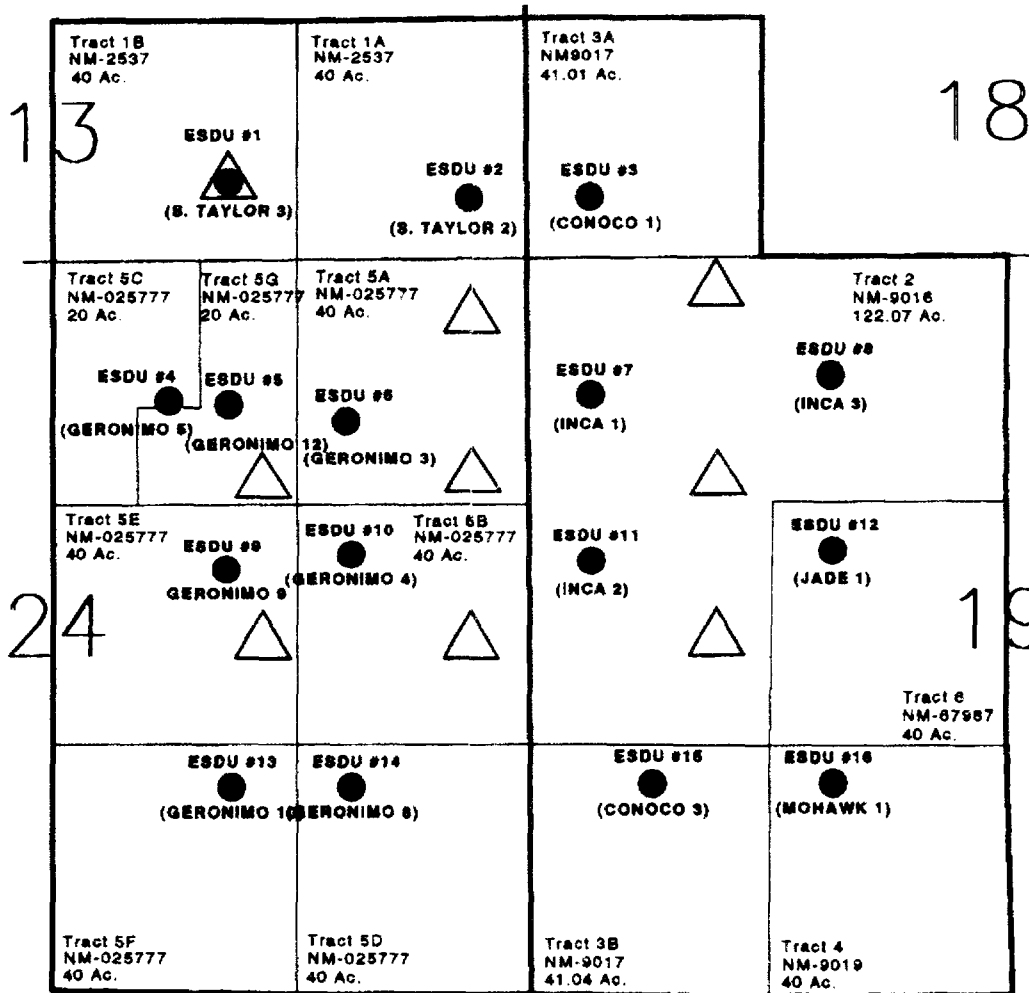


R 31 E

R 32 E



LEGEND

Proposed Well:
(Circle = Well Name)

- Delaware Producer
- ▲ Proposed Conversion
- △ Proposed D&C Injection Well

St. Mary Land & Exploration Co.

**EAST SHUGART DELAWARE UNIT
PROPOSED WATERFLOOD
Drill 8 Injectors Convert 1 Producer**

Scale 1:12745.58

EXHIBIT

TABLE

UNIT AGREEMENT
FOR THE DEVELOPMENT AND OPERATION
OF THE
EAST SHUGART (DELAWARE) UNIT AREA
EDDY AND LEA COUNTIES, NEW MEXICO
NO. NMNM101361X



UNIT AGREEMENT
FOR THE DEVELOPMENT AND OPERATION
OF THE
EAST SHUGART (DELAWARE) UNIT
EDDY AND LEA COUNTIES, NEW MEXICO

TABLE OF CONTENTS

	Page
SECTION 1. <u>ENABLING ACT AND REGULATIONS</u>	2
SECTION 2. <u>UNIT AREA AND DEFINITIONS</u>	2
SECTION 3. <u>EXHIBITS</u>	4
SECTION 4. <u>EXPANSION</u>	5
SECTION 5. <u>UNITIZED LAND</u>	7
SECTION 6. <u>UNIT OPERATOR</u>	7
SECTION 7. <u>RESIGNATION OR REMOVAL OF UNIT OPERATOR</u>	7
SECTION 8. <u>SUCCESSOR UNIT OPERATOR</u>	8
SECTION 9. <u>ACCOUNTING PROVISIONS AND UNIT OPERATING AGREEMENT</u>	9
SECTION 10. <u>RIGHTS AND OBLIGATIONS OF UNIT OPERATOR</u>	9
SECTION 11. <u>PLAN OF OPERATIONS</u>	9
SECTION 12. <u>USE OF SURFACE AND USE OF WATER</u>	10
SECTION 13. <u>TRACT PARTICIPATION</u>	10
SECTION 14. <u>TRACTS QUALIFIED FOR PARTICIPATION</u>	12
SECTION 15.	
A. <u>ALLOCATION OF UNITIZED SUBSTANCES</u>	13
B. <u>TAKING UNITIZED SUBSTANCES IN KIND</u>	14
SECTION 16. <u>OUTSIDE SUBSTANCES</u>	15
SECTION 17. <u>ROYALTY SETTLEMENT</u>	15
SECTION 18. <u>RENTAL SETTLEMENT</u>	16
SECTION 19. <u>CONSERVATION</u>	17
SECTION 20. <u>DRAINAGE</u>	17

SECTION 21.	<u>LOSS OF TITLE</u>	17
SECTION 22.	<u>LEASES AND CONTRACTS CONFORMED AND EXTENDED</u>	18
SECTION 23.	<u>COVENANTS RUN WITH LAND</u>	19
SECTION 24.	<u>EFFECTIVE DATE AND TERM</u>	19
SECTION 25.	<u>RATE OF PROSPECTING, DEVELOPMENT & PRODUCTION</u> ...	21
SECTION 26.	<u>NONDISCRIMINATION</u>	21
SECTION 27.	<u>APPEARANCES</u>	21
SECTION 28.	<u>NOTICES</u>	21
SECTION 29.	<u>NO WAIVER OF CERTAIN RIGHTS</u>	22
SECTION 30.	<u>EQUIPMENT AND FACILITIES NOT FIXTURES ATTACHED TO REALTY</u>	22
SECTION 31.	<u>UNAVOIDABLE DELAY</u>	22
SECTION 32.	<u>NONJOINDER AND SUBSEQUENT JOINDER</u>	22
SECTION 33.	<u>COUNTERPARTS</u>	23
SECTION 34.	<u>JOINDER IN DUAL CAPACITY</u>	24
SECTION 35.	<u>TAXES</u>	24
SECTION 36.	<u>NO PARTNERSHIP</u>	24
SECTION 37.	<u>PRODUCTION AS OF THE EFFECTIVE DATE</u>	24
SECTION 38.	<u>STATUTORY UNITIZATION</u>	25
EXHIBIT "A".	<u>MAP OF UNIT AREA</u>	
EXHIBIT "A-1".	<u>TRACT DESCRIPTIONS</u>	
EXHIBIT "B".	<u>SCHEDULE OF OWNERSHIP</u>	
EXHIBIT "C".	<u>SCHEDULE OF TRACT PARTICIPATION</u>	
EXHIBIT "D".	<u>SCHEDULE OF TRACT NET REVENUE INTERESTS</u>	

UNIT AGREEMENT
FOR THE DEVELOPMENT AND OPERATION
OF THE
EAST SHUGART (DELAWARE) UNIT
EDDY AND LEA COUNTIES, NEW MEXICO

THIS AGREEMENT, entered into as of the 1st day of February, 1999, by and between the parties subscribing, ratifying, or consenting hereto, and herein referred to as the "parties hereto,"

WITNESSETH:

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

WHEREAS, the Mineral Leasing Act of February 25, 1920, 41 Stat. 437, as amended, 30 U.S.C. §§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 Oil Conservation Division of the State of New Mexico (hereinafter referred to as the "Division") is authorized by law(NMSA 1978 §§70-2-1 et seq. and §§70-7-1 et seq.) to approve this Agreement and the conservation provisions hereof; and

WHEREAS, the parties hereto hold sufficient interest in the Unit Area covering the land hereinafter described to give reasonably effective control of operations therein; and

WHEREAS, it is the purpose of the parties hereto to conserve natural resources, prevent waste, increase the ultimate recovery of oil, gas and associated minerals and secure other benefits obtainable through development and operation of the area subject to this Agreement under the terms, conditions, and limitations herein set forth;

NOW THEREFORE, in consideration of the premises and the promises herein contained, the parties hereto commit to this Agreement their 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 or valid, pertinent, and reasonable regulations hereafter issued thereunder are accepted and made a part of this Agreement, provided such regulations are not inconsistent with the terms of this Agreement; and state oil and gas operating regulations in effect as of the Effective Date hereof governing drilling and producing operations, not inconsistent with the terms hereof or federal laws and regulations, are hereby accepted and made a part of this Agreement.

SECTION 2. UNIT AREA AND DEFINITIONS. For the purpose of this Agreement, the following terms and expressions as used herein shall mean:

(a) "Unit Area" is defined as those lands described in Exhibit "B" and depicted on Exhibit "A" hereof, and such land is hereby designated and recognized as constituting the Unit Area, containing 604.12 acres, more or less, in Eddy and Lea Counties, New Mexico.

(b) "Authorized Officer" or "A.O." is any employee of the Bureau of Land Management who has been delegated the required authority to act on behalf of the BLM.

(c) "Secretary" is defined as the Secretary of the Interior of the United States of America, or his duly authorized delegate.

(d) "Department" is defined as the Department of the Interior of the United States of America.

(e) "Proper BLM Office" is defined as the Bureau of Land Management office having jurisdiction over the federal lands included in the Unit Area.

(f) "Unitized Formation" shall mean that interval underlying the Unit Area, the vertical limits of which extend from an upper limit described as the top of the Brushy Canyon Formation of the Delaware Mountain Group to the stratigraphic equivalent of 5600 feet within the Delaware Brushy Canyon Formation as determined by the Geronimo Federal No. 3 well log; the geologic markers having been previously found to occur at 5007 feet and 5600 feet, respectively, in the Geronimo Federal No. 3 well (located 890 feet FNL and 990 feet FEL of Section 24, T-18-S, R-31-E, Eddy County, New Mexico) as recorded on the Compensated Neutron Litho Density Log taken on September, 21, 1985.

(g) "Unitized Substances" are all oil, gas, gaseous substances, sulphur contained in gas, condensate, distillate and all associated and constituent liquid or liquefiable hydrocarbons, other than outside substances, within and produced from the Unitized Formation.

(h) "Tract" is each parcel of land described as such and given a Tract number in Exhibit "B".

(i) "Tract Participation" is defined as the percentage of participation shown on Exhibit "C" for allocating Unitized Substances to a Tract under this agreement.

(j) "Unit Participation of each Working Interest Owner" is the sum of the percentages obtained by multiplying the Working Interest of a Working Interest Owner in each Tract by the Tract Participation of such Tract.

(k) "Working Interest" is an interest in Unitized Substances acquired by virtue of mineral fee simple title, pursuant to the terms of a lease, operating agreement or otherwise, which includes the right to search for, produce and acquire such Unitized Substances and 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 and operations relative to such rights. Any Royalty Interest created by the owner of a Working Interest out of its interest subsequent to the execution of this Agreement shall be the sole burden and obligation of said Working Interest Owner. Such interest shall be subject to the same lien and security provisions as the Working Interest so creating such Royalty Interest.

(l) "Working Interest Owner" is any party hereto owning a Working Interest.

(m) "Royalty Interest" or "Royalty" is an interest (other than a Working Interest) in the Unitized Substances and includes the right to receive a portion of the Unitized Substances or the proceeds thereof. A "Royalty Interest" may be the royalty interest reserved by the lessor of an oil and gas lease; or it may be any overriding royalty interest, oil payment interest, net profit interest, a carried working interest, or any other payment burdening a Working Interest which does not carry with it the right to search for and produce Unitized Substances and does not bear any cost obligation.

(n) "Royalty Owner" is the owner of a Royalty Interest.

(o) "Unit Operating Agreement" is the agreement entered into by and between the Unit Operator and the Working Interest Owners as provided in Section 9, *infra*, and shall be styled "Unit Operating Agreement, East Shugart (Delaware) Unit, Eddy and Lea Counties, New Mexico".

(p) "Oil and Gas Rights" is the right to explore, develop and operate lands within the Unit Area for the production of Unitized Substances, or to share in the production so obtained or the proceeds thereof.

(q) "Outside Substances" is any substance obtained from any source other than the Unitized Formation and injected into the Unitized Formation.

(r) "Unit Manager" is any person or corporation appointed by Working Interest Owners to perform the duties of Unit Operator until the selection and qualification of a successor Unit Operator as provided for in Section 7 hereof.

(s) "Unit Operator" is the party designated by Working Interest Owners under the Unit Operating Agreement to conduct Unit Operations.

(t) "Unit Operations" is any operation conducted pursuant to this Agreement and the Unit Operating Agreement.

(u) "Unit Equipment" is all personal property, lease and well equipment, plants, and other facilities and equipment taken over or otherwise acquired for the joint account for use in Unit Operations.

(v) "Unit Expense" is all cost, expense, or indebtedness incurred by Working Interest Owners or Unit Operator pursuant to this Agreement and the Unit Operating Agreement for or on account of Unit Operations.

(w) "Effective Date" is the date determined in accordance with Section 24, or as redetermined in accordance with Section 38.

SECTION 3. EXHIBITS. The following exhibits are incorporated herein by reference:

Exhibit "A" attached hereto is a map showing the Unit Area and the boundaries and identity of tracts and leases in said Unit Area to the extent known to the Unit Operator.

Exhibit "A-1" attached hereto is a schedule of tracts detailing well name, well status, operator prior to unitization, acreage attributable to the tracts, and location by county for each tract.

Exhibit "B" attached hereto is a schedule showing, to the extent known to the Unit Operator, the acreage comprising each Tract, percentages and types of ownership of oil and gas interests in each Tract, and participation factors for each Tract.

Exhibit "C" attached hereto recites the percentage of Unit Participation attributable to each Tract.

Exhibit "D" attached hereto is a schedule of all Unit owners showing their net revenue interests on a tract-by-tract basis and their total net revenue interest in the Unit.

Nothing herein or in said Exhibits 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 Exhibits as owned by such party. The shapes and descriptions of the respective Tracts have been established by using the best information available. Each Working Interest Owner is responsible for supplying Unit Operator with accurate information relating to each Working Interest Owner's interest.

If it subsequently appears that any Tract, because of diverse royalty or working interest ownership on the Effective Date hereof, should be divided into more than one Tract, or when any revision is requested by the A.O., or any correction of any error other than mechanical miscalculations or clerical is needed, then the Unit Operator, with the approval of the Working Interest Owners, may correct the mistake by revising the exhibits to conform to the facts. The revision shall not include any reevaluation of engineering or geological interpretations used in determining Tract Participation. Each such revision of an exhibit made prior to thirty (30) days after the Effective Date shall be effective as of the Effective Date. Each other such revision of an exhibit shall be effective at 7:00 a.m. on the first day of the calendar month next following the filing for record of the revised exhibit or on such other date as may be determined by Working Interest Owners and set forth in the revised exhibit. Not less than four copies shall be filed with the A.O. In any such revision, there shall be no retroactive allocation or adjustment of Unit Expense or of interests in the Unitized Substances produced, or proceeds thereof.

SECTION 4. EXPANSION. The above described Unit Area may be expanded with the approval of the A.O. to include therein any

additional Tract or Tracts regarded as reasonably necessary or advisable for the purposes of this Agreement; provided, however, in such expansion there shall be no retroactive allocation or adjustment of Unit Expense or of interests in the Unitized Substances produced, or proceeds thereof. Pursuant to Subsection (b), the Working Interest Owners may agree upon an adjustment of investment by reason of the expansion. Such expansion shall be effected in the following manner:

(a) The Working Interest Owner or Owners of a Tract or Tracts desiring to bring such Tract or Tracts into this unit, shall file an application therefor with Unit Operator requesting such admission.

(b) Unit Operator shall circulate a notice of the proposed expansion to each Working Interest Owner in the Unit Area and in the Tract proposed to be included in the unit, setting out the basis for admission, the Tract Participation to be assigned to each Tract in the enlarged Unit Area and other pertinent data. After negotiation (at Working Interest Owners' meeting or otherwise) if at least three Working Interest Owners having in the aggregate seventy-five percent (75%) of the Unit Participation then in effect have agreed to inclusion of such Tract or Tracts in the Unit Area, then Unit Operator shall:

1. After obtaining preliminary concurrence by the A.O., 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 thereto and the proposed effective date thereof; and

2. Deliver copies of said notice to the A.O. at the proper BLM Office, to each Working Interest Owner, and to the last known address of each party hereto whose interests are affected, advising such parties that thirty (30) days will be allowed for submission to the Unit Operator of any objection to such proposed expansion; and

3. Upon the expiration of said thirty (30) day period as set out in (2) immediately above, file the following with the A.O.: (a) evidence of mailing or delivering copies of said notice of expansion; (b) an application for approval of such expansion; (c) an instrument containing the appropriate joinders in compliance with the participation requirements of Section 14, and Section 34, *infra*; and (d) a copy of all objections

received along with the Unit Operator's response thereto.

After due consideration of all pertinent information and approval by the A.O., the expansion shall become effective as of the date prescribed in the notice thereof, preferably the first day of the month subsequent to the date of notice. The revised Tract Participation of the respective Tracts included within the Unit Area prior to such enlargement shall remain in the same ratio one to another.

SECTION 5. UNITIZED LAND. 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". Nothing herein shall be construed to unitize, pool, or in any way affect the oil, gas and other minerals contained in or that may be produced from any formation other than the Unitized Formation as defined in Section 2(f) of this Agreement.

SECTION 6. UNIT OPERATOR. St. Mary Land & Exploration Company is hereby designated the Unit Operator, and by signing this instrument as Unit Operator, agrees and consents to accept the duties and obligations of Unit Operator for the operation, development, and production of Unitized Substances as herein provided. Whenever reference is made herein to the Unit Operator, such reference means the Unit Operator acting in that capacity and not as an owner of interests in Unitized Substances. The term "Working Interest Owner" when used herein shall include the Unit Operator as the owner of a Working Interest.

Unit Operator shall have a lien upon interests of Working Interest Owners in the Unit Area 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 for a period of three (3) months after written notice of intention to resign has been given by Unit Operator to all Working Interest Owners and the A.O. 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.

Upon default or failure in the performance of its duties and obligations hereunder, the Unit Operator shall be subject to removal by Working Interest Owners having in the aggregate eighty-five percent (85%) or more of the Unit Participation then in effect exclusive of the Working Interest Owner who is the Unit Operator. Such removal shall be effective upon notice thereof to the A.O.

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

Upon the effective date of resignation or removal of Unit Operator, such Unit Operator shall deliver possession of all wells, equipment, books and records, materials, appurtenances and any other assets used in connection with the Unit Operations to the new duly qualified successor Unit Operator or to the Unit Manager if no such new Unit Operator is elected. Nothing herein shall be construed as authorizing the removal of any material, equipment or appurtenances needed for the preservation of any wells. Nothing herein contained shall be construed to relieve or discharge any Unit Operator or Unit Manager who resigns or is removed hereunder from any liability or duties accruing or performable by it prior to the effective date of such resignation or removal.

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.

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 as herein provided. 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 A.O. If no successor Unit Operator or Unit Manager is selected and qualified as herein provided, the A.O., at his or her election, may declare this Agreement terminated.

In selecting a successor Unit Operator, the affirmative vote of three or more Working Interest Owners having a total of sixty-five percent (65%) or more of the total Unit Participation shall prevail; provided that if any one Working Interest Owner has a Unit Participation of more than thirty-five percent (35%), its negative vote or failure to vote shall not be regarded as sufficient unless supported by the vote of one or more other Working Interest Owners having a total Unit Participation of at least five percent (5%). If the Unit Operator who is removed votes only to succeed itself or fails to vote, the successor Unit Operator may be selected by the affirmative vote of the owners of at least seventy-five percent (75%) of the Unit Participation

remaining after excluding the Unit Participation of Unit Operator so removed.

SECTION 9. ACCOUNTING PROVISIONS AND UNIT OPERATING AGREEMENT. Costs and expenses incurred by Unit Operator prior to unitization in preparation for unitization and in conducting Unit Operations hereunder shall be apportioned among and paid by the Working Interest Owners in accordance with the Unit Operating Agreement. Such Unit Operating Agreement shall also provide the manner in which the Working Interest Owners shall be entitled to receive their respective proportionate and allocated share of the benefits accruing hereto in conformity with their underlying operating agreements, leases or other contracts. The Unit Operating Agreement shall set out other rights and obligations as between Unit Operator and the Working Interest Owners as may be agreed upon by such parties; however, the Unit Operating Agreement shall not be deemed either to modify any of the terms and conditions of this Agreement or to relieve the Unit Operator of any right or obligation established under this Agreement. In case of any inconsistency or conflict between this Agreement and the Unit Operating Agreement, this Agreement shall prevail. Copies of the Unit Operating Agreement executed pursuant to this Section shall be filed with the A.O. at the proper BLM Office as required 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 including surface rights 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. 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 to 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. PLAN OF OPERATIONS. It is recognized and agreed by the parties hereto that all of the land subject to this Agreement is reasonably proved to be productive of Unitized Substances and that the object and purpose of this Agreement is to formulate and to put into effect an improved recovery project in order to effect additional recovery of Unitized Substances, prevent waste and conserve natural resources. Unit Operator shall have the right to inject into the Unitized Formation any substances for secondary recovery or enhanced recovery purposes in

accordance with a plan of operation approved by the Working Interest Owners, the A.O., and the Division, including the right to drill and maintain injection wells on the Unitized Land and completed in the Unitized Formation, and to use abandoned well or wells producing from the Unitized Formation for said purpose. Subject to like approval, the Plan of Operation may be revised as conditions may warrant.

The initial Plan of Operation shall be filed with the A.O. and the Division concurrently with the filing of the Unit Agreement for final approval. Said initial plan of operations and all revisions thereof shall be as complete and adequate as the A.O. and the Division may determine to be necessary for timely operation consistent herewith. Upon approval of this Agreement and the initial plan by the A.O. and the Division, said plan and all subsequently approved plans shall constitute the operating obligations of the Unit Operator under this Agreement for the period specified therein. 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 operations. After such operations are commenced, reasonable diligence shall be exercised by the Unit Operator in complying with the obligations of the approved Plan of Operation.

Notwithstanding anything to the contrary herein contained, should the Unit Operator fail to commence Unit Operations for the secondary recovery of Unitized Substances from the Unit Area within eighteen (18) months after the Effective Date of this Agreement, or any extension thereof approved by the A.O., this Agreement shall terminate automatically as of the date of default.

SECTION 12. USE OF SURFACE AND USE OF WATER. To the extent of their rights and interests, the parties hereby grant to Unit Operator the right to use as much of the surface, including the water thereunder, and of the Unitized Land as may reasonably be necessary for Unit Operations.

Unit Operator's free use of water or brine or both for Unit Operations, shall not include any water from any well, lake, pond or irrigation ditch of a surface owner, unless approval for such use is granted by the surface owner.

Unit Operator shall pay the surface owner for damages to growing crops, fences, improvements, and structures on the Unitized Land that result from Unit Operations, and such payments shall be considered as items of Unit Expense to be borne by all the Working Interest Owners.

SECTION 13. TRACT PARTICIPATION. In Exhibit "C" attached hereto there are listed and numbered the various Tracts within the Unit Area. Set forth opposite each Tract are figures which

represent the Tract Participation during Unit Operations if all Tracts in the Unit Area qualify as provided herein. The Tract Participation of each Tract as shown in Exhibit "C" was determined in accordance with the following formula:

Factor A: 5% of Total Tract Participation

Total number of acres attributable to the Tract divided by the total number of acres in the Unit Area.

Factor B: 15% of Total Tract Participation

Total cumulative oil production from the Unitized Formation in each Tract as of June 1, 1998 divided by the total cumulative oil production from the Unitized Formation within the Unit Area as of June 1, 1998.

Factor C: 25% of Total Tract Participation

Rate of oil production from the Unitized Formation in each Tract as determined by average barrels of oil produced each month from January through May, 1998 divided by the total rate of oil production from the Unitized Formation within the Unit Area for the same period of time.

Factor D: 40% of Total Tract Participation

Original oil in place in the Unitized Formation in each Tract as determined by the reservoir simulation study, East Shugart (Delaware) Field, June 8, 1998, Petroleum Consulting & Engineering, Inc., divided by the original oil in place in the Unitized Formation within the Unit Area as determined by said study.

Factor E: 15% of Total Tract Participation

Remaining primary oil reserves from the Unitized Formation in each Tract beginning July 1, 1998 as determined by the reservoir simulation study, East Shugart (Delaware) Field, June 8, 1998, Petroleum Consulting & Engineering, Inc., divided by the remaining primary oil reserves from the Unitized Formation within the Unit Area beginning July 1, 1998 as determined by said study.

Tract Participation for each Tract shall equal the total percentages represented by the sum of percentages resulting from the calculations contemplated in Factors A through E above.

In the event less than all Tracts are qualified on the Effective Date hereof, the Tract Participation shall be calculated on the basis of all such qualified Tracts rather than all Tracts in the Unit Area.

SECTION 14. TRACTS QUALIFIED FOR PARTICIPATION. On and after the Effective Date hereof, the Tracts within the Unit Area which shall be entitled to participation in the production of Unitized Substances shall be those Tracts more particularly described in Exhibit "B" that corner or have a common boundary (Tracts separated only by a public road 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 have become parties to this Agreement and as to which Royalty Owners owning seventy-five percent (75%) or more of the Royalty Interest have become parties to this Agreement.

(b) Each Tract as to which Working Interest Owners owning one hundred percent (100%) of the Working Interest have become parties to this Agreement, and as to which Royalty Owners owning less than seventy-five percent (75%) of the Royalty Interest have become parties to this Agreement, and as to which (1) the Working Interest Owner who operates the Tract and Working Interest Owners owning at least seventy-five percent (75%) of the remaining Working Interest in such Tract have joined in a request for the inclusion of such Tract, and as to which (2) Working Interest Owners owning at least seventy-five percent (75%) of the combined Unit Participation in all Tracts that meet the requirements of Section 14(a) above have voted in favor of the inclusion of such Tract.

(c) Each Tract as to which Working Interest Owners owning less than one hundred percent (100%) of the Working Interest have become parties to this Agreement, regardless of the percentage of Royalty Interest therein that is committed hereto; and as to which (1) the Working Interest Owner who operates the Tract and Working Interest Owners owning at least seventy-five percent (75%) of the remaining Working Interest in such Tract who have become parties to this Agreement have joined in a request for inclusion of such Tract, and have executed and delivered, or obligated, themselves to execute and deliver an indemnity agreement indemnifying and agreeing to hold harmless the other owners of committed Working Interests, their successors and assigns, against all claims and demands that may be made by the owners of Working Interest in such Tract who are not parties to this Agreement, and which arise out of the inclusion of the Tract; and as to which (2) Working Interest Owners owning at least

seventy-five percent (75%) of the Unit Participation in all Tracts that meet the requirements of Section 14 (a) and 14 (b) have voted in favor of the inclusion of such Tract and to accept the indemnity agreement. Upon the inclusion of such a Tract, the Tract Participation which would have been attributed to the nonsubscribing owners of 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, and joined in the indemnity agreement, in proportion to their respective Working Interests in the Tract.

On the Effective Date of this Agreement, if there is any Tract or Tracts which have not been effectively committed to or made subject to this Agreement by qualifying as above provided, then such Tract or Tracts shall not be entitled to participate hereunder. When submitting this Agreement for final approval by the A.O., Unit Operator shall file therewith a schedule of those Tracts which have been committed and made subject to this Agreement and are entitled to participate in Unitized Substances.

Said schedule shall set forth opposite each such committed Tract the lease number, the owner of record of the lease, and the percentage participation of such Tract which shall be computed according to the participation formula set forth in Section 13 (Tract Participation) above. This schedule of participation shall be revised Exhibit "B". Upon approval thereof by the A.O., it shall become a part of this Agreement and shall govern the allocation of production of Unitized Substances until a new schedule is approved by the A.O.

SECTION 15.A. ALLOCATION OF UNITIZED SUBSTANCES. With the exception of any Unitized Substances used in conformity with good operating practices on Unitized Land for drilling, operating, camp and other production or development purposes and for injection or which is unavoidably lost in accordance with a Plan of Operation approved by the A.O. all Unitized Substances produced and saved shall be apportioned among and allocated to the qualified Tracts in accordance with the respective Tract Participations effective hereunder during the respective periods such Unitized Substances were produced, as set forth in the schedule of participation in Exhibit "B". The amount of Unitized Substances so allocated to each Tract, and only that amount (regardless of whether it be more or less than the amount of the actual production of Unitized Substances from the well or wells, if any, on such Tract) shall, for all intents, uses and purposes, be deemed to have been produced from such Tract.

The Unitized Substances allocated to each Tract shall be distributed among, or accounted for, to the parties entitled to share in the production from such Tract in the same manner, in the

same proportions, and upon the same conditions, as they would have participated and shared in the production from such Tracts, or in the proceeds thereof, had this Agreement not been entered into; and with the same legal force and effect.

No Tract committed to this Agreement and qualified for participation as above provided shall be subsequently excluded from participation hereunder on account of depletion of Unitized Substances.

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

SECTION 15.B. TAKING UNITIZED SUBSTANCES IN KIND. The Unitized Substances allocated to each Tract shall be delivered in kind to the respective parties entitled thereto by virtue of the ownership of Oil and Gas Rights therein. Each such party shall have the right to construct, maintain and operate all necessary facilities for that purpose within the Unitized Area, provided the same are so constructed, maintained and operated as not to interfere with Unit Operations. Subject to Section 17 hereof, any extra expenditure incurred by Unit Operator by reason of the delivery in kind of any portion of the Unitized Substances shall be borne by the party taking delivery. In the event any Working Interest Owner shall fail to take or otherwise adequately dispose of its proportionate share of the production from the Unitized Formation then so long as such condition continues, Unit Operator, for the account and at the expense of the Working Interest Owner of the Tract or Tracts concerned, and in order to avoid curtailing the production of the Unit Area, may, but shall not be required to, sell or otherwise dispose of such production to itself or to others. All contracts of sale by Unit Operator of any other party's share of Unitized Substances shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the circumstances. The price received under such contracts shall not be less than the prevailing market price in the area for like production. The account of such Working Interest Owner shall be charged therewith as having received such production. The net proceeds, if any, of the Unitized Substances so disposed of by Unit Operator shall be paid to the Working Interest Owner of the Tract or Tracts concerned. Notwithstanding the foregoing, Unit Operator shall not make a sale into interstate commerce of any Working Interest Owner's share of gas production without first giving such Working Interest Owner sixty (60) days notice of such intended sale.

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 if the same is sold or purchased by Unit Operator, shall be responsible for the payment of all royalty, overriding royalty and production payments due thereon, and each such party shall hold each other Working Interest Owner harmless against all claims, demands and causes of action by owners of such royalty, overriding royalty, and production payments.

If, after the Effective Date of this Agreement, there is any Tract or Tracts that are subsequently committed hereto, as provided in Section 4 (Expansion) hereof, or any Tract or Tracts within the Unit Area not committed hereto as of the Effective Date hereof but which are subsequently committed hereto under the provisions of Section 14 (Tracts Qualified for Participation) and Section 32 (Nonjoinder and Subsequent Joinder); or if any Tract is excluded from this Agreement as provided for in Section 21 (Loss of Title), the schedule of participation as shown in Exhibits "B" and "D" shall be revised by the Unit Operator; upon approval by the A.O., the revised Exhibits "B" and "D" shall govern the allocation of production on and after the effective date thereof until a revised schedule is approved as hereinabove provided.

SECTION 16. OUTSIDE SUBSTANCES. If gas obtained from formations not subject to this Agreement is introduced into the Unitized Formation for use in repressuring, stimulating of production or increasing ultimate recovery (which shall be in conformity with a Plan of Operation first approved by the A.O.), a like amount of gas with appropriate deduction for loss or depletion from any cause may be withdrawn from unit wells completed in the Unitized Formation royalty free as to dry gas, but not royalty free as to the products extracted therefrom. Such withdrawal shall be at such time as may be provided in the approved Plan of Operation or as otherwise may be consented to or prescribed by the A.O. as conforming to good petroleum engineering practices. Such right of withdrawal shall terminate on the termination date of this Agreement.

SECTION 17. 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 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. Unit Operator shall make deliveries of such Royalty share taken in kind in conformity with the applicable contracts, laws and regulations. Settlement for Royalty 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. However, 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 the leases, except that such Royalty shall be computed on Unitized Substances as allocated to each Tract in accordance with the terms of this Agreement. With respect to Federal leases committed hereto on which the royalty rate depends upon the daily average production per well, such average production shall be determined in accordance with the operating regulations pertaining to Federal leases as though the committed Tracts were included in a single consolidated lease.

If the amount of production or the proceeds thereof accruing to any Royalty Owner (except the United States of America) in a Tract depends upon the average production per well or the average pipeline runs per well from such Tract during any period of time, then such production shall be determined from and after the Effective Date hereof by dividing the quantity of Unitized Substances allocated hereunder to such Tract during such period of time by the number of wells located thereon capable of producing Unitized Substances as of the Effective Date hereof. Any Tract not having any well so capable of producing Unitized Substances on the Effective Date hereof shall be considered as having one such well for the purpose of this provision.

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

With the exception of Federal and State requirements to the contrary, Working Interest Owners may use or consume Unitized Substances for Unit Operations and no Royalty, overriding royalty, production or other payments shall be payable on account of Unitized Substances used, lost, or consumed in Unit Operations.

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

SECTION 18. RENTAL SETTLEMENT. Rentals or minimum royalties due on the leases committed hereto shall be paid by Working Interest Owners responsible therefor under existing contracts,

laws and regulations. Nothing herein contained shall operate to relieve the lessees of any lease from their respective lease obligations for the payment of any rental or minimum royalty in lieu thereof due under their leases. With respect to lands of the United States of America subject to this Agreement, rental or minimum royalty shall be paid at the rate specified in the respective leases from the United States of America, unless such rental or minimum royalty is waived, suspended or reduced by law or by approval of the Secretary or his duly authorized representative.

SECTION 19. 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 20. DRAINAGE. The Unit Operator shall take all reasonable and prudent measures to prevent drainage of Unitized Substances from Unitized Land by wells on land not subject to this Agreement.

Upon approval by the Working Interest Owners and the A.O., the Unit Operator is hereby empowered to enter into a borderline agreement or agreements with working interest owners of adjoining lands not subject to this Agreement with respect to operation in the border area for the maximum economic recovery, conservation purposes and proper protection of the parties and interest affected.

SECTION 21. LOSS OF TITLE. In the event title to any Tract of Unitized Land shall fail and the true owner cannot be induced to join in this Agreement, such Tract shall be regarded as not committed hereto, and there shall be such readjustment of future costs and benefits as may be required on account of the loss of such title. In the event of a dispute as to title to any Royalty, Working Interest, or other interests subject hereto, payment or delivery on account thereof may be withheld without liability for interest until the dispute is finally settled. However, as to Federal lands or leases, no payments of funds due the United States shall be withheld, but such funds shall be deposited as directed by the A.O. 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.

If the title or right of any party claiming the right to receive in kind all or any portion of the Unitized Substances allocated to a Tract is in dispute, Unit Operator at the direction of Working Interest Owners shall either:

(a) require that the party to whom such Unitized Substances are delivered or to whom the proceeds thereof are paid furnish security for the proper accounting therefor to the rightful owner if the title or right of such party fails in whole or in part; or

(b) withhold and market the portion of Unitized Substances with respect to which title or right is in dispute, and impound the proceeds thereof until such time as the title or right thereto is established by a final judgement of a court of competent jurisdiction or otherwise to the satisfaction of Working Interest Owners. Upon such conclusion, the proceeds so impounded shall be paid to the party rightfully entitled thereto.

Each Working Interest Owner shall indemnify, hold harmless, and defend all other Working Interest Owners against any and all claims by any party against the interest attributed to such Working Interest Owner on Exhibit "D".

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

SECTION 22. 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. Otherwise such instruments shall remain in full force and effect. The Secretary, by his or her approval hereof, or by the approval hereof by his or her duly authorized representatives, 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 Tract subject to this Agreement, regardless of whether there is any development or operations on any particular 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 improved recovery operations performed hereunder shall be deemed to be performed upon and for the benefit of each Tract, and no lease shall be deemed to expire by reason of failure to drill or produce wells situated on the land therein embraced.

(c) Suspension of drilling or producing operations within the Unit Area pursuant to direction or consent of the A.O., or his or her duly authorized representatives, shall be deemed to constitute such suspension pursuant to such direction or consent as to each Tract within the Unitized Area.

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

(e) The segregation of any Federal lease committed to this Agreement is governed by the following provision in the fourth paragraph of Section 17 (j) of the Mineral Leasing Act, as amended by the Act of September 2, 1960 (74 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 of the effective date of unitization; provided, however, that any such lease as to 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 23. 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. Any grant, transfer or conveyance of interest in land or leases subject hereto shall be and hereby is conditioned upon the assumption of all privileges and obligations hereunder by the grantee, transferee or other successor in interest. No assignment or transfer of any Working Interest subject hereto shall be binding upon Unit Operator until the first day of the calendar month after Unit Operator is furnished with the original, or acceptable photostatic or certified copy, of the recorded instrument or transfer; and no assignment or transfer of any Royalty Interest subject hereto shall be binding upon the Working Interest Owner responsible therefor until the first day of the calendar month after said Working Interest Owner is furnished with the original, or

acceptable photostatic or certified copy, of the recorded instrument or transfer.

SECTION 24. 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 on the first day of the calendar month next following the approval of this Agreement by the A.O. and the Division.

If this Agreement does not become effective on or before January 1, 2000, it shall *ipso facto* expire on said date (hereinafter call "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 Participation of at least seventy-five percent (75%); and at least seventy-five percent (75%) of such Working Interest Owners committed to this Agreement have decided to extend Expiration Date for a period not to exceed one (1) year (hereinafter called "Extended Expiration Date"). If the Expiration Date is so extended and this Agreement does not become effective on or before the Extended Expiration Date, it shall *ipso facto* expire on Extended Expiration Date and thereafter be of no further force and effect.

Unit Operator shall file for record within thirty (30) days after the Effective Date of this Agreement, in the office of the County Clerks of Eddy and Lea Counties, New Mexico, a counterpart of this Agreement stating that this Agreement has become effective according to its terms and stating further the Effective Date.

The terms of this Agreement shall be for and during the time that Unitized Substances are produced from the Unitized Land and so long thereafter as drilling, reworking or other operations (including improved recovery operations) are prosecuted thereon without cessation of more than ninety (90) consecutive days unless sooner terminated as herein provided.

This Agreement may be terminated with the approval of the A.O. by Working Interest Owners owning eighty percent (80%) of the Unit Participation then in effect whenever such Working Interest Owners determine that Unit Operations are no longer profitable, or in the interest of conservation. Upon approval, such termination shall be effective as of the first day of the month after said Working Interest Owners' determination. Notice of any such termination shall be filed by Unit Operator in the office of the County Clerk of Eddy and Lea Counties, New Mexico, within thirty (30) days of 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 just as if this Agreement had never been entered into.

Notwithstanding any other provisions in the leases unitized under this Agreement, Royalty Owners hereby grant Working Interest Owners a period of six 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 25. RATE OF PROSPECTING, DEVELOPMENT & PRODUCTION. All production and the disposal thereof shall be in conformity with allocations and quotas made or fixed by any duly authorized person or regulatory body under any Federal or State statutes. The A.O. is hereby vested with authority to alter or modify from time to time, in his discretion, the rate of prospecting and development and within the limits made or fixed by the Division to alter or modify the quantity and rate of production under this Agreement. Such authority is 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.

Powers in this Section vested in the A.O. shall only be exercised after notice to Unit Operator and opportunity for hearing to be held not less than fifteen (15) days from notice, and thereafter subject to administrative appeal before becoming final.

SECTION 26. NONDISCRIMINATION. In connection with the performance of work under this Agreement relating to leases of the United States, Unit Operator agrees to comply with all of the provisions of Section 202 (1)-(7) inclusive of Executive Order 11246, (30 F.R. 12319), which are hereby incorporated by reference in this Agreement.

SECTION 27. APPEARANCES. Unit Operator shall have the right to appear for or on behalf of any interests affected hereby before the Department and the Division, and to appeal any order issued under the rules and regulations of the Department or the Division, or to apply for relief from any of said rules and regulations or in any proceedings relative to operations before the Department or the Division or any other legally constituted authority. However, any other interested party shall also have the right at his or its own expense to be heard in any such proceeding.

SECTION 28. 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

delivered to the party or parties or sent by postpaid certified or registered mail, courier service, or by facsimile addressed to such party or parties at their last known address set forth in connection with the signatures hereto or to the ratification or consent hereof, or to such other address as any such party or parties may have furnished in writing to the party sending the notice, demand, or statement.

SECTION 29. NO WAIVER OF CERTAIN RIGHTS. Nothing in this Agreement contained shall be construed as a waiver by any party hereto of the right to assert any legal or constitutional right or defense as to the validity or invalidity of any law of the State wherein said Unitized Lands are located, 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. However, each party hereto covenants that it will not resort to any action to partition the Unitized Land or the Unit Equipment.

SECTION 30. EQUIPMENT AND FACILITIES NOT FIXTURES ATTACHED TO REALTY. Each Working Interest Owner has heretofore 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 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 such equipment and personal property shall be and remain personal property of the Working Interest Owners for all purposes.

SECTION 31. UNAVOIDABLE DELAY. All obligations under this Agreement requiring the Unit Operator to commence or continue improved 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, uncontrollable delays in transportation, inability to obtain necessary materials or equipment in open market, or other matters beyond the reasonable control of the Unit, Operator whether similar to matters herein enumerated or not.

SECTION 32. NONJOINDER AND SUBSEQUENT JOINDER. 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 this Agreement by a Working Interest Owner,

at any time, must be accompanied by appropriate joinder to the Unit Operating Agreement in order for such interest to be regarded as effectively committed to this Agreement.

Any oil or gas interest in the Unitized Formations not committed hereto prior to submission of this Agreement to the A.O. 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 on the same basis of Tract Participation as provided in Section 13, by the owner or owners thereof subscribing, ratifying, or consenting in writing to this Agreement. If the interest is a Working Interest, the owner of such interest must also subscribe to the Unit Operating Agreement.

It is understood and agreed, however, that from and after 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 owning not less than sixty-five percent (65%) of the Unit Participation then in effect, and approved by the A.O. Such subsequent joinder by a proposed Working Interest Owner must be evidenced by his execution or ratification of this Agreement and the Unit Operating Agreement. Where State or Federal land is involved, such joinder must be approved by the A.O. Such joinder by a proposed Royalty Owner must be evidenced by his execution, ratification or consent of this Agreement and must be consented to in writing by the Working Interest Owner responsible for the payment of any benefits that may accrue hereunder in behalf of such proposed Royalty Owner. Except as may be otherwise herein provided, subsequent joinder to this Agreement shall be effective as of the first day of the month following the filing with the A.O. 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 A.O. is duly made sixty (60) days after such filing.

SECTION 33. 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 land within the described Unit Area. Furthermore, this Agreement shall extend to and be binding on the parties hereto, their successors, heirs and assigns.

SECTION 34. JOINDER IN DUAL CAPACITY. Execution as herein provided by any party as either a Working Interest Owner or a Royalty Owner shall commit all interests owned or controlled by such party. If the party is the owner of a Working Interest, he must also execute the Unit Operating Agreement.

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 Substances produced from the Unitized Land. If it is required or if it is 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 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. The duties, obligations and liabilities of the parties hereto are intended to be several and not joint or collective. This Agreement is not intended to create, and shall not be construed to create, an association or trust, or to impose a partnership duty, obligation or liability with regard to any one or more of the parties hereto. Each party hereto shall be individually responsible for its own obligation as herein provided.

SECTION 37. PRODUCTION AS OF THE EFFECTIVE DATE. Unit Operator shall make a proper and timely gauge of all leases and other tanks within the Unit Area in order to ascertain the amount of merchantable oil above the pipeline connection, in such tanks as of 7:00 a.m. on the Effective Date hereof. All such oil which has been produced in accordance with established allowables shall be and remain the property of the Working Interest Owner entitled thereto, the same as if the unit had not been formed. The responsible Working Interest Owner shall promptly remove said oil from the Unitized Land. Any such oil not so removed shall be sold by Unit Operator for the account of such Working Interest Owners, subject to the payment of all Royalty to Royalty Owners under the terms hereof. The oil that is in excess of the prior allowable of the wells from which it was produced shall be regarded as Unitized Substances produced after Effective Date hereof.

If, as of the Effective Date hereof, any Tract is overproduced with respect to the allowable of the wells on that Tract and the amount of over-production has been sold or otherwise disposed of, such over-production shall be regarded as a part of the Unitized Substances produced after the Effective Date hereof

and shall be charged to such Tract as having been delivered to the parties entitled to Unitized Substances allocated to such Tract.

SECTION 38. STATUTORY UNITIZATION. If and when Working Interest Owners owning at least seventy-five percent (75%) Unit Participation and Royalty Owners owning at least seventy-five percent (75%) Royalty Interest have become parties to this Agreement or have approved this Agreement in writing and such Working Interest Owners have also become parties to the Unit Operating Agreement, Unit Operator may make application to the Division for statutory unitization of the uncommitted interests pursuant to the Statutory Unitization Act (NMSA 1978 §§70-7-1 et seq.). If such application is made and statutory unitization is approved by the Division, then effective as of the date of the Division's order approving statutory unitization, this Agreement and/or the Unit Operating Agreement shall automatically be revised and/or amended in accordance with the following:

- (1) Section 14 of this Agreement shall be revised by substituting for the entire said section the following:

"SECTION 14. TRACTS QUALIFIED FOR PARTICIPATION. On and after the Effective Date hereof, all Tracts within the Unit Area shall be entitled to participation in the production of Unitized Substances."

- (2) Section 24 of this Agreement shall be revised by substituting for the first three paragraphs of said section the following:

"SECTION 24. EFFECTIVE DATE AND TERM. This Agreement shall become effective on the first day of the calendar month next following the effective date of the Division's order approving statutory unitization upon the terms and conditions of this Agreement, as amended (if any amendment is necessary) to conform to the Division's order, approval of this Agreement as so amended by the A.O., and the recording by Unit Operator of this Agreement or notice thereof in the office of the County Clerk of Eddy and Lea Counties, New Mexico. Unit Operator shall not record this Agreement or notice thereof, and hence this Agreement shall not become effective, unless within ninety (90) days after the date all other prerequisites for effectiveness of this Agreement have been satisfied, such filing is approved by Working Interest Owners owning a combined Unit Participation of at least sixty-five percent (65%) as to all Tracts within the Unit Area.

"Unit Operator shall, within thirty (30) days after the Effective Date of this Agreement, record in the office of the County Clerk of Eddy and Lea Counties, New Mexico, a certificate to the effect that this Agreement has become effective in accordance with its terms, therein identifying the Division's order approving statutory unitization and stating the Effective Date."

(3) This Agreement and/or the Unit Operating Agreement shall be amended in any and all respects necessary to conform to the Division's order approving statutory unitization.

Any and all amendments of this Agreement and/or the Unit Operating Agreement that are necessary to conform said agreements to the Division's order approving statutory unitization shall be deemed to be hereby approved in writing by the parties hereto without any necessity for further approval by said parties, except as follows:

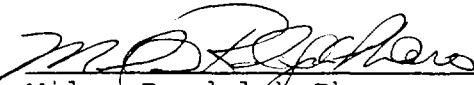
(a) If any amendment of this Agreement has the effect of reducing any Royalty Owner's participation in the production of Unitized Substances, such Royalty Owner shall not be deemed to have hereby approved the amended agreement without the necessity of further approval in writing by said Royalty Owner; and

(b) If any amendment of this Agreement and/or the Unit Operating Agreement has the effect of reducing any Working Interest Owner's participation in the production of Unitized Substances or increasing such Working Interest Owner's share of Unit Expense, such Working Interest Owner shall not be deemed to have hereby approved the amended agreements without the necessity of further approval in writing by said Working Interest Owner.

Executed as of the day and year first above written.

UNIT OPERATOR:

ST. MARY LAND & EXPLORATION COMPANY

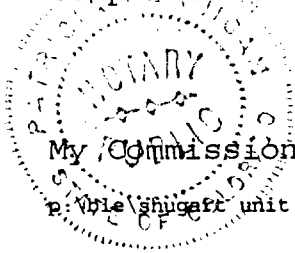
By: 
Milam Randolph Pharo
Vice President - Land & Legal

Date: 2/26/99

STATE OF COLORADO
COUNTY OF DENVER

)
) ss.
)

The foregoing instrument was acknowledged before me this 26 day of February, 1999, by Milam Randolph Pharo Randolph Pharo, Vice President - Land & Legal of ST. MARY LAND & EXPLORATION COMPANY, a Delaware corporation, on behalf of said corporation.



Patricia Ramirez
Notary Public

My Commission Expires: May 15, 1999
p: Vol 1 shugart unit agreement

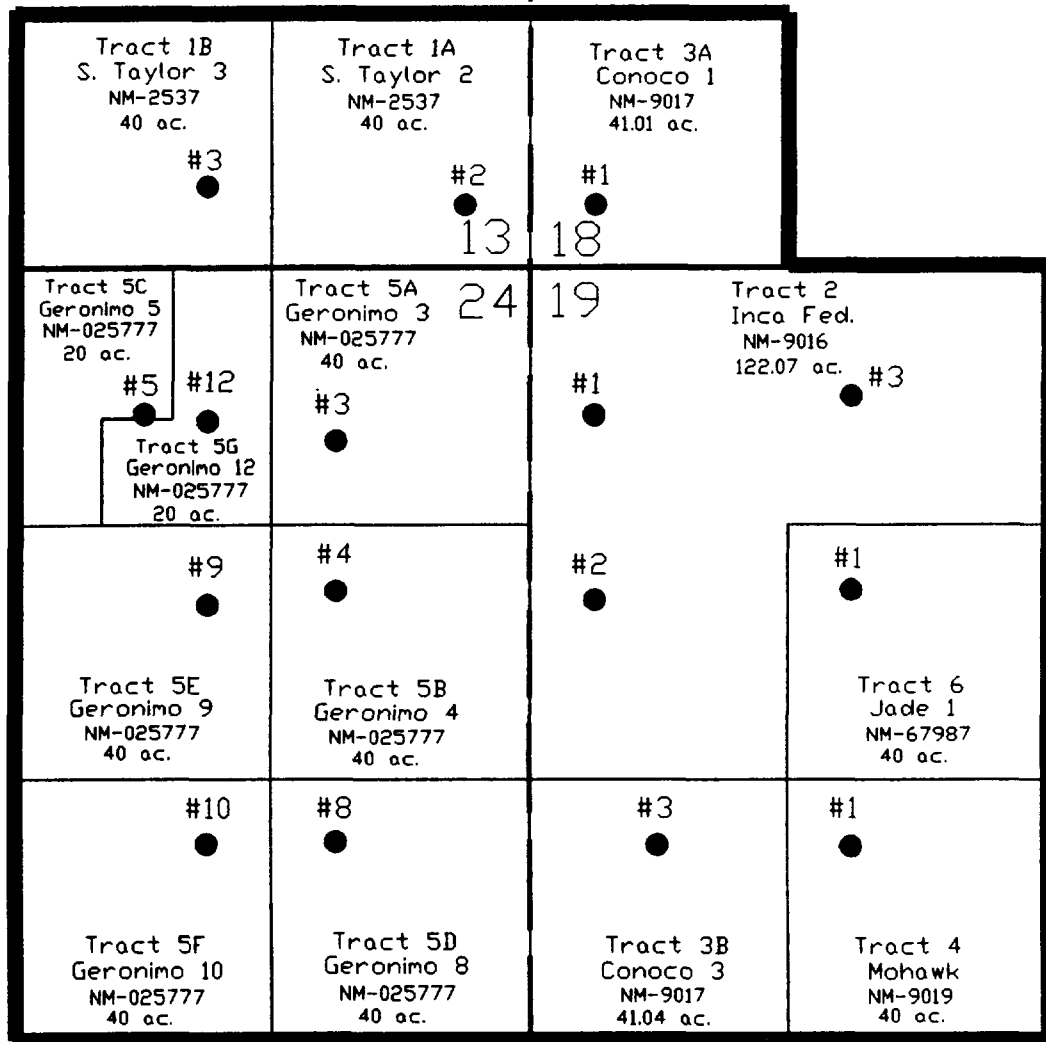
EXHIBIT A

R 31 E

R 32 E

T 18 S

T 18 S



EDDY COUNTY

LEA COUNTY

604.12 ACRES

ST. MARY LAND & EXPLORATION COMPANY
EAST SHUGART (DELAWARE) UNIT
EDDY & LEA COUNTIES, NEW MEXICO



PROPOSED UNIT BOUNDARY

SCALE: 1' = 1000'

EXHIBIT "A-1"					
EAST SHUGART (DELAWARE) UNIT					
TRACT DESCRIPTIONS					
Tract No.	Tract Name	Status	Tract Operator	Acres	County
1A	S. Taylor 2	HBP	Harvey E. Yates Company	40.00	Eddy
1B	S. Taylor 3	HBP	Harvey E. Yates Company	40.00	Eddy
2	Inca Fed	HBP	St. Mary Land & Exploration Company	122.07	Lea
3A	Conoco 1	HBP	St. Mary Land & Exploration Company	41.01	Lea
3B	Conoco 3	HBP	St. Mary Land & Exploration Company	41.04	Lea
4	Mohawk 1	HBP	St. Mary Land & Exploration Company	40.00	Lea
5A	Geronimo 3	HBP	St. Mary Land & Exploration Company	40.00	Eddy
5B	Geronimo 4	HBP	St. Mary Land & Exploration Company	40.00	Eddy
5C	Geronimo 5	HBP	St. Mary Land & Exploration Company	20.00	Eddy
5D	Geronimo 8	HBP	St. Mary Land & Exploration Company	40.00	Eddy
5E	Geronimo 9	HBP	St. Mary Land & Exploration Company	40.00	Eddy
5F	Geronimo 10	HBP	St. Mary Land & Exploration Company	40.00	Eddy
5G	Geronimo 12	HBP	St. Mary Land & Exploration Company	20.00	Eddy
6	Jade 1	HBP	St. Mary Land & Exploration Company	40.00	Lea
				604.12	
Total Federal Acres:		604.12			
Total State Acres		0			
Total Fee Acres		0			
Total Unit Acres		604.12			