working Interests in the Unitized Land to the extent provided in the Unit Operating Agreement.

SECTION 7. RESIGNATION OR REMOVAL OF UNIT OPERATOR. Unit Operator shall have the right to resign at any time, but such resignation shall not become effective so as to release Unit Operator from the duties and obligations of Unit Operator and terminate Unit Operator's rights as such for a period of six (6) months after written notice of intention to resign has been given by Unit Operator to all Working Interest Owners and the Supervisor, and until all unit wells are placed in a condition satisfactory for suspension, abandonment, or operations, whichever is required by the Supervisor, unless a new Unit Operator shall have taken over and assumed the duties and obligations of Unit Operator prior to the expiration

of said period.

The Unit Operator shall, upon default or failure in the performance of its duties or obligations hereunder, be subject to removal of not less than sixty-five (65) percent of the committed Working Interest (on the basis of Unit Participation) exclusive of any Working Interest owned by the Unit Operator. Such removal shall be effective upon notice thereof to the Supervisor.

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

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

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

SECTION 9. ACCOUNTING PROVISIONS AND UNIT OPERATING AGREEMENT. Costs and expenses incurred by Unit Operator in conducting Unit Operations hereunder shall be paid, apportioned among, and borne by the Working Interest Owners in accordance with the Unit Operating Agreement; however, no such Unit Operating Agreement shall be deemed either to modify any of the terms and conditions of this Unit Agreement or to relieve the Unit Operator of any right or obligation established under this Agreement, and in case of any inconsistency or conflict between this Agreement and the Unit Operating Agreement, this Agreement shall prevail. Three true copies of any Unit Operating Agreement executed pursuant to this Section shall be filed with the Supervisor prior to approval of this Agreement.

SECTION 10. RIGHTS AND OBLIGATIONS OF UNIT OPERATOR. Except as otherwise specifically provided herein, the exclusive right, privilege and duty of exercising any and all rights of the parties hereto which are necessary or convenient for prospecting for, producing, storing, allocating and distributing the Unitized Substances are hereby delegated to and shall be exercised by the Unit Operator as herein provided. The parties hereto, to the extent they have the right to do so, grant to Unit Operator the use of brine or water, or both from any formation in and under the Unitized Land for injection into the Unitized Formation. Upon request, acceptable evidence of title to said rights shall be deposited with said Unit Operator and, together with this Agreement, shall constitute and define the rights, privileges, and obligations of Unit Operator. Nothing herein, however, shall be construed to transfer title of any land or to any lease or operating agreement, it being understood that under this Agreement the Unit Operator, in its capacity as Unit Operator, shall exercise the rights of possession and use vested in the parties hereto only for the purposes herein specified.

SECTION 11. EASEMENTS OR USE OF SURFACE.

- (a) The parties hereto, to the extent of their rights and interests, hereby grant to Working Interest Owners the right to use as much of the surface of the unitized land as may reasonably be necessary for Unit Operations and the removal of Unitized Substances therefrom; provided that nothing herein shall be construed as leasing or otherwise conveying to Working Interest Owners a site for a water, gas injection, processing or other plant, or camp site.
- (b) Working Interest Owners shall have and are hereby granted free use of water from the Unitized Land for Unit Operations, except water from any well, lake, pond, or irrigation ditch of a Royalty Owner.
- (c) Working Interest Owners shall pay the owner for damages to growing crops, timber, fences, improvements, and structures on the Unit Area that result from Unit Operations.

SECTION 12. PLAN OF OPERATION. It is recognized and agreed by the parties hereto that all of the land subject to this Agreement is reasonably proved to be productive of Unitized Substances in paying quantities and that the object and purpose of this Agreement is to formulate and put into effect a secondary recovery project in order to effect the greatest recovery of Unitized Substances, prevent waste and conserve natural resources consistent with good engineering practices expected of a prudent operator. The parties hereto agree that the Unit Operator may, subject to the consent and approval of a plan of operation by the Working Interest Owners, the Supervisor, and the Commission inject into the Unitized Formation, through any well or wells completed therein, brine, water, air, gas, oil, liquid petroleum gases, and any one or more other substances or combination thereof whether produced from the Unitized Formation or not, and that the location of input wells and the rates of injection therein and the rate of production shall be governed by standards of good geologic and petroleum engineering practices and conservation methods. After commencement of secondary operations, Unit Operator shall furnish the Commission and the Supervisor monthly injection and production reports for each Unit Well.

The Working Interest Owners, the Supervisor, and the Commission shall be furnished periodic reports on the progress of the plan of operations. A revision of the plan of operation involving a deviation from the approved plan of operation shall be subject to consent and approval of the Working Interest Owners, the Supervisor, and the Commission.

The initial plan of operation shall be filed with the Supervisor and the Commission concurrently with the filing of this Unit Agreement for final approval. Said initial plan of operation and all revisions thereof shall be as complete and adequate as the Supervisor and the Commission may determine to be necessary for timely operation consistent herewith. Thereafter, from time to time before the expiration of any existing plan, the Unit Operator shall submit for like approval a plan for an additional specified period of operation. Reasonable diligence shall be exercised in complying with the obligations of the approved plan of operation.

Notwithstanding anything to the contrary herein contained, if Unit Operator fails to commence Unit Operations for the secondary recovery of Unitized Substances from the Unit Area within six (6) months after the effective date of this Agreement or any extension thereof approved by the Supervisor and the NMOCD Commission, this agreement shall terminate automatically upon the expiration of said six (6) month period. After such operations are commenced, Unit Operator shall carry on such operations as would a reasonably prudent operator under the same or similar circumstances.

SECTION 13. TRACT PARTICIPATION. In Exhibit "B" attached hereto there are listed and numbered the various Tracts within the Unit Area, and set forth in Exhibit "C" opposite each Tract number are figures which represent the Tract Participation percentages allocated to that Tract, calculated on the basis of all Tracts within the Unit Area being committed to this Agreement as of the effective date hereof. The Tract Participations of each Tract within the Unit Area as set forth in Exhibit "C" shall govern the allocation of Unitized Substances produced from the Unit Area from and after the effective date hereof, subject to any revision or revisions of the Unit Area or the Exhibits to this Agreement in accordance with the provisions hereof.

The percentage of Tract Participations set forth in Exhibit "C" for each Tract within the Unit Area have been calculated and determined in accordance with the following factors and formulas:

$$\begin{array}{lcl} \text{Percentage Participation} & & \\ \text{of each Tract} & = & 100\% \frac{\text{Tract Cumulative Production}}{\text{Unit Cumulative Production}} \end{array}$$

In the event less than all of the Tracts within the Unit Area are committed to this Agreement as of the effective date hereof, Unit Operator shall promptly prepare revised Exhibits "B" & "C" setting forth opposite each of the qualified Tracts (as determined from Section 14, Tracts qualified for participation), the revised Tract Participations, which shall be calculated and determined by using the factors and formulas set forth above, but applying the same only to the qualified Tracts. Unit Operator shall promptly file copies of such revised Exhibits "B" & "C" with the Supervisor; and, unless such revised Exhibits "B" & "C" are disapproved by the Supervisor within sixty (60) days after such filing, the revised Exhibits "B" & "C" shall be effective as of the effective date of this Agreement and shall

thereafter govern the allocation of all Unitized Substances, subject, however, to any further revision or revisions of Exhibits "B" & "C" in accordance with the provisions hereof (Sections 3, 4, 31, and 32).

SECTION 14. TRACTS QUALIFIED FOR PARTICIPATION. On and after the effective date hereof the Tracts within the Unit Area which shall be entitled to participate in the production of Unitized Substances shall be those Tracts more particularly described in Exhibit "B" that corner or have a common boundary (Tracts separated only by a public highway or a railroad right of way shall be considered to have a common boundary) and that otherwise qualify as follows:

- (a) Each Tract as to which Working Interest Owners owning one hundred percent (100%) of the Working Interest therein have become parties to this Agreement and as to which Royalty Owners owning eighty-five percent (85%) or more of the Royalty Interest therein created by the basic leases have become parties to this Agreement.
- (b) Each Tract to which Working Interest Owners owning one hundred percent (100%) of the Working Interest therein have become parties to this Agreement, and as to which Royalty Owners owning less than eighty-five percent (85%) of the Royalty Interest therein created by the basic leases have become parties to this Agreement, and as to which: (1) All Working Interest Owners in any such Tract have joined in a request for the acceptance of such Tract as qualified for participation under this Agreement, and as to which (2) Eighty percent (80%) of the combined "voting interests" of working Interest Owners in all Tracts that meet with requirements of Section 14 (a) have voted in favor of the acceptance of such Tract. For the purpose of this Section 14 (b) the "voting interest" of a Working Interest Owner shall be equal to the ratio expressed as a percentage that its Unit Participation in all Tracts that qualify under Section 14 (a) above bears to the total Unit Participation of all Working Interest Owners in all Tracts that qualify under Section 14 (a).
- (c) Each Tract as to which Working Interest Owners owning less than one hundred percent (100%) of the Working Interest therein have become parties to this Agreement, regardless of the percentage of Royalty Interest therein created by the basic leases that is committed hereto; and as to which: (1) The Working Interest Owner who operates the Tract and all of the other Working Interest Owners in such Tract who have become parties to this Agreement have joined in a request for acceptance of such Tract, and have executed and delivered an indemnity agreement indemnifying and agreeing to hold harmless the other Working Interest Owners that are parties hereto, their successors and assigns, against all claims and demands that may be made by the owners of Working Interests in such Tract who are not parties to this Agreement, and which arise out of the acceptance of the Tract as qualified for participation under this Agreement; and as to which (2) Eighty percent (80%) of the combined "voting interests" of Working Interest Owners in all Tracts that meet the requirements of Sections 14 (a) and 14 (b) above have voted in favor of the

acceptance of such Tract and to accept the indemnity agreement. For the purpose of this Section 14 (c), the "voting interest" of each Working Interest Owner shall be equal to the ratio expressed as a percentage that its Unit Participation in all Tracts that qualify under Sections 14 (a) and 14 (b) above bears to the total Unit Participation of all Working Interest Owners to all Tracts that qualify under Sections 14 (a) and 14 (b). Upon the acceptance of such a Tract as qualified for participation under this Agreement, the Unit Participation that would have been attributed to the non-subscribing owners of the Working Interest in Such Tract, had they become parties to this Agreement and the Unit Operating Agreement, shall be attributed to the Working Interest Owners in such Tract who have become parties to such Agreements, in proportion to their respective Working Interests in the Tract.

If, on the effective date of this Agreement, there is any Tract or Tracts in the Unit Area which have not been qualified as above provided, then such Tract or Tracts shall not be entitled to participate hereunder. Unit Operator, shall, when submitting this Agreement for final approval by the Department, file therewith a schedule of those Tracts which are entitled to participate in the production of Unitized Substances. Said schedule shall set forth opposite each qualified Tract the assigned Tract number, the lease or assignment number, the owner of record of the lease, and the Tract Participation percentage which shall be computed according to the participation formula set out in Section 13 (Tract Participation) above.

SECTION 15. ALLOCATION OF UNITIZED SUBSTANCES. All Unitized Substances produced and saved (less, save and except any part of such Unitized Substances unavoidably lost or used in conformity with good operating practices on Unitized Land for drilling, operating, camp and other production or development purposes and for pressure maintenance) shall be apportioned among and allocated to the qualified Tracts in accordance with the respective Tract Participation, as set forth in the then effective schedule of participation in Exhibit "C" or any revision thereof. The amount of Unitized Substances so allocated to each Tract, and only that amount (regardless of whether it be more or less than the amount of actual production of Unitized Substances from the well or wells, if any, on such Tract, shall, for all intents, uses and purposes, be deemed to have been produced from such Tract.

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

No Tract committed to this Agreement and qualified for participation as above provided shall be subsequently excluded from participation hereunder contained, except as provided in Section 33 hereof, shall be construed as requiring any retroactive adjustment for production obtained prior to the to the effective date of the joinder of any Tract.

If the Working Interest of the Royalty Interest in any Tract, as of the effective date hereof, or thereafter become divided with respect to separate parcels or portions of such Tract, the percentages of Tract Participation assigned to such Tract shall, in the absence of a recordable instrument executed by all owners and fixing the division of ownership, be divided among the owners of such parcels or portions in proportions to the number of surface acres in each parcel or portion.

Subject to the provisions of Section 16 (Royalty Settlement), the Unitized Substances allocated to each Tract shall be delivered in kind to the respective Working Interest Owners and parties entitled thereto by virtue of the ownership of oil and gas rights therein. Each Working Interest Owner and the parties entitled thereto shall have the continuing right to receive such production in kind at a common point within the Unit Area and to sell or dispose of the same as it sees fit. Each such party shall have the right to construct, maintain, and operate all necessary facilities for that purpose on Unitized Land, provided the same are so constructed, maintained and operated as not to interfere with operations carried on pursuant hereto. Any extra expenditure incurred by Unit Operator by reason of the delivery in kind of any portion of the Unitized Substances shall be borne by the party responsible for the payment of such expense.

In the event any party hereto shall fail to take in kind or separately dispose of its proportionate share of the Unitized Substances, then so long as such conditions continue, Unit Operator, for the account and at the expense of such party, and in order to avoid curtailing the operation of the Unit Area, may sell or otherwise dispose of such production to itself or others on a day-to-day basis at not less than the prevailing market price in the area for like production; and the account of such party shall be charged therewith as having received such production. Unit Operator shall not make a sale into interstate commerce of any other party's share of gas production without first giving such other party ninety (90) days notice of such intended sale. The net proceeds, if any, of the Unitized Substances so disposed of by the Unit Operator shall be paid to the parties entitled thereto.

Any Working Interest Owner receiving in kind or separately disposing of all or any part of the Unitized Substances allocated to any Tract, or receiving the proceeds therefrom is the same if sold or purchased by Unit Operator, shall be responsible for the payment of all royalty on the lease or leases affected; and each such party shall hold each other party harmless against all claims, demands, and causes of action for the payment of such Royalty.

If, after the effective date of this Agreement, there is any Tract or Tracts subsequently committed hereto, as provided in Section 4 (EXPANSION) hereof, or if any Tract or Tracts within the Unit Area are not qualified hereunder as of the effective date hereof are subsequently qualified for participation under the provision of Section 14 (TRACTS QUALIFIED FOR PARTICIPATION) and Section 32 (NON-JOINDER AND SUBSEQUENT JOINDER), or if any Tract is excluded from this Agreement as provided for in Section 31 (LOSS OF TITLE) the schedule of participation as shown in the current Exhibit "C" shall be revised by the Unit Operator and distributed to the Working Interest Owners and the Supervisor to show the new Tract Participations of all the then qualified Tracts; and the revised Exhibit "C", upon appro-

val by the Supervisor, shall govern the allocation of Unitized Substances produced on and after the effective date thereof until the effective date of a new schedule so approved by the Supervisor. In any such revision of Exhibit "C" pursuant to this paragraph the Tract Participations of the previously qualified Tracts shall remain in the same ratio one to the other.

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

If gas obtained from lands or formations not subject to this Agreement is introduced into the Unitized Formation for use in repressuring, stimulation of production, or increasing ultimate recovery in conformity with a plan approved pursuant to Section 12 (PLAN OF OPERATION), a like amount of gas, less appropriate deduction for loss from any cause, may be withdrawn from the Unitized Formation royalty free as to dry gas but not as to products extracted therefrom; provided that such withdrawal shall be at such time as may be provided in the approved plan of operation or as otherwise may be consented to by the Supervisor as conforming to good petroleum engineering practices. If liquid petroleum gases obtained from lands or formations not subject to this Agreement are introduced into the Unitized Formation for the purpose and under the conditions set forth in the preceding sentence, then part or all of such liquid petroleum gases may be withdrawn royalty free pursuant to such conditions and formulas as may be prescribed or approved by the Supervisor. The right of withdrawal contained in this Section shall terminate as of the effective date of termination of this Unit Agreement.

All Royalty due the Royalty Owners hereunder other than the United States of America shall be computed and paid on the basis of all Unitized Substances allocated to the respective Tract or Tracts of Unitized Land in lieu of actual production from such Tract or Tracts.

Royalty due the United States shall be computed as provided in the operating regulations and paid in value or delivered in kind as to all Unitized Substances on the basis of the amounts thereof allocated to Unitized Federal land as provided herein at the rates specified in the respective Federal leases, or at such lower rates as may be authorized by law or regulation, provided that for leases on which the royalty rate depends on the daily average production per well, said average production shall be determined in accordance with the operating regulations as though the Unitized Land were a single consolidated lease.

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

SECTION 17. RENTAL SETTLEMENT. Rentals or minimum royalties due on leases committed hereto shall be paid by Working Interest Owners responsible therefore under existing contracts, laws and regulations, provided that nothing herein contained shall operate to relieve the lessees of any land from their respective lease obligations for the payment of any rental or minimum royalty in lieu thereof, due under their leases. Rental or minimum royalty for lands of the United States of America subject to this Agreement shall be paid at the rate specified in the respective leases from the United States of America, unless rental or minimum royalty is waived, suspended, or reduced by law or by approval of the Secretary or his duly authorized representative.

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

SECTION 19. DRAINAGE. The Unit Operator shall take appropriate and adequate measures to prevent drainage of Unitized Substances from Unitized Land by wells on land not subject to this Agreement.

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

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

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

- (b) Drilling, producing or secondary recovery operations performed hereunder upon any Tract of Unitized Land shall be accepted and deemed to be performed upon and for the benefit of each and every Tract of Unitized Land; and no lease shall be deemed to expire by reason of failure to drill or produce wells situated on land therein embraced.
- (c) Suspension of drilling or producing operations on any or all of the Unitized Land pursuant to direction or consent of the Secretary or his duly authorized representative shall be deemed to constitute such suspension pursuant to such direction or consent as to each Tract of Unitized Land, specified in the suspension order.
- (d) Each lease, sublease, or contract relating to the exploration, drilling, development or operation for oil and gas, which by its term might expire prior to the termination of this Agreement, is hereby extended beyond any such terms so provided therein, so that it shall be continued in full force and effect for and during the term of this Agreement.
- (e) Termination of this Agreement shall not affect any lease which, pursuant to the terms thereof or any applicable laws, shall continue in force and effect thereunder.
- (f) The segregation of any Federal lease committed to this Agreement is governed by the following provisions in the fourth paragraph of Section 17 (j) of the Mineral Leasing Act, as amended by the Act of September 2, 1960 (72 Stat. 781-784): "Any (Federal) lease heretofore or hereafter committed to any such (unit) plan embracing lands that are in part within and in part outside of the area covered by any such plan shall be segregated into separate leases as to the lands committed and the lands not committed as to the effective date of unitization: Provided, however, that any such lease as of the nonunitized portion shall continue in force and effect for the term thereof but for not less than two years from the date of such segregation and so long thereafter as oil or gas is produced in paying quantities."

SECTION 21. MATHEMATICAL ERRORS. It is hereby agreed by all parties to this Agreement that Unit Operator is empowered to correct any mathematical or clerical errors which might exist in the pertinent exhibits to this Agreement upon approval of such changes by the Supervisor.

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

responsible therefor until the first day of the calendar month after said Working Interest owner is furnished with the original, or acceptable photostatic or certified copy, of the recorded instrument of transfer.

SECTION 23. EFFECTIVE DATE AND TERM. This Agreement shall become binding upon each party who executes or ratifies it as of the date of execution or ratification by such party and shall become effective as of 7:00 a.m. on the first day of the month next following:

- (a) The execution or ratification of this Agreement and Unit Operating Agreement by Working Interest Owners owning a combined Unit Participation of at least 95 percent (95%), and the execution or ratification of this Agreement by Royalty Owners owning a combined interest of at least 75 percent (75%) of the Royalty Interest, in said Unit Area; and,
- (b) The approval of this Agreement by the Secretary or his duly authorized representative, and the Commission; and, provided, further, that if (a) and (b) above are not accomplished on or before August 1, 1980, this Agreement shall ipso facto expire on said date (hereinafter called "expiration date") and thereafter be of no further force or effect, unless prior thereto this Agreement has been executed or ratified by Working Interest Owners owning a combined unit participation of at least ninety percent (90%) and such Working Interest Owners have decided to extend said expiration date for a period not to exceed six (6) months (hereinafter called "extended expiration date"). If said expiration date is so extended and (a), and (b) are not accomplished on or before said extended expiration date and thereafter be of no further force or effect. For the purpose of this Section, ownership shall be computed on the basis of Unit Participation as determined from Exhibit "C" attached hereto.
- (c) Unit Operator shall, within thirty (30) days after the effective date of this Agreement, file for record in the offices where a counterpart of this Agreement is recorded, a certificate to the effect that this Agreement has become effective according to its terms and stating further the effective date.

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

This Agreement may be terminated at any other time and for any other reason by the Working Interest Owners owning an aggregate of ninety percent (90%) or more of Unit Participation with the approval of the Commission and the Supervisor. Notice of any such termination shall be given by the Unit Operator to all parties hereto within thirty (30) days after the effective date of termination.

Upon termination of this Agreement, the parties hereto shall be governed by the terms and provisions of the leases and contracts affecting the separate Tracts.

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

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

SECTION 24. RATE OF PROSPECTING, DEVELOPMENT AND PRODUCTION.

The Director is hereby vested with the authority to alter or modify from time to time in his discretion the quantity and rate of production under this Agreement when such quantity and rate of production under this Agreement is not fixed pursuant to Federal or State law or does not conform to any statewide voluntary conservation or allocation program, which is established, recognized, and generally adhered to by the majority of operators in such State, such authority being hereby limited to alteration or modification in the public interest, the purpose thereof and the public interest to be served thereby to be stated in the order of alteration or modification. Without regard to the foregoing, the Director is also hereby vested with the authority to alter or modify from time to time, in his discretion, the rate of prospecting and development and the quantity and rate of production under this Agreement, when such alteration or modification is in the interest of attaining the conservation objectives stated in this Agreement and is not in violation of any applicable Federal or State Law.

Powers in this Section vested in the Director shall only be exercised after notice to Unit Operator and opportunity for hearing to be held not less than fifteen (15) days from notice.

SECTION 25. NON-DISCRIMINATION.

In connection with the performance of work under this Agreement, the Unit Operator agrees to comply with all of the provisions of Section 202 (1) to (7) inclusive of Executive Order 11246 (30 F.R. 12319) as amended, which are hereby incorporated by reference in this Agreement.

SECTION 26. APPEARANCES.

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

SECTION 27. NOTICES.

All notices, demands, objections or statements required hereunder to be given or rendered to the parties hereto shall be deemed fully given if made in writing and personally delivered to the party or parties or sent by postpaid certified mail, addressed to such party

or parties at their respective addresses set forth in connection with the signature hereto or to the ratification or consent hereof or to such other address as any such party or parties may have furnished in writing to the party sending the notice, demand or statement.

SECTION 28. NO WAIVER OF CERTAIN RIGHTS. Nothing in this Agreement contained shall be construed as a waiver by any party hereto of the right to assert any legal or constitutional right or defense as to the validity of invalidity of any law of the State wherein said Unitized Lands are located, or rules or regulations issued thereunder in any way affecting such party, or as a waiver by any such party of any right beyond his or its authority to waive.

SECTION 29. EQUIPMENT AND FACILITIES-FIXTURES ATTACHED TO REALTY. Each Working Interest Owner has hereto placed and used on its Tract or Tracts committed to this Agreement various well and lease equipment and other property, equipment and facilities. It is also recognized that additional equipment and facilities may hereafter be placed and used upon the Unitized Land as now or hereafter constituted. Therefore, for all purposes of this Agreement, any and all such equipment shall be considered to be personal property and not fixtures attached to realty. Accordingly, said well and lease equipment and personal property is hereby severed from the mineral estates affected by this Agreement, and it is agreed that any and all such equipment and personal property shall be and remain personal property for all purposes.

SECTION 30. UNAVOIDABLE DELAY. All obligations under this Agreement requiring the Unit Operator to commence or continue secondary recovery operations or to operate on or produce Unitized Substances from any of the lands covered by this Agreement shall be suspended while, but only so long as, the Unit Operator, despite the exercise of due care and diligence, is prevented from complying with such obligations, in whole or in part, by strikes, acts of God, Federal, State or municipal law or agency, unavoidable accident, open market, or other matters beyond the reasonable control of the Unit Operator whether similar to matter herein enumerated or not.

SECTION 31. LOSS OF TITLE. In the event title to any Tract of Unitized Land shall fail so as to render the Tract inoperable under this Agreement and the true owner cannot be induced to join this Unit Agreement, such Tract shall be automatically regarded as not committed hereto effective as of 7:00 a.m. on the first day after such title failure is determined; and there shall be such readjustment of future costs and benefits as may be required on account of the loss of such title. In such event, Unit Operator shall recompute the Tract Participations of each of the Tracts remaining subject to this Agreement and shall revise Exhibits "B" and "C" accordingly. The revised Exhibits "B" and "C" shall be effective as of the first day of the calendar month in which such failure of title is finally determined. The participation percentages so recomputed for the qualified Tracts shall remain the same ratio one to the other as before the loss of title was determined. If title to a Working Interest fails, the rights and obligations of Working Interest Owners by reason of failure of title shall be governed by the Unit Operating Agreement. If title to a Royalty Interest fails, but the Tract to which it relates remains qualified, the parties whose title failed shall not be entitled to share hereunder with respect to such interest. In the event of a dispute as to title as to any Royalty,

Working Interest or other, interest subject hereto, payment or delivery on account thereof may be withheld without liability or interest until the dispute is finally settled; provided that, as to Federal land or leases, no payments of funds due the United States of America shall be withheld, but such funds shall be deposited as directed by the Supervisor to be held as unearned money pending final settlement of the title dispute, and then applied as earned or returned in accordance with such final settlement.

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

SECTION 32. NON-JOINDER AND SUBSEQUENT JOINDER. If the owner of any substantial interest in a tract within the Unit Area fails or refuses to subscribe, ratify, or consent in writing to this Agreement, the Working Interest Owner in that Tract who has executed or ratified this Agreement may withdraw said Tract from this Agreement by written notice to the Supervisor and Unit Operator prior to the effective date of this Agreement. Joinder by any Royalty Owner, at any time, must be accompanied by appropriate joinder of the corresponding Working Interest Owner in order for the interest of such Royalty Owner to be regarded as effectively committed. Joinder to the Unit Agreement by a Working Interest Owner, at any time, must be accompanied by appropriate joinder to the Unit Operating Agreement in order for such interest to be regarded as effectively committed to this Unit Agreement.

Any oil or gas interest in the Unitized Substances not committed hereto prior to submission of this Agreement to the Supervisor for final approval may thereafter be committed hereto upon compliance with the applicable provisions of this Section and of Section 14 (TRACTS QUALIFIED FOR PARTICIPATION) hereof, at any time up to the effective date hereof and for a period of and including six (6) months thereafter, on the same basis of participation as provided in said Section 13, by the owner or owners hereof subscribing, ratifying or consenting in writing to this Agreement and, if the interest is a Working Interest, by the owner of such interest subscribing also to the Unit Operating Agreement.

It is understood and agreed, however, that from and after six (6) months from the effective date hereof the right of subsequent joinder as provided in this Section shall be subject to such requirements or approvals and on such basis as may be agreed upon by Working Interest Owners having a combined unit participation of ninety percent (90%) or more with the approval of the Supervisor. Such joinder by a proposed Working Interest Owner must be evidenced by his execution or ratification of this Agreement and the Unit Operating Agreement. Such joinder by a proposed Royalty Owner at any time must be evidenced by his execution, ratification or consent of this Agreement and must be consented to in writing by the Working Interest Owner responsible for the payment of any benefits that may accrue hereunder in behalf of such proposed Royalty Owner. Except as may be otherwise herein provided, subsequent joinders to this Agreement shall be effective at 7:00 a.m. on the first day of the month following the filing with the Supervisor of duly executed counterparts of any and all documents necessary to establish effective commitment of any Tract or interest to this Agreement, unless objection to such joinder by the Supervisor is duly made within sixty (60) days after such filing.

SECTION 33. OIL IN LEASE TANKAGE ON EFFECTIVE DATE. Unit Operator shall make a proper and timely gauge of all lease and other tanks on Unitized land in order to ascertain the amount of merchantable oil or other liquid hydrocarbons above the pipeline connection in such tanks as of 7:00 a.m. on the effective date hereof. Any such production which has been produced legally as part of the prior allowable of the well or wells from which produced shall be and remain the property of the Interest Owner entitled thereto the same as if the Unit had not been formed; and the Working Interest Owner shall promptly remove said oil from Unitized Land. Any such oil not promptly removed shall be sold by Unit Operator for the account of such Working Interest Owner who shall pay all royalty, overriding royalties, production payments, and all other payments under the terms and provisions of the applicable lease or leases and other contracts. All such oil as is in excess of the prior allowable of the well or wells from which the same was produced after the effective date hereof. If, as of the effective date hereof, any Tract of overproduced with respect to the allowable of the well or wells on that Tract and the amount of such overproduction has been sold or otherwise disposed of, such overproduction shall be regarded and included as a part of the Unitized Substances produced after the effective date hereof.

SECTION 34. COUNTERPARTS. This Agreement may be executed in any number of counterparts, no one of which needs to be executed by all parties and may be ratified or consented to by separate instrument in writing specifically referring hereto, and shall be binding upon all those parties who have executed such a counterpart, ratification or consent hereto with the same force and effect as if all parties had signed the same document, and regardless of whether or not it is executed by all other parties owning or claiming an interest in the lands within the above described Unit Area.

SECTION 35. TAXES. Each party hereto shall for its own account, render and pay its share of any taxes levied against or measured by the amount or value of the Unitized Land; provided, however, that, if it is required or if it be determined that the Unit Operator or the several Working Interest Owners must pay or advance said taxes for the account of the parties hereto, it is hereby expressly agreed that the parties so paying or advancing said taxes shall be reimbursed therefor by the parties hereto, including Royalty Owners, who may be responsible for the taxes on their respective allocated share of said Unitized Substances. No such taxes shall be charged to the United States, nor to any lessor who has a contract with a lessee which requires his lessee to pay such taxes.

SECTION 36. NO PARTNERSHIP. It is expressly agreed that the relation of the parties hereto is that of independent contractors and nothing in this Agreement contained, expressed or implied, or any operations conducted hereunder, shall create or be deemed to have created a partnership or association between the parties hereto or any of them.

SECTION 37. BORDER AGREEMENTS. Subject to the approval of the Supervisor, the Unit Operator may enter into a border-protection agreement or agreements with the Working Interest Owners of adjacent lands along the exterior boundary of the Unit Area with respect to the operations in the border area for the maximum ultimate recovery, conservation purposes and proper protection of the parties and interests.

YATES DRILLING COMPANY

DATE: _____

By _____
Attorney-in-Fact

UNIT OPERATOR AND
WORKING INTEREST OWNER

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____ day of _____, 1982, by _____ Attorney-in-Fact for YATES DRILLING COMPANY, a New Mexico corporation, on behalf of said corporation.

My Commission Expires:

Notary Public

SIGNATURE PAGE TO SOUTH LOCO HILLS (GRAYBURG) UNIT
AGREEMENT DATED FEBRUARY, 1982

MARTIN YATES, III

By: _____
Attorney-in-Fact

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by _____
Attorney-in-Fact for YATES DRILLING COMPANY, a New Mexico corporation, on
behalf of said corporation.

My Commission Expires:

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by FRANK YATES, Attorney-in-Fact for
MARTIN YATES, III.

My Commission Expires:

Notary Public

SIGNATURE PAGE TO SOUTH LOCO HILLS (GRAYBURG) UNIT
AGREEMENT DATED FEBRUARY, 1982

J. W. JONES

PAULINE HEWITT

ATTEST:

ANADARKO PRODUCTION COMPANY

By _____

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by J. W. JONES. .

My Commission Expires:

Notary Public

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by PAULINE HEWITT.

My Commission Expires:

Notary Public

STATE OF TEXAS)
 : §
COUNTY OF)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by _____,
President of ANADARKO PRODUCTION COMPANY, a _____ corporation, on
behalf of said corporation.

My Commission Expires:

Notary Public

SIGNATURE PAGE TO SOUTH LOCO HILLS (GRAYBURG) UNIT
AGREEMENT DATED FEBRUARY, 1982.

C. A. DENTON

G. C. DENTON

ATTEST:

SOUTHLAND ROYALTY COMPANY

By _____

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by C. A. DENTON.

My Commission Expires:

Notary Public

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by G. C. DENTON.

My Commission Expires:

Notary Public

STATE OF TEXAS)
 : §
COUNTY OF)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by _____, _____ President
of SOUTHLAND ROYALTY COMPANY, a _____ corporation, on behalf of said
corporation.

My Commission Expires:

Notary Public

SIGNATURE PAGE TO SOUTH LOCO HILLS (GRAYBURG) UNIT
AGREEMENT DATED FEBRUARY, 1982

ATTEST:

DEPCO, INC.

By _____

ATTEST:

HUSKY OIL COMPANY

By _____

STATE OF COLORADO)

COUNTY OF)

: §

The foregoing instrument was acknowledged before me this
day of _____, 1982, by _____, President
of DEPCO, INC., a _____ corporation, on behalf of said corporation.

My Commission Expires:

Notary Public

STATE OF COLORADO)

COUNTY OF)

: §

The foregoing instrument was acknowledged before me this
day of _____, 1982, by _____, President of
HUSKY OIL COMPANY, a _____ corporation, on behalf of said corporation.

My Commission Expires:

Notary Public

EXHIBIT "B"
To Unit Agreement
SOUTH LOCO HILLS (GRAYBURG) UNIT
Eddy County, New Mexico

Tract No.	Description	No. of Acres	Serial No. & Expiration Date of Lease	Basic Royalty Ownership & Percentage	Lessee of Record	Overriding Royalty Owner and Percentage	Working Interest Owner and Percentage
1.	T18S-R29E Sec. 20: NW/4NE/4	40.00	LC-062404 HBP	USA-12.5%	J.W. Jones & Pauline Hewitt-1/2 C.A. Denton & G. C. Denton-1/2	C. A. Denton .7500% G. C. Denton .7500 Marjorie W. Lester Quail .5000	Lessee-All
2.	T18S-R29E Sec. 19: E/2 SW/4, Lot 4 Sec. 30: NW/4NE/4, NE/4NW/4	191.76	NM-0924 HBP	USA-12.5%	T. J. Sivley	Lucille E. McGrary-.7500% L. Jay Root -.8667 Lucretia Conlon -.1333 Fred Brainard -.1250 E.C. Higgins Trust-.1250	Anadarko-1/2 Southland Royalty Co.-1/2 to 3350'
2a.	T18S-R29E Sec. 30: NE/4NE/4	40.00	NM-0924	USA-12.5%	T. J. Sivley	Higgins Trust, Inc. K. U. McGrary Nell McGrary Carol McGrary Odell L. Jay Root Patricia McGrary Shaffer T. J. Sivley John H. Trigg Violet Shipp Young Billie Kruse, Trustee Jimmy M. Joy, Trustee Jimmy M. Joy, Trustee Mary C. Johnston Charles M. Fuchtmann	Yates Drilling Co.-3/6 Martin Yates III-2/6, and Frank Yates -1/6 to 3000'

To Unit Agreement
SOUTH LOCO HILLS (GRAYSBURG) UNIT
Eddy County, New Mexico

Tract No.	Description	No. of Acres	Serial No. & Expiration Date of Lease	Basic Royalty Ownership Percentage	Lessee of Record	Overriding Royalty Owner and Percentage	Working Interest Owner and Percent
2b.	T18S-R29E Sec. 29: N/2NW/4	80.00	NM-0924	USA-12.5%	T. J. Sivley	Nell McCrary - .28125% K. U. McCrary - .18750 Patricia McCrary Shaffer - .09375 Carol McCrary Odell - .09375 Violet Shipp Young - .09375 L. Jay Root - .86670 Mary C. Johnston - .06665 Charles M. Fuchtmann - .06665 Jimmy M. Joy, Trustee - .04167 Jimmy M. Joy, Trustee - .04167 Billie L. Kruse, Trustee - .04166 E. C. Higgins Trust - .12500 T. J. Sivley - 7.06250 W. T. Wynn - .68750 John H. Trigg - 2.75000	Yates Drilling Company - 3/6 Martin Yates III - 2/6, and Frank Yates - 1/6 to 2500'
3.	T18S-R29E Sec. 30: Lot 1	31.91	NM-0924A HBP	USA-12.5%	T. J. Sivley - 7/8 W. T. Wynn - 1/3	George McCrary - 2%	Anadarko - 1/2 Southland Royalty Co. - 1/2 to 3350'

EXHIBIT "B"
To Unit Agreement
SOUTH LOCO HILLS (GRAYBURY) UNIT
Eddy County, New Mexico

Tract No.	Description	No. of Acres	Serial No. & Expiration Date of Lease	Basic Royalty Ownership & Percentage	Lessee of Record	Overriding Royalty Owner and Percentage	Working Interest Owner and Percent
4.	T18S-R29E Sec. 20: E/2NW/4, W/2NW/4, N/2SW/4	240.00	NM-0925 HBP	USA-12.5%	T. J. Sivley	Nell McCrary - .28125% K. U. McCrary - .18750 Patricia McCrary Shaffer - .09375 Carol McCrary Odell - .09375 Violet Shipp Young - .09375 L. Jay Root - .86670 Jimmy M. Joy, Trustee - .04167 Billie Kruse, Trustee - .04167 Jimmy M. Joy, Trustee - .04166 Higgins Trust, Inc. - .12500 Mary C. Johnston-.06665 Charles M. Fuchtmann - .06665 George Denton -3.00000 (T.J. Sivley) -3.00000	DEPCO, Inc.-1/2 Husky Oil Co.- 1/2 to 4000'

EXHIBIT "B"
To Unit Agreement
SOUTH LOCO HILLS (GRAYBURG) UNIT
Eddy County, New Mexico

<u>Tract No.</u>	<u>Description</u>	<u>No. of Acres</u>	<u>Serial No. & Expiration Date of Lease</u>	<u>Basic Royalty Ownership & Percentage</u>	<u>Lessee of Record</u>	<u>Overriding Royalty Owner and Percentage</u>	<u>Working Interest Owner and Percent</u>
4a.	T18S-R29E Sec. 20: SE/4SW/4	40.00	NW-0925 HBP	USA-12.5%	T. J. Sivley	<p>Neil McCrary, Execu- trix of Estate of George U. McCrary & Lucille McCrary, both deceased - .7500% L. Jay Root - .8667 Julia Brainard- .1250 Higgins Trust, Inc. - .1250 Lucretia E. Conlon - .1333 Lloyd Wright & Julia K. Wright -5.0000 George Denton & Frances Denton -3.0000</p>	<p>Yates Drilling Company-3/6 Martin Yates III-2/6 Frank Yates-1/6 to 2800'</p>

EXHIBIT "C"
To Unit Agreement
SOUTH LOCO HILLS (GRAYBURG) UNIT
Eddy County, New Mexico

Tract No.	Description	No. of Acres	Serial No. & Expiration Date of Lease	Basic Royalty Ownership & Percentage	Lessee of Record	Overriding Royalty Owner and Percentage	Working Interest Owner and Percent
5.	T18S-R29E Sec. 20: SW/4SW/4	40.00	NM-0593	USA-12.5%	Yates Drilling Company - 1/2 Martin Yates III-1/2	George Ferriman-2.000000% Higgins Trust, Inc. - .125000 K. U. McCrary - .187500 Nell McCrary - .281250 Carol McCrary Odell - .093750 L. Jay Root - .093750 Patricia McCrary Shaffer - .093750 Louise D. Yates-2.083330 Violet Shipp Young - .093750 Billie Kruse, Trustee - .041660 Jimmy M. Joy, Trustee - .041670 Jimmy M. Joy, Trustee - .041670 Mary C. Johnston-.066665 Charles M. Fuchtmann -.066665	Lessee - All
6.	T18S-R29E Sec. 19: NE/4NW/4	40.00	NM-05525B	USA-12.5%	Anadarko	Jack McCaw -6.250000%	Lessee to 2450'

EXHIBIT "B"
To Unit Agreement
SOUTH LOCO HILLS (GRAYBURG) UNIT
Eddy County, New Mexico

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<u>Tract No.</u>	<u>Description</u>	<u>No. of Acres</u>	<u>Serial No. & Expiration Date of Lease</u>	<u>Basic Royalty Ownership & Percentage</u>	<u>Lessee of Record</u>	<u>Overriding Royalty Owner and Percentage</u>	<u>Working Interest Owner and Percent</u>
7.	T18S-R29E Sec. 19: NW/4NE/4	40.00	NM-23417 (Step-Scale)	USA-12.5%	Anadarko Southland Royalty Co.-1/2	Harvey Yates - 12.5000%	Anadarko - 1/2 Southland Royalty Co.-1/2 to 2500'
7a.	T18S-R29E Sec. 19: S/2SE/4	80.00	NM-23417 (Step-Scale)	USA-12.5%	Yates Drilling Company -1/2 Martin Yates III -1/2	Eudora Hawley Heilman-.25000% Josephine D. Hawley-.25000 Yates Brothers -.25000 Olen F. Featherstone-.50000 Robert F. Travis, Sr.-.25000 Robert F. Travis, Jr.-.41670 John Lucas -.08330 Louise D. Yates-6.25000	Yates Drilling Company - 3/6 Martin Yates III - 2/6 and Frank Yates-1/6, to 2898'
7b.	T18S-R29E Sec. 19: N/2SE/4, S/2NE/4, NE/4NE/4	200.00	NM-23417 (Step-Scale)	USA-12.5%	Anadarko Southland Royalty Co.-1/2	Robert F. Travis, Jr.-2.00000% Harvey Yates 1.00000	Anadarko - 1/2 Southland Royalty Co.-1/2 to 3300'

EXHIBIT "C"

To Unit Agreement
SOUTH LOCO HILLS (GRAYBURG) UNIT
Eddy County, New Mexico

January 26, 1982

<u>Tract Number</u>	<u>Cumulative Production Thru 1980</u>	<u>Participation Percentage</u>
1	14,942	2.456233
2	66,098	10.865484
2a	15,967	2.624727
2b	27,286	4.485394
3	3,127	.514030
4	150,985	24.819588
4a	35,155	5.778935
5	72,218	11.871517
6	15,254	2.507521
7	3,617	.594579
7a	93,725	15.406934
7b	<u>109,956</u>	<u>18.075058</u>
	608,330	100.000000

UNIT OPERATING AGREEMENT
SOUTH LOCO HILLS (GRAYBURG) UNIT
EDDY COUNTY, NEW MEXICO

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UNIT OPERATING AGREEMENT
SOUTH LOCO HILLS (GRAYBURG) UNIT
EDDY COUNTY, NEW MEXICO

THIS AGREEMENT, entered into as the _____ day of _____, 1982, by and between the parties who have signed the original of this instrument, a counterpart thereof, or other instrument agreeing to become a party hereto,

WITNESSETH:

WHEREAS, the parties hereto as Working Interest Owners have executed, as of the date hereof, an Agreement entitled "Unit Agreement, South Loco Hills (Grayburg) Unit, Eddy County, New Mexico, "herein referred to as "Unit Agreement," which, among other things, provides for a separate agreement to be entered into by Working Interest Owners to provide for Unit Operations as therein defined.

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

ARTICLE 1

CONFIRMATION OF UNIT AGREEMENT

1.1 Confirmation of Unit Agreement. The Unit Agreement is hereby confirmed and by reference made a part of this Agreement. The definitions in the Unit Agreement are adopted for all purposes of this Agreement. If there is any conflict between the Unit Agreement and this Agreement, the Unit Agreement shall govern.

ARTICLE 2

EXHIBITS

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

2.1.1 Exhibits "A", "B", and "C", of the Unit Agreement. There is no Exhibit "D".

2.1.2 Exhibit "E", attached hereto, is a schedule showing the Unit Participation of each Working Interest Owner. Exhibit "E", or a revision thereof, shall not be conclusive as to the information therein, except it may be used as showing the Unit Participations of Working Interest Owners for purposes of this Agreement until shown to be in error or revised as herein authorized.

2.1.3 Exhibit "F", attached hereto, is the Accounting Procedure applicable to Unit Operations. If there is any conflict between this Agreement and Exhibit "F", this Agreement shall govern.

2.1.4 Exhibit "G", attached hereto, contains insurance provisions applicable to Unit Operations.

2.2 Revision of Exhibits. Whenever Exhibits "A", "B" or "C" are revised, Exhibit "E" shall be revised accordingly and be effective as of the same date. Unit Operator shall also revise Exhibit "E" from time to time as required to conform to changes in ownership of which Unit Operator has been notified as provided in the Unit Agreement.

2.3 Reference to Exhibits. When reference is made herein to an exhibit, it is to the exhibit as originally attached or if revised, to the last revision.

ARTICLE 3

SUPERVISION OF OPERATIONS BY WORKING INTEREST OWNERS

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

3.2 Specific Authorities and Duties. The matters with respect to which Working Interest Owners shall decide and take action shall include, but not be limited to, the following:

3.2.1 Method of Operation. The method of operation, including the type or types of pressure maintenance, secondary recovery, or other recovery program to be employed.

3.2.2 Drilling of Wells. The drilling of any well whether for production of Unitized Substances, for use as an injection well, or for other purposes.

3.2.3 Well Recompletion and Change of Status. The re-completion, abandonment, or permanent change of status of any well, or the use of any well for injection or other purposes. The Unit Operator shall be responsible for performing such work and such work shall be done at Unit Expense.

3.2.4 Expenditures. The making of any single expenditure in excess of Thirty Thousand Dollars (\$30,000.00); however, approval by Working Interest Owners of the drilling, reworking, deepening, or plugging back of any well shall include approval of all necessary, expenditures required therefore, and for completing, testing and equipping the well, including necessary flow lines, separators, and lease tankage; provided however, that in case of blowout, explosion, fire, flood or other sudden emergencies, Unit Operator may take steps and incur such expenses as in its opinion are required to deal with the emergency and to safeguard life

or property, but that Unit Operator shall, as promptly as possible, report the emergency to the Working Interest Owners.

3.2.5 Disposition of Unit Equipment. The selling or otherwise disposing of any major item of surplus Unit Equipment, if the current price of new equipment similar thereto is Five Thousand Dollars (\$5,000.00) or more.

3.2.6 Appearance Before a Court or Regulatory Agency. The designating of a representative to appear before any court or regulatory agency in matters pertaining to Unit Operations; however, such designation shall not prevent any Working Interest Owner from appearing in person or from designating another representative in its own behalf.

3.2.7 Audits. The auditing of the accounts of Unit Operator pertaining to Unit Operations hereunder; however, the audits shall

(a) not be conducted more than once each year except upon the resignation or removal of Unit Operator, and

(b) be made upon the approval of the owner or owners of a majority of Working Interest other than that of Unit Operator, at the expense of all Working Interest Owners other than Unit Operator, or

(c) be made at the expense of those Working Interest Owners requesting such audit, if owners of less than a majority of Working Interest, other than that of Unit Operator, request such an audit, and

(d) be made upon not less than thirty (30) days written notice to Unit Operator.

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

3.2.9 Technical Services. The authorizing of charges to the Joint Account of services by consultants or Unit Operator's technical personnel not covered by the overhead charges provided by Exhibit "F".

3.2.10 Assignments to Committees. The appointment of committees to study any problems in connection with Unit Operations.

3.2.11 The removal of Unit Operator and the selection of a successor.

3.2.12 The enlargement of the Unit Area.

3.2.13 The adjustment and readjustment of investments.

3.2.14 The termination of the Unit Agreement.

ARTICLE 4

MANNER OF EXERCISING SUPERVISION

4.1 Designation of Representatives. Each Working Interest Owner shall inform Unit Operator in writing of the names and addresses of the representative and alternate who are authorized to represent and bind such Working Interest Owner with respect to Unit Operations. The representative or alternate may be changed from time to time by written notice to Unit Operator.

4.2 Meetings. 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 Unit Participation then in effect 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 may amend items included in the agenda and may act upon an amended item or other items presented at the meeting. The representative of Unit Operator shall be chairman of each meeting.

4.3 Voting Procedure. Working Interest Owners shall decide all matters coming before them as follows:

4.3.1 Voting Interest. Each Working Interest Owner shall have a voting interest equal to its Unit Participation in effect at the time of the vote.

4.3.2 Vote Required. Unless otherwise provided herein or in the Unit Agreement, Working Interest Owners shall determine all matters by the affirmative vote of four or more Working Interest Owners having a combined voting interest of at least sixty-five percent (65%); however, should any one Working Interest Owner have more than thirty-five percent (35%) voting interest, its negative vote or failure to vote shall not defeat a motion, and such motion shall pass if approved by Working Interest Owners having a majority voting interest, unless three or more Working Interest Owners having a combined voting interest of at least five percent (5%) likewise vote against the motion or fail to vote.

4.3.3 Vote at Meeting by Nonattending Working Interest Owner. Any Working Interest Owner not represented at a meeting may vote on any agenda item by letter or telegram addressed to the representative of Unit Operator if its vote is received prior to the vote at the meeting, provided the agenda items are not amended.

4.3.4 Poll Votes. Working Interest Owners may vote on

and decide, by letter or telegram, any matter submitted in writing to Working Interest Owners. If a meeting is not requested, as provided in Section 4.2, within seven (7) days after a written proposal is sent to Working Interest Owners, the vote taken by letter or telegram shall become final. Unit Operator will give prompt notice of the results of such voting to all Working Interest Owners.

ARTICLE 5

INDIVIDUAL RIGHTS OF WORKING INTEREST OWNERS

5.1 Reservation of Rights. Working Interest Owners severally reserve to themselves all their rights, except as otherwise provided in this Agreement and the Unit Agreement.

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

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

5.2.2 Reports. The right to receive from Unit Operator, upon written request, copies of all reports to any governmental agency, reports of crude oil runs and stocks, inventory reports, and all other information pertaining to Unit Operations. The cost of gathering and furnishing information not ordinarily furnished by Unit Operator to all Working Interest Owners shall be charged to the Working Interest Owner that requests the information.

5.3 Undrilled Locations. Unit Operator shall have the option to drill any undrilled locations on tracts committed to the Unit Area at Unit Expense.

ARTICLE 6

UNIT OPERATOR

6.1 Unit Operator. Yates Drilling Company, a New Mexico corporation, is hereby designated as Initial Unit Operator.

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

ARTICLE 7

AUTHORITIES AND DUTIES OF UNIT OPERATOR

7.1 Exclusive Right to Operate Unit. Subject to the provisions of this Agreement and to instructions from Working Interest Owners, Unit Operator shall have the exclusive right and be obligated to conduct Unit Operations.

7.2 Workmanlike Conduct. Unit Operator shall conduct Unit Operations in a good and workmanlike manner as would prudent operator under the same or similar circumstances. Unit Operator shall freely consult with Working Interest Owners and keep them informed of all matters which Unit Operator, in the exercise of its best judgement, considers important. Unit Operator shall not be liable to Working Interest Owners for damages, unless such damages result from its gross negligence or willful misconduct.

7.3 Liens and Encumbrances. Unit Operator shall endeavor to keep the lands and leases in the Unit Area and Unit Equipment free from all liens and encumbrances occasioned by Unit Operations, except the lien and security interest of Unit Operator and Working Interest Owners granted hereunder.

7.4 Employees. The number of employees used by Unit Operator in conducting Unit Operations, their selection, hours of labor, and compensation shall be determined by Unit Operator. Such employees shall be the employees of Unit Operator.

7.5 Records. Unit Operator shall keep correct books, accounts, and records of Unit Operations.

7.6 Reports to Working Interest Owners. Unit Operator shall furnish Working Interest Owners periodic reports of Unit Operations.

7.7 Reports to Governmental Authorities. Unit Operator shall make all reports to governmental authorities that it has the duty to make as Unit Operator.

7.8 Engineering and Geological Information. Unit Operator shall furnish to a Working Interest Owner, upon written request, a copy of all logs and other engineering and geological data pertaining to wells drilled for Unit Operations.

7.9 Expenditures. Unit Operator is authorized to make single expenditures not in excess of Thirty Thousand Dollars (\$30,000.00) without prior approval of Working Interest Owners. If an emergency occurs, Unit Operator may immediately make or incur such expenditures as in its opinion are required to deal with the emergency. Unit Operator shall report to Working Interest Owners, as promptly as possible, the nature of the emergency and the action taken.

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

7.11 Mathematical Errors. Unit Operator is empowered to correct any mathematical errors which might exist in the pertinent exhibits to this Agreement.

7.12 Border Agreement. Subject to the provisions and conditions in the Unit Agreement, Unit Operator shall have the right and authority to enter into border protection agreements.

7.13 Conflict of Supervision. Neither the Unit Operator nor the Working Interest Owners, nor any of them, shall be subject to any forfeiture, termination or expiration of any rights hereunder or under any leases or contracts subject hereto, or to any penalty or liability on account of delay or failure in whole or in part to comply with any applicable provisions thereof to the extent that the said Unit Operator or the Working Interest Owners, or any of them, are hindered, delayed or prevented from complying therewith by reason of failure of the Unit Operator to obtain, in the exercise of due diligence, the concurrence of proper representatives of the United States and of the State of New Mexico in and about any matters or things concerning which it is required herein that such concurrence be obtained.

ARTICLE 8

TAXES

8.1 Ad Valorem Taxes. Beginning with the first calendar year after the Effective Date hereof, Unit Operator shall make and file all necessary ad valorem tax renditions and returns with the proper taxing authorities with respect to all property of each Working Interest Owner used or held by Unit Operator for Unit Operations. Unit Operator shall settle assessments arising therefrom. Any Working Interest Owner dissatisfied with any proposed rendition or assessment of its interest in property shall have the right, at its own expense, to protest and resist the same. All such ad valorem taxes shall be paid by Unit Operator and charged to the joint account; however, if the interest of a Working Interest Owner is subject to a separately assessed overriding royalty interests production payment, or other interest in excess of one-eighth (1/8) royalty, such Working Interest Owner shall notify Unit Operator of such interest prior to the rendition date and shall be given credit for the reduction in taxes paid resulting therefrom.

8.2 Other Taxes. Each Working Interest Owner 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 its share of Unitized Substances.

ARTICLE 9

INSURANCE

9.1 Insurance. Unit Operator, with respect to Unit Operations, shall:

- (a) comply with the Workmen's Compensation Laws of the State,

- (b) carry Employer's Liability and other insurance required by the laws of the State, and
- (c) provide other insurance as set forth in Exhibit "G".

ARTICLE 10

ADJUSTMENT OF INVESTMENTS

10.1 Personal Property Taken Over. Upon the Effective Date, Working Interest Owners shall deliver to Unit Operator the following:

10.1.1 Wells. All wells completed in the Unitized Formation.

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

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

10.2 Inventory and Evaluation of Personal Property. Working Interest Owners shall at Unit Expense inventory and evaluate, as determined by Working Interest Owners, the personal property taken over by Unit Operator under Section 10.1.2. Such inventory shall include and be limited to those items of equipment considered controllable under Exhibit "F" except, upon determination of Working Interest Owners, items considered noncontrollable may be included in the inventory in order to be included in the inventory for record purposes, but shall be excluded from evaluation and investment adjustment.

10.3 Investment Adjustment. Upon approval by Working Interest Owners of the inventory and evaluation, each Working Interest Owner shall be credited with the value, as determined in accordance with Section 10.2 above, of its interest in all personal property taken over by Unit Operator under Section 10.1.2. and charged with an amount equal to that obtained by multiplying the total value of all such personal property taken over the Unit Operator under Section 10.1.2. by such Working Interest Owner's Unit Participation. If the charge against any Working Interest Owner is greater than the amount credited to such Working Interest Owner, the resulting net charge shall be paid in all other respects be treated as any other item of Unit Expense chargeable against such Working Interest Owners. If the credit to any Working Interest Owner is greater than the amount charged against such Working Interest Owners, the resulting net credit shall be paid to such Working Interest Owner by Unit Operator out of funds received by it in settlement of the net charges described above.

10.4 General Facilities. The acquisition of warehouses, warehouse stocks, lease houses, camps, facility system, and office buildings

necessary for Unit Operations shall be by negotiation by the owners thereof and Unit Operator, subject to the approval of Working Interest Owners.

10.5 Ownership of Personal Property and Facilities. Each Working Interest Owner, individually, shall by virtue hereof own an undivided interest, equal to its Unit Participation, in all personal property and facilities taken over or otherwise acquired by Unit Operator pursuant to this agreement.

ARTICLE 11

UNIT EXPENSE

11.1 Basis for Charge to Working Interest Owners. Unit Operator initially shall pay all Unit Expenditures. Each Working Interest Owner shall reimburse Unit Operator for its share of Unit Expenditures. Each Working Interest Owner's share of such Unit Expenditures shall be the same as its Unit Participation for:

- (a) items in the nature of capital assets including, without limitation, real property if acquired;
- (b) acquiring, drilling, re-drilling, equipping and re-equipping water injection wells, replugging or converting oil wells to water injection wells, pumping and pipeline facilities for such wells, and changing any injection interval in any such well;
- (c) re-entry and replugging of wells outside the unit area as necessary to permit water injection into appropriate wells within the unit area;
- (d) gathering lines and facilities and common tank batteries utilized or acquired for Unit Operations, and
- (e) water purchased or otherwise obtained for injection purposes and the costs of injection thereof into the Unit Area.

Each Working Interest Owner's share of all other Unit Expenditures shall be the same as its Unit Participation in effect at that time. All charges, credits and accounting for Unit Expenditures shall be in accordance with Exhibit "F".

11.2 Budgets. Before or as soon as practical after the Effective Date, Unit Operator shall prepare a budget of estimated Unit Expense for the remainder of the calendar year and on or before the first day of each October thereafter shall prepare such a budget for the ensuing calendar year. Budgets shall be estimates only, and shall be adjusted or corrected by Working Interest Owners and Unit Operator whenever an adjustment or correction is proper. A copy of each budget and adjusted budget shall be furnished promptly to each Working Interest Owner.

11.3 Advance Billings. Unit Operator shall have the right, without prejudice to other rights or remedies, to require Working Interest

Owners to advance their respective share of estimated Unit Expense by submitting to Working Interest Owners, on or before the 15th day of any month, an itemized estimate thereof for the succeeding month, with a request for payment in advance. Within fifteen (15) days after receipt of the estimate, each Working Interest Owner shall pay to Unit Operator its share of such estimate. Adjustments between estimated and actual Unit Expense shall be made by Unit Operator at the close of each calendar month, and the accounts of Working Interest Owners shall be adjusted accordingly.

11.4 Commingling of Funds. Funds received by Unit Operator under this agreement need not be segregated or maintained by it as a separate fund, but may be commingled with its own funds.

11.5 Lien and Security Interest of Unit Operator and the Working Interest Owners. Each Working Interest Owner grants to Unit Operator a lien upon its Oil and Gas Rights in each Tract and a security interest in its share of Unitized Substances when extracted and its interest in all Unit Equipment to secure payment of its share of Unit Expense, together with interest thereon at the rate of twelve percent (12%) per annum, with the further provision that Unit Operator grants a like lien to Working Interest Owners. To the extent that Unit Operator has a security interest under the Uniform Commercial Code of the State of New Mexico, Unit 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 a judgment by Unit 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 Working Interest Owners in the payment of its share of Unit Expense, Unit Operator shall have the right, without prejudice, to other rights or remedies, to collect from the purchaser the proceeds from the sale of such Working Interest Owner's share of Unitized Substances until the amount owed by such Working Interest Owners, plus interest, has been paid. Each purchaser shall be entitled to rely upon Unit Operator's written statement concerning the amount of any default. The rights herein granted the Unit Operator shall in like manner apply to the other Working Interest Owners.

11.6 Unpaid Unit Expense. If any Working Interest Owner fails to pay its share of Unit Expense within sixty (60) days after rendition of a statement therefor by Unit Operator, each Working Interest Owner agrees upon request by Unit Operator, to pay its proportionate part of the unpaid share of Unit Expense of the defaulting Working Interest Owner. Working Interest Owners that pay the share of Unit Expense of a defaulting Working Interest Owner shall be reimbursed by Unit Operator for the amount so paid, plus any interest collected thereon, upon receipt by Unit Operator of any past due amount collected from the defaulting Working Interest Owners. Any Working Interest Owner so paying a defaulting Working Interest Owner's share of Unit Expense shall, to obtain reimbursement thereof, be subrogated to the lien and other rights herein granted Unit Operator.

11.7 Carved-Out Interest. If any Working Interest Owners shall, after executing this agreement, create an overriding royalty, production payment, net proceeds interest, carried interest, or any other interest out of its Working Interest, such carved-out interest shall be subject to the

terms and provisions of this agreement, specifically including, but without limitation, Section 11.5 hereof entitled "Lien of Unit Operator." If the Working Interest Owner creating such carved-out interest (a) fails to pay any Unit Expense chargeable to such Working Interest Owner under this agreement, and the production of Unitized Substances accruing to the credit of such Working Interest Owner is insufficient for that purpose, or (b) withdraws from this agreement under the terms and provisions of Article 17 hereof, the carved-out interest shall be chargeable with a pro rata portion of all Unit Expense incurred hereunder, the same as though such carved-out interest were a Working Interest, and Unit Operator shall have the right to enforce against such carved-out interest the lien and all other rights granted in Section 11.5 for the purpose of collecting the Unit Expense chargeable to the carved-out interest.

11.8 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, 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 one-eighth (1/8) 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.

11.9 Salvage Credit. Credit for Unit Equipment salvaged during shall be divided in the same proportion as the Unit Participation.

11.10 Rentals. The Working Interest Owners in each Tract shall pay all rentals, minimum royalty, advance rentals or delay rentals due under the lease thereon and shall concurrently submit to the Unit Operator evidence of payment.

ARTICLE 12

NON-UNITIZED FORMATIONS

12.1 Right to Operate. Any Working Interest Owner that now has or hereafter acquires the right to drill for and produce oil, gas, or other minerals, from a formation underlying the Unit Area other than the Unitized Formation, shall have the right to do so notwithstanding this Agreement or the Unit Agreement. In exercising the right, however, the Working Interest Owner shall exercise care to prevent unreasonable interference with Unit Operations. No Working Interest Owner shall produce Unitized Substances through any well drilled or operated by it. If any Working Interest Owner drills any well into or through the Unitized Formation, the Unitized Formation shall be protected in a manner satisfactory to Working Interest Owners so that the production of Unitized Substances will not be affected adversely.

ARTICLE 13

TITLES

13.1 Warranty and Indemnity. Each Working Interest Owner represents and warrants that it is not liable for any failure.

sents and warrants that it is the owner of the respective working interests set forth opposite its name in Exhibit "B" of the Unit Agreement, and agrees to indemnify and hold harmless the other Working Interest Owners from any loss due to failure, in whole or in part, of its title to any such interest, except failure of title arising out of Unit Operations; however, such indemnity and any liability for breach of warranty shall be limited to an amount equal to the net value that has been received from the sale or receipt of Unitized Substances attributed to the interest as to which title failed. Each failure of title will be deemed to be effective, insofar as this Agreement is concerned, as of 7:00 a.m. on the first day of the calendar month in which such failure is finally determined, and there shall be no retroactive adjustment of Unit Expense, or retroactive allocation of Unitized Substances or the proceeds therefrom, as a result of title failure.

13.2 Failure Because of Unit Operations. The failure of title of any Working Interest in any Tract because of Unit Operations, including nonproduction from such Tract, shall not change the Unit Participation of the Working Interest Owner whose title failed in relation to the Unit Participations of the other Working Interest Owners at the time of the title failure.

ARTICLE 14

LIABILITY, CLAIMS, AND SUITS

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

14.2 Settlements. Unit Operator may settle any single damage claim or suit involving Unit Operations if the expenditure does not exceed Fifteen Thousand Dollars (\$15,000.00) and if the payment is in complete settlement of such claim or suit. If the amount required for settlement exceeds the above amount, Working Interest Owners shall assume and take over the further handling of the claim or suit, unless such authority, is delegated to Unit Operator. All costs and expense of handling, settling, or otherwise discharging such claim or suit shall be an item of Unit Expense. If a claim is made against any Working Interest Owner or if any Working Interest Owner is sued on account of any matter arising from Unit Operations over which such Working Interest Owner individually has not control because of the rights given Working Interest Owners and Unit Operator by this Agreement and the Unit Agreement, the Working Interest Owner shall immediately notify Unit Operator, and the claim or suit shall be treated as any other claim or suit involving Unit Operations.

ARTICLE 15

LAWS AND REGULATIONS

15.1 Internal Revenue Provision. Notwithstanding any provisions herein that the rights and liabilities of the parties 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 then each of the parties hereto 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. Unit Operator is hereby authorized and directed to execute on behalf of each of the parties hereto 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 1.761-1(a). Should there be any requirement that each party hereto further evidence this election, each party hereto agrees to 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. Each party hereto further agrees not to 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 Unit Area is located, or any future income tax law 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 of the parties agrees to make such election as may be permitted, or required by such laws. In making this election, each of the parties states that the income derived by such party from the operations under this Agreement can be adequately determined without the computation of partnership taxable income.

15.2 Statutory Unitization. If Working Interest Owners owning at least seventy-five percent (75%) of the Unit Participation have become parties to this Agreement and if Royalty Interest Owners owning at least seventy-five percent (75%) of the Royalty Interest have become parties hereto, the Unit Operator may make application to the New Mexico Oil Conservation Division of the Energy and Minerals Department for statutory unitization of the uncommitted interests.

ARTICLE 16

NOTICES

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

ARTICLE 17

WITHDRAWAL OF WORKING INTEREST OWNER

17.1 Withdrawal. A Working Interest Owner may withdraw from this Agreement by transferring, without warranty of title, either express or implied, to the other Working Interest Owners, all its Oil and Gas Rights, exclusive of Royalty Interests, together with its interest in all Unit Eq-

uipment and in all wells used in Unit Operations. The instrument of transfer may be delivered to Unit Operator for the transferees. Such transfer shall not relieve the Working Interest Owner from any obligation or liability incurred prior to the date of the delivery of the instrument of transfer; however, the tender has to be accepted unless Working Interest Owners decide within ninety (90) days to terminate the Unit. The interest transferred shall be owned by the transferees in proportion to their respective Unit Participations then in effect. The transferees, in proportion to the respective interests so acquired, shall pay transferor, for its interest in Unit Equipment, the net salvage value thereof as determined by Working Interest Owners. In the event such withdrawing party's interest in the aforesaid fair salvage value after deducting the estimated cost of salvaging same is less than the withdrawing party's share of the estimated cost of plugging and abandoning all wells then being used or hold for Unit Operations, then the withdrawing party, as a condition precedent to withdrawal, shall pay in cash to the party or parties succeeding to its interest a sum equal to the deficiency. After the date of delivery of the instrument of transfer, the withdrawing Working Interest Owner shall be relieved from all further obligations and liability hereunder and under the Unit Agreement, and the rights of such Working Interest Owner hereunder and under the Unit Agreement shall cease inssofar as they existed by virtue of the interest transferred.

ARTICLE 18

ABANDONMENT OF WELLS

18.1 Rights of Former Owners. If Working Interest Owners decide to permanently abandon any well within the Unit Area prior to termination of the Unit Agreement, Unit Operator shall give written notice thereof to the Working Interest Owners of the Tract on which the well is located, and they shall have the option for a period of ninety (90) days after the sending of such notice to notify Unit Operator in writing of their election to take over and own the well. Within ten (10) days after the Working Interest Owners of the Tract on which the well is located, and they shall have the option for a period of ninety (90) days after the sending of such notice to notify Unit Operator in writing of their election to take over and own the well. Within ten (10) days after the Working Interest Owners of the Tract have notified Unit Operator of their election to take over the well, they shall pay Unit Operator, for credit to the joint account, the amount determined by Working Interest Owners to be the net salvage value of the casing and equipment in on the well. The Working Interest Owners of the Tract, by taking over the well, agree to seal off the Unitized formation, and upon abandonment to plug the well in compliance with applicable laws and regulations.

18.2 Plugging. If the Working Interest Owners of a Tract do not elect to take over a well located within the Unit Area that is proposed for abandonment, Unit Operator shall plug and abandon the well in compliance with applicable laws and regulations.

ARTICLE 19

EFFECTIVE DATE AND TERM

19.1 Effective Date. This Agreement shall become effective when the Unit Agreement become effective.

19.2 Term. This Agreement shall continue in effect so long as the Unit Agreement remains in effect, and thereafter until (a) all Unit wells have been plugged and abandoned or turned over to Working Interest Owners in accordance with Article 20; (b) all Unit Equipment and real property acquired for the joint account have been disposed of by Unit Operator in accordance with instructions of Working Interest Owners; and (c) there has been a final accounting.

ARTICLE 20

ABANDONMENT OF OPERATIONS

20.1 Termination. Upon termination of the Unit Agreement, the following will occur:

20.1.1 Oil and Gas Rights. Oil and Gas Rights in and to each separate Tract shall no longer be affected by this Agreement, and thereafter the parties shall be governed by the terms and provisions of the leases, contracts and other instruments affecting the separate Tracts.

20.1.2 Right to Operate. Working Interest Owners of any Tract that desire to take over and continue to operate wells located thereon may do so by paying Unit Operator, for credit to the joint account, the net salvage values, as determined by Working Interest Owners, of the casing and equipment in and on the wells taken over and by agreeing upon abandonment to plug each well in compliance with applicable laws and regulations.

20.1.4 Cost of Abandonment. The cost of abandonment of Unit Operations shall be Unit Expense.

20.1.5 Distribution of Assets. Working Interest Owners shall share in the distribution of Unit Equipment, or the proceeds thereof, in proportion to their Unit Participations.

ARTICLE 21

EXECUTION

21.1 Original, Counterpart, or other Instrument. An owner of a Working Interest may become a party to this Agreement by signing the original of this instrument, a counterpart thereof, or other instrument agreeing to become a party hereto. The signing of any such instrument shall have the same effect as if all parties had signed the same instrument.

ARTICLE 22

SUCCESSORS AND ASSIGNS

22.1 Successors and Assigns. This Agreement shall extend to, be binding upon, and inure to the benefit of the parties hereto and their respective heirs, devisees, legal representative, successors, and assigns, and shall constitute a covenant running with the lands, leases, and interests covered hereby.

No party hereto shall assign or convey less than his entire interest in any Tract committed hereto unless such leased interest, if any, is an undivided interest in such entire tract; and, should any interest committed hereto be or become owned by three (3) or more parties, then all of such parties shall be obligated to appoint a single agent to represent such interest for the purpose of accepting billings and receiving payments, if any, arising hereunder, or under the Unit Agreement, and for voting upon any matter which is the subject of determination of by the Working Interest Owners.

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

YATES DRILLING COMPANY
Unit Operator and Working Interest Owner

By: _____ Attorney-in-fact

SIGNATURE PAGE TO SOUTH LOCO HILLS (GRAYBURG) UNIT
AGREEMENT DATED _____.

MARTIN YATES, III

By: _____
Attorney-in-Fact FRANK YATES

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by
Attorney-in-Fact for YATES DRILLING COMPANY, a New Mexico corporation, on
behalf of said corporation.

My Commission Expires:

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by FRANK YATES, individually, and as
Attorney-in-Fact for MARTIN YATES, III.

My Commission Expires:

Notary Public

SIGNATURE PAGE TO SOUTH LOCO HILLS (GRAYBURG) UNIT
OPERATING AGREEMENT DATED _____.

J. W. JONES

PAULINE HEWITT

ATTEST:

ANADARKO PRODUCTION COMPANY

By _____

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by J. W. JONES.

My Commission Expires:

Notary Public

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by PAULINE HEWITT.

My Commission Expires:

Notary Public

STATE OF TEXAS)
 : §
COUNTY OF)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by _____,
President of ANADARKO PRODUCTION COMPANY, a _____ corporation, on
behalf of said corporation.

My Commission Expires:

Notary Public

SIGNATURE PAGE TO SOUTH LOCO HILLS (GRAYBURG) UNIT
OPERATING AGREEMENT DATED _____.

C. A. DENTON

G. C. DENTON

ATTEST:

SOUTHLAND ROYALTY COMPANY

By _____

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by C. A. DENTON.

My Commission Expires:

Notary Public

STATE OF NEW MEXICO)
 : §
COUNTY OF EDDY)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by G. C. DENTON.

My Commission Expires:

Notary Public

STATE OF TEXAS)
 : §
COUNTY OF)

The foregoing instrument was acknowledged before me this _____
day of _____, 1982, by _____, _____ President
of SOUTHLAND ROYALTY COMPANY, a _____ corporation, on behalf of said
corporation.

My Commission Expires:

Notary Public

EXHIBIT "E"
To Unit Operating Agreement
SOUTH LOCO HILLS (GRAYBURG) UNIT
Eddy County, New Mexico

January 26, 1982

<u>Working Interest Owner</u>	<u>Tract No.</u>	<u>Cumulative Production Thru 1980</u>	<u>Participation Percentage</u>
J. W. Jones & Pauline Hewitt	1	7471	1.228116
C. A. Denton & G. C. Denton	1	7471	1.228116
Anadarko Production Co.	2	33049	
	3	1563.5	
	6	15254	
	7	3617	
	7b	54978	
COMPANY TOTAL		108461.5	17.829386
Southland Royalty Co.	2	33049	
	3	1563.5	
	7b	54978	
COMPANY TOTAL		89590.5	14.727286
Yates Drilling Co.	2a	7983.5	
	2b	27286	
	4a	17577.5	
	5	36109	
	7a	46862.5	
COMPANY TOTAL		135818.5	22.326451
Martin Yates III and Frank Yates	2a	7983.5	
	4a	17577.5	
	5	36109	
	7a	46862.5	
COMPANY TOTAL		108532.5	17.841057
Depeco, Inc.	4	75492.5	12.409794
Husky Oil Co.	4	75492.5	12.409794
TOTALS		608330.0	100.000000

60710

EXHIBIT "F"

Attached to and made a part of Unit Operating Agreement, South
Loco Hills (Grayburg) Unit, Eddy 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 of First Level Supervisors in the field.
- (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 per cent (20%), or percentage most recently recommended by COPAS.

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

I. 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:

- (☒) 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 (☒) 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 \$ 2800.00
Producing Well Rate \$ 280.00

- (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. 6 % of total costs if such costs are more than \$ 25,000 but less than \$ 100,000 ; plus

B. 6 % of total costs in excess of \$ 100,000 but less than \$1,000,000; plus

C. 5 % 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 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-Operator 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

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(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 "G"

ATTACHED TO AND MADE A PART OF
UNIT OPERATING AGREEMENT
SOUTH LOCO HILLS (GRAYBURG) UNIT
EDDY COUNTY, NEW MEXICO

ADDITIONAL INSURANCE PROVISIONS

Operator, during the term of this agreement, shall carry insurance for the benefit and at the expense of the parties hereto, as follows:

- (A) Workmen's Compensation Insurance as contemplated by the state in which operations will be conducted, and Employer's Liability Insurance with limits of not less than \$100,000.00 per employee.
- (B) Public Liability Insurance:
Bodily Injury - \$500,000.00 each occurrence.
- (C) Automobile Public Liability Insurance:
Bodily Injury - \$250,000.00 each person.
\$500,000.00 each occurrence.

Property Damage - \$100,000.00 each occurrence.

Except as authorized by this Exhibit "G", Operator shall not make any charge to the joint account for insurance premiums. Losses not covered by Operator's insurance (or by insurance required by this agreement to be carried for the benefit and at the expense of the parties hereto) shall be charged to the joint account.