

UNIT OPERATING AGREEMENT  
WEST LOVINGTON STRAWN UNIT AREA  
LEA COUNTY, NEW MEXICO

*Gilespie-Crow*

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11/95

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**UNIT OPERATING AGREEMENT**  
**WEST LOVINGTON STRAWN UNIT AREA**  
**LEA COUNTY, NEW MEXICO**

THIS AGREEMENT is entered into as of the \_\_\_\_ day of \_\_\_\_\_, 1995, by the parties who have signed the original of this instrument, a counterpart thereof, or other instrument agreeing to be bound by the provisions hereof.

W I T N E S S E T H:

WHEREAS, the parties hereto, as Working Interest Owners, have executed that certain agreement entitled "Unit Agreement for the Development and Operation of the West Lovington Strawn Unit Area, Lea County, New Mexico," hereinafter referred to as the "Unit Agreement," which, among other things, provides for a separate agreement to be made and entered into by and between Working Interest Owners to provide for Unit Operations herein defined;

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

ARTICLE 1

CONFIRMATION OF UNIT AGREEMENT

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

## ARTICLE 2

### EXHIBITS

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

2.1.1 Exhibits "A", "B", and "C" of the Unit Agreement.

2.1.2 Exhibit "D", attached hereto, is a summary showing each Working Interest Owner's Working Interest in each Tract, the percentage of total Unit Participation attributable to each such interest, and the total Unit Participation of each Working Interest Owner.

2.1.3 Exhibit "E", attached hereto, contains insurance provisions applicable to Unit Operations.

2.1.4 Exhibit "F", attached hereto, is the Accounting Procedure applicable to Unit Operations. In the event of a conflict between this Agreement and Exhibit "F", this Agreement shall prevail.

2.1.5 Exhibit "G", attached hereto, contains Certificate of Compliance provisions provided for in Article 20.

2.1.6 Exhibit "H", attached hereto, is the Gas Balancing Agreement applicable to Unit Operations.

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

## ARTICLE 3

### SUPERVISION OF OPERATIONS BY WORKING INTEREST OWNERS

3.1 Overall Supervision. Subject to the other terms and provisions of this Agreement and of the Unit Agreement,



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 power, each Working Interest Owner shall act solely in its own behalf in the capacity of an individual owner, and not on behalf of the owners as an entirety.

3.2 Particular Powers and Duties. The Working Interest Owners, using the voting procedure given in Section 4.3, unless otherwise specifically provided in this Agreement or in the Unit Agreement, shall decide matters pertaining to Unit Operations, which include, but are not limited to, the following:

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

3.2.2 Drilling of Wells. The drilling, deepening, or sidetracking of any well within the Unit Area for the production of Unitized Substances, and the drilling of any well for injection, salt water disposal, or for any other Unit purpose.

3.2.3 Well Workovers and Conversion of Wells. The reworking, recompleting, or repairing of any well for the purpose of production of Unitized Substances reasonably estimated to require an expenditure in excess of the expenditure limitation specified in Section 3.2.4 below, and the abandonment or conversion of the use of any well from one purpose to another, or the use of any such well for injection or any other purpose other than production. Unit Operator shall have the right to shut-in or temporarily abandon a well, or to reactivate a well which was shut-in or temporarily abandoned to its former use, with notification to the Working Interest Owners, if doing so is reasonably estimated to require an expenditure not in excess of the expenditure limitation specified in Section 3.2.4 below.

3.2.4 Expenditures. The making of any single expenditure in excess of fifty thousand dollars (\$50,000.00), except as provided in Section 7.9 below; provided that approval by Working Interest Owners for the drilling, sidetracking, reworking, drilling deeper, or plugging back of any well shall include approval of all necessary expenditures required therefor and for completing, testing, and equipping the same, including necessary flow lines, separators, and lease tankage, if the authority for expenditure ("AFE") for

such work contains the estimated cost of all necessary expenditures.

3.2.5 Amendment of Overhead Rates. The overhead rates, as provided for in Section III of Exhibit "F" attached hereto, shall be amended from time to time by affirmative vote of the parties as set out in Section 4.3.2 below.

3.2.6 Disposition of Surplus Facilities. The sale or other disposal of any major item of surplus unit material or equipment, if the current list price of new equipment similar thereto is twenty-five thousand dollars (\$25,000.00) or more.

3.2.7 Appearance Before a Court or Regulatory Body. The designating of a representative to appear before any court or regulatory body in matters pertaining to Unit Operations; provided, however, that the authorization by Working Interest Owners of the designation of any such representatives shall not prevent any Working Interest Owner from appearing in person or from designating another representative to appear in his or its own behalf.

3.2.8 Audit Exceptions. The resolution of audit exceptions, as provided for in accordance with COPAS Bulletin No. 3.

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

3.2.10 Selection of Successor to Unit Operator. The selection of a successor to the Unit Operator.

3.2.11 Enlargement of Unit Area. The enlargement of the Unit Area.

3.2.12 Investment Adjustment. The adjustment and readjustment of investments.

3.2.13 Acquisition of Wells for Unit Operations. The acquisition of wells for Unit Operations.

3.2.14 Termination of Unit Agreement. The termination of the Unit Agreement.

## ARTICLE 4

### MANNER OF EXERCISING SUPERVISION

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

4.2 Meetings. All meetings of Working Interest Owners for the purpose of considering and acting upon any matter pertaining to the development and operation of the Unit Area shall be called by Unit Operator upon its own motion or at the request of two or more Working Interest Owners having a total Unit Participation of not less than ten percent (10%). The representative of Unit Operator shall be Chairman of each meeting. No meeting shall be called on less than fourteen (14) days' advance written notice, with an agenda for the meeting attached, unless notice is waived by Working Interest Owners owning ninety percent (90%) or more of the Unit Participation. The Working Interest Owners attending such meeting shall not be prevented from amending items included in the agenda, or from deciding such amended item or other items presented at such meeting. Any item proposed at a meeting that was not included on the agenda or any amended agenda cannot be brought to a vote at said meeting, but will require approval by a poll vote or a subsequent meeting.

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

4.3.1 Voting Interest. Each Working Interest Owner shall have a voting interest equal to its Unit Participation, listed in Exhibit "D" attached hereto.

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 three (3) or more Working Interest Owners having a combined voting interest of at least seventy percent (70%); however, should any one Working Interest Owner have more than thirty percent (30%) 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 one (1) or more additional Working Interest Owners

having a combined voting interest of at least five percent (5%) likewise votes against the motion or fails to vote.

Unless otherwise specified in an AFE, work approved by a vote must be commenced within one (1) year of the approval date. If not commenced during this period, the work must be repropose.

4.3.3 Vote at Meeting by Non-Attending Working Interest Owners. Any Working Interest Owner not represented at a meeting may vote on any item included in the agenda of the meeting by letter, telegram, or facsimile transmission, followed by U. S. Mail, addressed to the Chairman of the meeting, provided such vote is received prior to the submission of such item to vote. Such vote shall not be counted with respect to any item on the agenda which is amended at the meeting.

4.3.4 Poll Votes. Working Interest Owners may decide any matter by vote taken (without a meeting) by letter, telegram, or facsimile transmission, followed by U. S. Mail, provided the matter is first submitted in writing to each Working Interest Owner and no meeting on the matter is called, as provided in Section 4.2, within fourteen (14) days after such proposal is dispatched to Working Interest Owners. If a meeting is called within the fourteen (14) days, then the poll vote is canceled and the vote shall be held at the meeting. Such vote will be final, and Unit Operator will give prompt notice of the results of such voting to all Working Interest Owners.

## ARTICLE 5

### INDIVIDUAL RIGHTS AND PRIVILEGES OF WORKING INTEREST OWNERS

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

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

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

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

5.2.3 Audits. The right to audit the accounts of Unit Operator according to the provisions of Exhibit "F."

## ARTICLE 6

### UNIT OPERATOR

6.1 Unit Operator. GILLESPIE-CROW, INC. is hereby designated as the initial Unit Operator.

6.2 Resignation or Removal of Unit Operator. Unit Operator may resign at any time. Resignation or removal of Unit Operator shall be pursuant to and handled in accordance with the provisions of Section 7 of the Unit Agreement.

If Unit Operator becomes insolvent or bankrupt, or is placed in receivership, he shall be deemed to have resigned without any action required by non-operating Working Interest Owners. If a petition for relief under the federal bankruptcy laws is filed by or against Unit Operator, and the removal of Unit Operator is prevented by the federal bankruptcy court, all non-operating Working Interest Owners and Unit Operator shall comprise an interim operating committee to serve until Unit Operator has elected to reject or assume this Agreement pursuant to the federal Bankruptcy Code. An election to reject this Agreement by Unit Operator as a debtor in possession, or by a trustee in bankruptcy, shall be deemed a resignation as Unit Operator without any action required by non-operating Working Interest Owners, except the selection of a successor Unit Operator. During the period of time that the operating committee controls Unit Operations, all actions shall require the approval of two (2) or more parties owning a majority of the Unit Participation.

If Unit Operator sells all of its interest in the Unit, it shall be deemed to have resigned without any action required by non-operating Working Interest Owners. However, a merger or consolidation, or the change of a corporate or partnership name, or the sale or transfer to a subsidiary, parent company, a subsidiary of a parent company, or an

affiliate organization, shall not be construed as a sale of all of Unit Operator's interest in the Unit Area.

6.3 Selection of Successor Unit Operator. Upon the resignation or removal of Unit Operator, a successor Unit Operator shall be selected by Working Interest Owners as provided in Section 8 of the Unit Agreement.

In the event no Working Interest Owner obtains the percentage vote necessary to become successor Unit Operator under Section 8 of the Unit Agreement, a Unit Manager shall be selected by the Working Interest Owners owning a plurality of the Unit Participation, who shall perform the duties of Unit Operator until a successor Unit Operator is elected.

6.4 Records and Information. A Unit Operator resigning or being removed shall give complete cooperation to the successor Unit Operator or Unit Manager, and shall deliver thereto all records and information necessary to the discharge of the successor Unit Operator's or Unit Manager's duties and obligations.

## ARTICLE 7

### POWERS AND DUTIES OF UNIT OPERATOR

7.1 Exclusive Rights to Operate Unit. Subject to the other provisions of this Agreement, and to the orders, directions, and limitations rightfully given or imposed by Working Interest Owners, Unit Operator shall have the exclusive right and be obligated to conduct Unit Operations.

The parties, to the extent of their rights and interests, hereby grant to Unit Operator the right to use as much of the surface of the Unitized Land as may reasonably be necessary for Unit Operations.

7.2 Workmanlike Conduct. Unit Operator shall conduct all operations hereunder in a good and workmanlike manner and, in the absence of specific instructions from Working Interest Owners, shall have the right and duty to conduct such operations in the same manner as would a prudent operator under the same or in similar circumstances. Unit Operator shall freely consult with Working Interest Owners and keep them advised of all matters arising in connection with such operations which Unit Operator, in the exercise of its best judgment, considers important. Unit Operator shall not be liable to Working Interest Owners for damages unless such

damages result from the gross negligence or willful misconduct of Unit Operator.

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

7.4 Employees. The number of employees used by Unit Operator in conducting operations hereunder, the selection of such employees, the hours of labor, and the compensation for services to be paid any and all such employees, shall be determined by Unit Operator. Such employees shall be employed by Unit Operator. Notwithstanding the foregoing, Unit Operator shall have the right to contract with third persons for the performance of any labor or services, or for the provision of materials and equipment, required for operations hereunder, under such terms as are reasonable in the industry.

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

7.6 Reports to Working Interest Owners. Unit Operator shall furnish to each Working Interest Owner periodic reports of the development and operation of the Unit Area.

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 each Working Interest Owner, upon written request, a copy of the logs of, and copies of 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 fifty thousand dollars (\$50,000.00) without prior approval of the Working Interest Owners. This expenditure limit may be revised from time to time by an affirmative vote of three (3) or more Working Interest Owners having a combined voting interest then in effect of at least eighty percent (80%). However, if an emergency occurs, Unit Operator may immediately incur such expenditures which in his or its opinion are necessary and reasonable to deal with the emergency. Unit Operator shall

report to Working Interest Owners, as promptly as possible, on the nature of the emergency and of 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 prevailing rate 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 Border Agreements. Unit Operator may, after approval by Working Interest Owners, enter into border agreements with owners of lands adjacent to the Unit Area for the purpose of coordinating operations.

Such agreements may provide for the cooperative development, operation, fluid injection, or similar programs with respect to the equivalent of the Unitized Formation outside the Unit Area. Any such agreement may make provision for the drilling or conversion, equipping, and operation of compensating fluid injection wells in the Unitized Formation and the adjoining equivalent of the Unitized Formation outside the Unit Area. Any such cooperative agreement shall in no way affect or alter the percentages of participation established hereunder as to the parties hereto, nor shall such agreement provide for the sharing or allocation of production between the Unit Area and any outside lands.

## 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 property tax renditions, whether on real or personal property, 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. All such property 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 interest, production payment, or other interest in excess of a 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. Any Working Interest Owner dissatisfied with any assessment of its interest in real or personal property shall have the right, at its own expense, and after due notice to Unit Operator, to protest and resist any such assessment.

If ad valorem taxes are based in whole or in part upon separate valuations of each party's Working Interest, then notwithstanding anything to the contrary herein, charges to the joint account for ad valorem taxes shall be made and paid by the parties hereto in accordance with the percentage of tax value generated by each party's Working Interest.

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

8.3 Income Tax Election. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this Agreement and operations hereunder shall not constitute a partnership, if for federal income tax purposes this Agreement and the operations hereunder are regarded as a partnership, 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 1986, as permitted and authorized by Section 761 of the Internal Revenue Code and regulations promulgated thereunder. Unit Operator is 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 by the federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and data required by Treasury Regulation 1.761. Should there be any requirement that each party hereto give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the federal Internal Revenue Service or as may be necessary to evidence this election. 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 State of New Mexico income tax law, 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 1986, under which an election similar to that provided by Section 761 of the Internal Revenue Code is permitted, each of the parties hereto agrees

to make such election as may be permitted or required by such laws. In making the foregoing election, each of the parties hereto 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.

## ARTICLE 9

### INSURANCE

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

- (a) comply with the workers' compensation laws of the State of New Mexico;
- (b) carry employer's liability and other insurance required by the laws of the State of New Mexico; and
- (c) provide insurance as set forth in Exhibit "E."

## ARTICLE 10

### ADJUSTMENT OF INVESTMENTS

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

10.1.1 Wells and Well Equipment. All useable wells and nonuseable wells that are capable of producing Unitized Substances, together with the casing, tubing, and down-hole equipment up to and including all wellhead connections.

10.1.2 Lease and Operating Equipment. All surface, lease, and well operating equipment, injection or salt water disposal wells, and other facilities related to current production from the Unitized Formation which Working Interest Owners determine to be necessary or desirable for conducting Unit Operations.

10.1.3 Records. A copy of all production and well records pertaining to any well which has historically or is currently producing from the Unitized Formation.

10.2 Inventory and Evaluation of Personal Property. Unit Operator shall prepare a list of each Working Interest Owner's current major equipment within the Unit Area that is

to be inventoried into the joint account. A Working Interest Owner may remove any item(s) from his list only on the condition that the Unit may use it as long as needed prior to return. This list shall include all of a Working Interest Owner's current equipment being utilized in producing oil or gas from the Unitized Formation, except that any item may be deleted from the list by Unit Operator, based upon a preliminary environmental assessment recommendation. Unit Operator shall have until the actual inventory is performed to recommend deletion of additional items based upon revised or additional environmental assessments. Working Interest Owners shall appoint an inventory committee which shall, as of the Effective Date hereof, or as soon thereafter as feasible, cause to be taken, under the supervision of Unit Operator and at Unit Expense, joint physical inventories of all lease and well equipment on the inventory list, which inventories shall be used as a basis for determining the controllable items of equipment to be taken over by Unit Operator hereunder. Unit Operator shall notify each Working Interest Owner within each separate Tract at least fifteen (15) days prior to the taking of the inventory with respect to said Tract, so that each of said Working Interest Owners may make arrangements to be represented at the taking of the inventory. Such inventories shall include and be limited to those items of equipment normally considered controllable as recommended in the material classification manual in Bulletin No. 6 dated May, 1971, or any amendments thereto, published by the Petroleum Accountants Society of North America, except that certain items normally considered noncontrollable, such as sucker rods and other items as agreed upon by the Working Interest Owners may be included in the inventories in order to insure a more equitable adjustment of investments. Immediately following completion, such inventories shall be priced in accordance with the provisions of Exhibit "F", Accounting Procedure, attached hereto and made a part hereof. Such pricing shall be performed under the supervision of, by the personnel of, and in the offices of Unit Operator, with Working Interest Owners furnishing such additional pricing help as may be available and necessary. With respect to each well taken over for Unit Operations, no value shall be assigned to intangible drilling costs of such well or to the down-hole casing therein.

10.3 Inventory and Valuations. After completion of the inventory and evaluation of property in accordance with the provisions of Section 10.2, Unit Operator shall submit to each Working Interest Owner a copy of the inventory and valuations thereon together with a letter ballot for approval of such inventory and valuations. Within sixty (60) days after receipt of such inventory and valuations, each Working

Interest Owner shall return such letter ballot to Unit Operator indicating its approval or disapproval thereof. It is agreed that such inventory and valuations shall be binding upon all parties if approved by Working Interest Owners owning at least seventy percent (70%) of the Working Interest in the Unit Area.

10.4 Investment Adjustments. As soon as practicable after approval by Working Interest Owners of the inventory and valuations as provided in Section 10.3, each Working Interest Owner shall be credited with the value of its interest in all personal property taken over by Unit Operator under Sections 10.1.1 and 10.1.2, and charged with an amount equal to that obtained by multiplying the total value of all such personal property so taken over by Unit Operator under Sections 10.1.1 and 10.1.2 by such Working Interest Owner's Unit Participation, as shown on Exhibit "D." If the charge against any Working Interest Owner is greater than the amount credited to such Working Interest Owner, the resulting net charge shall be paid and in all other respects be treated as any other item of Unit Expense chargeable against such Working Interest Owner. If the credit to any Working Interest Owner is greater than the amount charged against such Working Interest Owner, the resulting net credit shall be paid to such Working Interest Owner by Unit Operator out of funds received by it in settlement of the net charges described above.

All wells completed in the Strawn formation within the Unit Area shall be Unit wells. If a Unit well has not reached payout status as of the effective date of unitization, the Working Interest Owners in the Unit, in proportion to their working interest in the Unit, shall pay to the working owners of each such well the amount necessary to reach payout.

10.5 Pre-Unitization Costs. The Working Interest Owners shall pay Gillespie-Crow, Inc. the necessary and reasonable pre-unitization costs and fees incurred by it or by Charles B. Gillespie, Jr. for engineering, geological, land, legal, and other professional services attendant to the formation of the Unit.

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

10.7 Ownership of Personal Property and Facilities. Each Working Interest Owner, individually, shall, by virtue hereof,

own an undivided interest in all personal property and facilities taken over or otherwise acquired by Unit Operator pursuant to this Agreement equal to its then current Unit Participation, shown on Exhibit "D."

## ARTICLE 11

### DEVELOPMENT AND OPERATING COSTS

11.1 Basis of Charge to Working Interest Owners. Subject to the provisions of Section 11.2 hereof, Unit Operator initially shall pay all Unit Expenses. Each Working Interest Owner shall reimburse Unit Operator for its share of Unit Expenses. All charges, credits, and accounting for Unit Expenses shall be in accordance with Exhibit "F." All costs and expenses for equipment, drilling of wells, conversion of wells for injection purposes, and construction of enhanced oil recovery facilities shall be "Investment Costs." Each Working Interest Owner's share of Investment Costs and monthly operating expenses shall be the same as its Unit Participation.

11.2 Advance Billings. Unit Operator shall have the right, at its option, to require other Working Interest Owners to advance their respective proportionate share of estimated development and operating costs and expenses by submitting to such other Working Interest Owners, on or before the 15th day of any month, an itemized estimate of such costs and expenses for the succeeding month with a request for payment in advance. Within thirty (30) days thereafter, each Working Interest Owner shall pay to Unit Operator its proportionate part of such estimate. Adjustment between estimates and the actual costs shall be made by Unit Operator at the close of each calendar month, and the accounts of the Working Interest Owners shall be adjusted accordingly.

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

11.4 Lien and Security Interest of Unit Operator and 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 prime rate set by Citibank N.A., New York, New York, for the same period plus

one percent (1%) per annum, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts. 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 Uniform Commercial Code. The bringing of a suit and the obtaining of 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 owner 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 a purchaser of production the proceeds from the sale of such Working Interest Owner's share of Unitized Substances until the amount owed by such Working Interest Owner, plus interest, has been paid. Each purchaser of production shall be entitled to rely upon Unit Operator's written statement concerning the amount of any default. Unit Operator grants a like lien and security interest to the Working Interest Owners.

11.5 Carved-Out Interest. If any Working Interest Owner shall, after executing this Agreement, create an overriding royalty interest, production payment interest, 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 11.4 hereof. If the Working Interest Owner creating such carved-out (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 16 hereof, the carved-out interest shall be chargeable with a pro rata portion of all Unit Expense incurred hereunder, the same as though the 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 11.4 for the purpose of collecting the Unit Expense chargeable to the carved-out interest.

11.6 Carried Interest. Approved Investment Costs shall be billed to the individual Working Interest Owners. If any Working Interest Owner fails to pay its proportionate share of such Investment Costs within sixty (60) days of receipt of such bill, then such party shall be deemed a defaulting Working Interest Owner. Any such defaulting Working Interest

Owner shall not be entitled to participate in, nor shall its account be credited with, any share of Unitized Substances or the proceeds thereof; instead, such defaulting Working Interest Owner shall be deemed to have relinquished its Working Interest in the Unit to Unit Operator or, at the option of Unit Operator, to all non-defaulting Working Interest Owners, who shall pay such defaulted Investment Costs and carry the defaulted Working Interest until such defaulted Investment Costs shall have been recovered from the Unitized Substances or proceeds thereof attributable to such defaulting Working Interest Owner, after first deducting monthly overhead charges therefrom, plus an amount equal to two hundred percent (200%) of such defaulted Investment Costs.

If Unit Operator elects to allow non-defaulting Working Interest Owners to carry such defaulted Investment Costs, Unit Operator shall give notice to all non-defaulting Working Interest Owners of such default. All Working Interest Owners receiving such notice shall carry their proportionate part of any such defaulting Working Interest Owner(s) interest by paying the unpaid amount as if it were a Unit Expense in the proportion that the Unit Participation of each such Working Interest Owner bears to the Unit Participation of all such Working Interest Owners. Any such additional amounts shall be due and payable to Unit Operator within fifteen (15) days following receipt of notice.

Upon failure by any defaulting Working Interest Owner to pay its share of any Investment Costs, Unit Operator (for itself and/or for the benefit of the non-defaulting Working Interest Owners) shall be entitled to collect and receive from a purchaser of production the proceeds that otherwise would accrue to such defaulting Working Interest Owner's share of Unitized Substances, in satisfaction of such debt. All Working Interest Owners covenant and agree to save all purchasers of production harmless from any and all liability by reason of paying such proceeds of Unitized Substances to Unit Operator. Each purchaser of production shall be entitled to rely on Unit Operator's written statement of the amounts in default.

During the period of time Unit Operator and/or the non-defaulting Working Interest Owners are entitled to receive the defaulting Working Interest Owner's share of production of Unitized Substances, or the proceeds thereof, Unit Operator and/or the non-defaulting Working Interest Owners shall be responsible for the payment of all production, severance, excise, gathering, and other taxes, and all royalty,

overriding royalty, and other burdens applicable to the Working Interest of said defaulting Working Interest Owner.

A defaulting Working Interest Owner shall lose its voting interest (as defined in Section 4.3.1 above) during its period of default. Its voting rights shall be shared proportionally and exercised by Unit Operator, or each of the non-defaulting Working Interest Owners, as provided for in Section 4.3 above. Each non-defaulting Working Interest Owner paying its share of the unpaid amount shall, to obtain reimbursement thereof, be subrogated to the security rights described in Section 11.4 of this Agreement.

If and when Unit Operator and/or the non-defaulting Working Interest Owners recover from a defaulting Working Interest Owner's relinquished interest the amounts provided for above, the relinquished interest of such defaulting Working Interest Owner shall automatically revert to it, and, from and after such reversion, such defaulting Working Interest Owner shall own the same interest in the Unit, the material and equipment in or pertaining thereto, and the production therefrom as such defaulting Working Interest Owner would have been entitled to had it timely paid its share of Investment Costs as provided hereinabove. Thereafter, such defaulting Working Interest Owner shall be charged with and shall pay its proportionate share of the further costs of Unit Operations in accordance with the terms of this Agreement and Exhibit "F."

The remedies included in this provision shall be in addition to the rights provided by law and by Section 11.4 above.

11.7 Rentals. The Working Interest Owners of 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, upon written request, evidence of payment.

11.8 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 December thereafter, shall prepare a budget for the ensuing calendar year. A budget shall set forth the estimated Unit Expense by quarterly periods. 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.

## 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 other than Unit Operator 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 Unit Operator and other Working Interest Owners so that production of Unitized Substances will not be adversely affected.

12.2 Multiple Completions. No well now or hereafter completed in the Unitized Formation shall ever be completed as a multiple completion, unless such multiple completion and subsequent handling of the multiple completion is approved by Working Interest Owners in accordance with the voting procedure described in Section 4.3 above.

## ARTICLE 13

### TITLES

13.1 Warranty and Indemnity. Each Working Interest Owner represents and warrants that it is the owner of the respective Working Interest as shown to be owned by it on appropriate Exhibits to this Agreement, and hereby indemnifies and holds the other Working Interest Owners harmless from any loss due to the failure, in whole or in part, of its title to any such interest, except failure of title arising out of operations hereunder; provided, however, that such indemnity and any liability for breach of warranty shall be limited to an amount equal to the net value that had been received from the sale of Unitized Substances attributed hereunder to the interest as to which title failed. Each failure of title will be effective, insofar as this Agreement is concerned, as of the first day of the calendar month in which such failure is finally determined, and there shall be no retroactive adjustment of

Unit Expense or retroactive allocation of Unitized Substances or the proceeds therefrom as a result of title failure.

13.2 Failure of Title Because of Unit Operations. The failure of title to 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. Nothing contained herein shall ever be construed as creating a partnership, joint venture, or an association or trust between or 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 Twenty Thousand Dollars (\$20,000.00), provided that 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 determine 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, subject to such limitation as is set forth in Exhibit "F." 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 no control because of the rights given Working Interest Owners and Unit Operator by this Agreement and by 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

##### NOTICES

15.1 Notices. All notices required hereunder shall be in writing and shall be deemed to have been properly served when sent by mail, telegram, or facsimile transmission followed by

first class U. S. Mail, to the address of the representative of each Working Interest Owner as furnished to Unit Operator in accordance with Article 4 hereof.

## ARTICLE 16

### WITHDRAWAL OF WORKING INTEREST OWNER

16.1 Withdrawal. A Working Interest Owner may withdraw from this Agreement by transferring, without warranty of title, either express or implied, to the Working Interest Owners who do not desire to withdraw, all its Oil and Gas Rights, exclusive of Royalty Interests, together with its interests in all Unit Equipment and in all wells used in Unit Operations, provided that such transfer shall not relieve such Working Interest Owner from any obligation or liability incurred prior to the first day of the month following receipt by Unit Operator of such transfer. The delivery of the transfer shall be made to Unit Operator for the transferees. The transferred interest shall be owned by the transferees in proportion to their respective Unit Participations. The transferees, in proportion to the respective interests so acquired, shall pay the transferor for its interest in Unit Equipment, being the salvage value thereof less its share of the estimated cost of salvaging same and of plugging and abandoning and restoring the surface of all wells then being used or held for Unit Operations, as determined by Working Interest Owners. In the event such withdrawing owner's interest in the aforesaid salvage value is less than such owner's share of such estimated costs, the withdrawing owner, as a condition precedent to withdrawal, shall pay the Unit Operator, for the benefit of Working Interest Owners succeeding to its interest, a sum equal to the deficiency. Within sixty (60) days after receiving delivery of the transfer, Unit Operator shall render a final statement to the withdrawing owner for its share of Unit Expense, including any deficiency in salvage value, as determined by Working Interest Owners, incurred as of the first day of the month following the date of receipt of the transfer. Provided all Unit Expense, including any deficiency hereunder, due from the withdrawing owner has been paid in full within thirty (30) days after the rendering of such final statement by the Unit Operator, the transfer shall be effective the first day of the month following its receipt by Unit Operator, and, as of such effective date, the withdrawing owner shall be relieved from all further obligations and liabilities hereunder and under the Unit Agreement, and the rights of the withdrawing Working Interest Owner hereunder and under the Unit Agreement shall

cease insofar as they existed by virtue of the interest transferred.

16.2 Limitation on Withdrawal. Notwithstanding anything set forth in Section 16.1, Working Interest Owners may refuse to permit the withdrawal of a Working Interest Owner if its Working Interest is burdened by any royalties, overriding royalties, production payment, net proceeds interest, carried interest, or any other interest created out of the Working Interest in excess of a one-eighth (1/8th) lessor's royalty, unless the other Working Interest Owners willing to accept the assignment agree to accept the Working Interest subject to such burdens.

## ARTICLE 17

### ABANDONMENT OF WELLS

17.1 Rights of Former Owners. If Working Interest Owners decide to permanently abandon any useable well completed in the Unitized Formation within the Unit Area prior to termination of the Unit Agreement, Unit Operator shall give written notice of such fact to the Working Interest Owners of the Tract on which such well is located, and said Working Interest Owners shall have the right and option for a period of sixty (60) days after receipt of such notice to notify Unit Operator of their election to take over and own said well and to deepen or plug back said well to a formation other than the Unitized Formation. Within sixty (60) days after said Working Interest Owners have so notified Unit Operator of their desire to take over such well, they shall pay Unit Operator, for credit to the joint account of the Working Interest Owners, the amount as estimated and fixed by Working Interest Owners to be the net salvage value of the equipment in and on said well, except casing and other equipment originally contributed at no cost, plus costs to seal off the Unitized Formation and perform casing integrity and Bradenhead tests. The Working Interest Owners of the Tract, by taking over the well, agree to seal off the Unitized Formation in a manner satisfactory to Working Interest Owners in the entire Unit Area, and upon abandonment to plug the well in compliance with all applicable laws and regulations.

17.2 Plugging. In the event the Working Interest Owners of a Tract do not elect to take over a well located thereon which is proposed for abandonment, Unit Operator shall plug and abandon the well in accordance with applicable laws and regulations.

## ARTICLE 18

### EFFECTIVE DATE AND TERM

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

18.2 Term. This Agreement shall continue in full force and effect so long as the Unit Agreement remains in force and effect, and thereafter, until (a) all Unit wells have been abandoned and plugged or turned over to Working Interest Owners in accordance with Article 19 hereof, (b) all personal and real property acquired for the joint account of Working Interest Owners have been disposed of by Unit Operator in accordance with instructions of Working Interest Owners, (c) all required surface and subsurface restoration has been performed, and (d) there has been a final accounting.

## ARTICLE 19

### ABANDONMENT OF OPERATIONS

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

19.1.1 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 hereto shall be governed by the terms and provisions of the leases, contracts, and other instruments affecting the separate Tracts.

19.1.2 Right to Operate. The Working Interest Owners of any Tract desiring to take over and continue to operate a well or wells located thereon may do so by paying Unit Operator, for the credit of the joint account, the net salvage value, as determined by the Working Interest Owners, of the equipment in and on the well, except casing and other equipment originally contributed at no cost, and by agreeing to properly plug the well(s) at such time as it is abandoned in compliance with applicable laws and regulations.

19.1.3 Salvaging Wells. Unit Operator shall salvage as much of the casing and equipment in or on wells not taken over by Working Interest Owners of separate Tracts as can economically and reasonably be salvaged, and shall cause the wells to be plugged and abandoned in compliance with applicable laws and regulations.

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

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

## ARTICLE 20

### LAWS, REGULATIONS, AND CERTIFICATE OF COMPLIANCE

20.1 Laws and Regulations. This Agreement and all operations hereunder are subject to all valid laws and valid rules, regulations, and orders of all regulatory bodies having jurisdiction, and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and orders, including those relating to environmental issues; and any provision of this Agreement found to be contrary to or inconsistent with any such law, ordinance, rule, regulation, or order shall be deemed modified accordingly.

20.2 Certificate of Compliance. In the performance of work under this Agreement, the parties hereto agree to comply and Unit Operator shall require each independent contractor to comply with the provisions of Exhibit "G."

## ARTICLE 21

### GOVERNMENTAL REGULATIONS

21.1 Governmental Regulations. The Working Interest Owners agree to release Unit Operator from any and all liability, losses, damages, injuries, claims, and causes of action arising out of, incident to, or resulting directly or indirectly from Unit Operator's interpretation or application of rules, rulings, regulations, or orders of any governmental agency to the extent Unit Operator's interpretation or application of such rules, rulings, regulations, or orders were made in good faith. Working Interest Owners further agree to reimburse Unit Operator for their proportionate share of any amounts Unit Operator may be required to refund, rebate, or pay as a result of an incorrect interpretation or application of such rules, rulings, regulations, or orders, together with their proportionate part of interest and penalties owing by Unit Operator as a result of such incorrect interpretation or application of such rules, rulings, regulations, or orders, to the extent that such incorrect interpretation or application was made in good faith.

ARTICLE 22

COUNTERPART EXECUTION

22.1 Counterpart Execution. 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 Unit Area. Furthermore, this Agreement will extend to and be binding on the parties hereto, their successors, devisees, heirs, personal representatives, and assigns.

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

UNIT OPERATOR:

GILLESPIE-CROW, INC.

Date: \_\_\_\_\_ By: \_\_\_\_\_  
Its: \_\_\_\_\_

**ACKNOWLEDGEMENT**

STATE OF TEXAS            )  
                                  ) ss.  
COUNTY OF MIDLAND        )

The foregoing instrument was acknowledged before me this  
\_\_\_\_ day of \_\_\_\_\_, 1994, by \_\_\_\_\_,  
\_\_\_\_\_ of Gillespie-Crow, Inc., a Texas corporation,  
on behalf of the corporation.

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

My Commission Expires:

\_\_\_\_\_

strawnop.agr



ATTACHED TO AND MAKE A PART OF THAT  
UNIT OPERATING AGREEMENT DATED  
WEST TOWNSEN SUBAN UNIT AREA,  
GULFSTREAM, INC., AS  
UNIT OPERATOR, LEA COUNTY, NEW MEXICO

[illegible]

EXHIBIT "D"  
SUMMARY OF WORKING INTERESTS  
PAGE 2

UNIT PARTICIPATION	TRACT 1	TRACT 2	TRACT 3	TRACT 4	TRACT 5	TRACT 6	TRACT 7	TRACT 8	TRACT 9	TRACT 10	TRACT 11	TOTAL
Tract Interest:	0.280140037	0.177215496	0.055420300	0.07467056	0.212593893	0.061259740	0.063063823	0.035613.80	0.019382478	0.014701997	0.003878383	1.000000000
Working Interest Owner:												
Anderson, Leonardo S. Jr.					0.001328712							0.001328712
Crow, William R.								0.000890330	0.000484562	0.000367550	0.000096960	0.001839402
DALEN RESOURCES O & G Co.	0.105052514	0.088617748	0.027710150	0.037335334	0.100982099	0.031649870	0.031531914	0.017806590	0.005691239	0.007350998	0.001939192	0.459667648
Gillespie, Charles B. Jr.	0.105052514	0.088617748	0.027710150	0.037335333	0.100982099	0.031649870	0.031531914	0.016916360	0.005206677	0.006583449	0.001842231	0.457828246
Hill, Laura Geraldine					0.001328712							0.001328712
McFarland, Monty D.					0.007972271							0.007972271
Phillips Petroleum Co.	0.010035009											0.010035009
Total	0.280140037	0.177215496	0.055420300	0.074670568	0.212593893	0.063259740	0.063063823	0.035613180	0.019382478	0.014701997	0.003878383	1.000000000

## **EXHIBIT "E"**

Attached to and made a part of that certain Unit Operating Agreement dated \_\_\_\_\_, 1995, by and between Gillespie-Crow, Inc., as Unit Operator, and Non-Operators named therein, Lea County, New Mexico:

West Lovington Strawn Unit Area  
Lea County, New Mexico

### **INSURANCE PROVISIONS**

1. Unit Operator shall carry insurance as follows for the benefit and protection of the parties to this Agreement:
  - a. Worker's Compensation Insurance in accordance with the laws of governmental bodies having jurisdiction including, if applicable, United States Longshore and Harbor Worker's Compensation Act with Outer Continental Shelf Extension, and Employers' Liability Insurance. Employers' Liability Insurance shall provide coverage of \$100,000.00 per accident.
  - b. Unit Operator may include the aforesaid risks under its qualified self-insurance program, if any, provided Unit Operator complies with applicable laws, and in such event Unit Operator shall charge to the joint account a premium determined by applying manual insurance rates to the payroll.
2. Unit Operator shall not be obligated or authorized to obtain or carry on behalf of the joint account any additional insurance covering the parties or the operations to be conducted hereunder without the consent and agreement of all parties. Each party individually may acquire at its own expense such insurance as it deems proper to protect itself against claims, losses, or damages arising out of the joint operations, provided that such insurance shall include a waiver of subrogation against the other parties in respect of their interests hereunder. All uninsured losses and all damages to jointly owned property shall be borne by the parties in proportion to their respective interests.
3. Unit Operator shall promptly notify non-operators in writing of any losses involving damage to a jointly owned property in excess of \$100,000.
4. Unit Operator shall require all contractors engaged in operations under this Agreement to comply with applicable worker's compensation laws and to maintain such other insurance and in such amounts as Unit Operator deems necessary.
5. In the event less than all parties participate in an operation conducted under the terms of this Agreement, then the insurance requirements and costs, as well as all losses, liabilities, and expenses incurred as the result of such operations, shall be the burden of the party or parties participating therein.

EXHIBIT " F "

Attached to and made a part of Unit Operating Agreement covering the West  
Lovington-Strawn Unit Area, Lea County, New Mexico, dated  
. 1995, by and between Gillespie-Crow, Inc., as  
Unit Operator, and Dalen Resources Oil & Gas Co., et al.,  
Non-Operators.

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.

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

A. 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 within fifteen (15) days after receipt of the billing or by the first day of the month for which the advance is required, whichever is later. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.  
B. 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 prime rate in effect at Citibank, N.Y. or New York, New York on the first day of the month in which delinquency occurs plus 1% 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. 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 a joint audit 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. The audits shall not be conducted more than once each year without prior approval of Operator, except upon the resignation or removal of the Operator, and shall be made at the expense of those Non-Operators approving such audit.

B. The Operator shall reply in writing to an audit report within 180 days after receipt of such report.

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. Ecological and Environmental

Costs incurred for the benefit of the Joint Property as a result of governmental or regulatory requirements to satisfy environmental considerations applicable to the Joint Operations. Such costs may include surveys of an ecological or archaeological nature and pollution control procedures as required by applicable laws and regulations.

2. Rentals and Royalties

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

3. 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.

(4) Salaries and wages of Technical Employees either temporarily or permanently assigned to and directly employed in the operation of 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 3A of this Section II. Such costs under this Paragraph 3B 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 3A 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 3A and 3B of this Section II.

D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II.

4. 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 3A and 3B of this Section II shall be Operator's actual cost not to exceed the percent most recently recommended by the Council of Petroleum Accountants Societies.

5. 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.

6. 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 Operators 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 where like material is normally available or railway receiving point nearest the Joint Property unless agreed to by the Parties.
- B. If surplus Material is moved to Operators 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 where like material is normally available, or railway receiving point nearest the Joint Property 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, the option to equalize or charge actual trucking cost is available when the actual charge is \$400 or less excluding accessorial charges. The \$400 will be adjusted to the amount most recently recommended by the Council of Petroleum Accountants Societies.

7. Services

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 10 of Section II and Paragraph ii, iii, and iv, 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.

8. 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 gross investment less accumulated depreciation not to exceed twelve percent (12%) 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 8A 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.

9. 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.

10. Legal Expense

Expense of handling, investigating and settling litigation or claims, discharging of liens, payment of judgements 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 Operators 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.

11. 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. If the ad valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then notwithstanding anything to the contrary herein, charges to the Joint Account shall be made and paid by the Parties hereto in accordance with the tax value generated by each party's working interest.

12. 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 Workers Compensation and/or Employers Liability under the respective states 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.

13. Abandonment and Reclamation

Costs incurred for abandonment of the Joint Property, including costs required by governmental or other regulatory authority.

14. Communications

Cost of acquiring, leasing, installing, operating, repairing and maintaining communication systems, including radio and microwave facilities directly serving the Joint Property. In the event communication facilities/systems serving the Joint Property are Operator owned, charges to the Joint Account shall be made as provided in Paragraph 3 of this Section II.

15. 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 of direct benefit to the Joint Property and is incurred by the Operator in the necessary and proper conduct of the Joint Operations.

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

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

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

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 3A, 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 be covered by the overhead rates, or  
( X ) shall not be covered by the overhead rates.

iii. The salaries, wages and Personal Expenses of Technical Employees and/or costs of professional consultant services and contract services of technical personnel either temporarily or permanently assigned to and directly employed in the operation of the Joint Property:

- ( X ) shall be covered by the overhead rates, or  
( ) 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 \$ 6000  
(Prorated for less than a full month)

Producing Well Rate \$ 600

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

(a) Drilling Well Rate

(1) Charges for drilling wells shall begin on the date the well is spudded and terminate on the date the drilling rig, or other units used in completion of the well is released, whichever

is later, except that no charge shall be made during suspension of drilling or completion operations for fifteen (15) or more consecutive calendar days.

- (2) Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive work 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 or other units used in workover, commence through date of rig or other unit release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive calendar 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 shall be made for the month in which plugging and abandonment operations are completed on any well. This one-well charge shall be made whether or not the well has produced except when drilling well rate applies.
- (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 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 10 of Section II and all salvage credits.

(b) Operating

\_\_\_\_\_ Percent ( \_\_\_\_\_ %) of the cost of operating the Joint Property exclusive of costs provided under Paragraphs 2 and 10 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, re-drilling, deepening, or any remedial operations on any or all wells involving the use of drilling rig and crew capable of drilling to the producing interval on the Joint Property; 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 \$ 100,000.00

- A. 5 % of first \$100,000 or total cost if less, plus  
B. 3 % of costs in excess of \$100,000 but less than \$1,000,000, plus  
C. 2 % of 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 and artificial lift equipment shall be excluded.

### 3. Catastrophe Overhead

To compensate Operator for overhead costs incurred in the event of expenditures resulting from a single occurrence due to oil spill, blowout, explosion, fire, storm, hurricane, or other catastrophes as agreed to by the Parties, which are necessary to restore the Joint Property to the equivalent condition that existed prior to the event causing the expenditures. Operator shall either negotiate a rate prior to charging the Joint Account or shall charge the Joint Account for overhead based on the following rates:

- A. 5 % of total costs through \$100,000; plus  
B. 3 % of total costs in excess of \$100,000 but less than \$1,000,000; plus  
C. 2 % of total costs in excess of \$1,000,000.

Expenditures subject to the overheads above will not be reduced by insurance recoveries, and no other overhead provisions of this Section III shall apply.

### 4. Amendment of Rates

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

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

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

### 1. Purchases

Material purchased shall be charged at the price paid by Operator after deduction of all discounts received. In case of Material found to be defective or returned to vendor for any other reasons, 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 basis exclusive of cash discounts:

#### A. New Material (Condition A)

##### (1) Tubular Goods Other than Line Pipe

- (a) Tubular goods, sized 2 1/2 inches OD and larger, except line pipe, shall be priced at Eastern mill published carload base prices effective as of date of movement plus transportation cost using the 30,000 pound carload weight basis to the railway receiving point nearest the Joint Property for which published rail rates for tubular goods exist. If the 30,000 pound rail rate is not offered, the 70,000 pound or 90,000 pound rail rate may be used. Freight charges for tubing will be calculated from Lorain, Ohio and casing from Youngstown, Ohio.

- (b) For grades which are special to one mill only, prices shall be computed at the mill base of that mill plus transportation cost from that mill to the railway receiving point nearest the Joint Property as provided above in Paragraph 2.A.(1)(a). For transportation cost from points other than Eastern mills, the 30,000

1 pound Oil Field Haulers Association interstate truck rate shall be used.

2  
3 (c) Special end finish tubular goods shall be priced at the lowest published out-of-stock price, f.o.b. Houston,  
4 Texas, plus transportation cost, using Oil Field Haulers Association interstate 30,000 pound truck rate,  
5 to the railway receiving point nearest the Joint Property.

6  
7 (d) Macaroni tubing (size less than 2 1/2 inch OD) shall be priced at the lowest published out-of-stock prices  
8 f.o.b. the supplier plus transportation costs, using the Oil Field Haulers Association interstate truck rate  
9 per weight of tubing transferred, to the railway receiving point nearest the Joint Property.

10  
11 (2) Line Pipe

12  
13 (a) Line pipe movements (except size 24 inch OD and larger with walls 1/4 inch and over) 30,000 pounds or  
14 more shall be priced under provisions of tubular goods pricing in Paragraph A.1(1a) as provided above.  
15 Freight charges shall be calculated from Lorain, Ohio.

16  
17 (b) Line pipe movements (except size 24 inch OD and larger with walls 1/4 inch and over) less than 30,000  
18 pounds shall be priced at Eastern mill published cartload base prices effective as of date of shipment,  
19 plus 20 percent, plus transportation costs based on freight rates as set forth under provisions of tubular  
20 goods pricing in Paragraph A.1(1a) as provided above. Freight charges shall be calculated from Lorain,  
21 Ohio.

22  
23 (c) Line pipe 24 inch OD and over and 1/4 inch wall and larger shall be priced f.o.b. the point of  
24 manufacture at current new published prices plus transportation cost to the railway receiving point  
25 nearest the Joint Property.

26  
27 (d) Line pipe, including fabricated line pipe, drive pipe and conduit not listed on published price lists shall  
28 be priced at quoted prices plus freight to the railway receiving point nearest the Joint Property or at  
29 prices agreed to by the Parties.

30  
31 (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable  
32 supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the  
33 railway receiving point nearest the Joint Property.

34  
35 (4) Unused new Material, except tubular goods, moved from the Joint Property shall be priced at the current  
36 new price, in effect on date of movement, as listed by a reliable supply store nearest the Joint Property, or  
37 point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint  
38 Property. Unused new tubulars will be priced as provided above in Paragraph 2.A.(1) and (2).

39  
40 B. Good Used Material (Condition B)

41  
42 Material in sound and serviceable condition and suitable for reuse without reconditioning:

43  
44 (1) Material moved to the Joint Property

45  
46 At seventy-five percent (75%) of current new price, as determined by Paragraph A.

47  
48 (2) Material used on and moved from the Joint Property

49  
50 (a) At seventy-five percent (75%) of current new price, as determined by Paragraph A, if Material was  
51 originally charged to the Joint Account as new Material or

52  
53 (b) At sixty-five percent (65%) of current new price, as determined by Paragraph A, if Material was  
54 originally charged to the Joint Account as used Material.

55  
56 (3) Material not used on and moved from the Joint Property

57  
58 At seventy-five percent (75%) of current new price as determined by Paragraph A.

59  
60 The cost of reconditioning, if any, shall be absorbed by the transferring property.

61  
62 C. Other Used Material

63  
64 (1) Condition C

65  
66 Material which is not in sound and serviceable condition and not suitable for its original function until  
67 after reconditioning shall be priced at fifty percent (50%) of current new price as determined by  
68 Paragraph A. The cost of reconditioning shall be charged to the receiving property, provided Condition  
69 C value plus cost of reconditioning does not exceed Condition B value.  
70

(2) Condition D

Material, excluding junk, no longer suitable for its original purpose, but usable for some other purpose shall be priced on a basis commensurate with its use. Operator may dispose of Condition D Material under procedures normally used by Operator without prior approval of Non-Operators.

(a) Casing, tubing, or drill pipe used as line pipe shall be priced as Grade A and B seamless line pipe of comparable size and weight. Used casing, tubing or drill pipe utilized as line pipe shall be priced at used line pipe prices.

(b) Casing, tubing or drill pipe used as higher pressure service lines than standard line pipe, e.g. power oil lines, shall be priced under normal pricing procedures for casing, tubing, or drill pipe. Upset tubular goods shall be priced on a non upset basis.

(3) Condition E

Junk shall be priced at prevailing prices. Operator may dispose of Condition E Material under procedures normally utilized by 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 or unloading costs may be charged to the Joint Account at the rate of twenty-five cents (25¢) per hundred weight on all tubular goods movements, in lieu of actual loading or unloading costs sustained at the stocking point. The above rate shall be adjusted as of the first day of April each year following January 1, 1985 by the same percentage increase or decrease used to adjust overhead rates in Section III, Paragraph LA(3). Each year, the rate calculated shall be rounded to the nearest cent and shall be the rate in effect until the first day of April next year. Such rate shall be published each year by the Council of Petroleum Accountants Societies.

(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

Adjustments to the Joint Account resulting from the reconciliation of a physical inventory shall be made within six months following the taking of the inventory. Inventory adjustments shall be made by Operator to 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, change of interest, or change of Operator 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. In cases involving a change of Operator, all Parties shall be governed by such inventory.

4. Expense of Conducting Inventories

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

B. The expense of conducting special inventories shall be charged to the Parties requesting such inventories, except inventories required due to change of Operator shall be charged to the Joint Account.

**EXHIBIT "G"**  
**CERTIFICATE OF COMPLIANCE**

**ATTACHED TO AND MADE A PART OF THAT  
UNIT OPERATING AGREEMENT DATED \_\_\_\_\_, 1995,  
WEST LOVINGTON STRAWN UNIT AREA,  
GILLESPIE-CROW, INC., AS  
UNIT OPERATOR, LEA COUNTY, NEW MEXICO**

Unless this Agreement is exempted by law, rule, regulation, or order, Unit Operator shall comply with the following clauses contained in the Code of Federal Regulations (including any revision or redesignation thereof), which are incorporated herein by reference, the full text of which will be made available upon request:

48.C.F.R. §52.222-35	(Disabled and Vietnam Era Veterans)
48.C.F.R. §52.222-36	(Handicapped Workers)
48.C.F.R. §52.222-26	(Equal Opportunity)
48.C.F.R. §52.219-8 and -9	(Small Disadvantaged Business Concerns)
48.C.F.R. §52.219-13	(Women-Owned Small Businesses)

Where required by law, and unless previously provided, Unit Operator shall provide a Certificate of Non-Segregated Facilities to Non-Operators and shall require its contractors and subcontractors to so provide the same to Unit Operator. Unit Operator agrees and covenants that none of its employees, or employees of its contractors or subcontractors who provide services pursuant to this Agreement, are unauthorized aliens as defined in the Immigration Reform and Control Act of 1986.

EXHIBIT "H"  
GAS BALANCING AGREEMENT

ATTACHED TO AND MADE A PART OF THAT  
UNIT OPERATING AGREEMENT DATED \_\_\_\_\_, 1995  
WEST LOVINGTON STRAWN UNIT AREA  
GILLESPIE-CROW, INC. (UNIT OPERATOR)  
LEA COUNTY, NEW MEXICO

For the purpose of this Agreement, the working interest owners are sometimes hereinafter referred to as "a party" or "the parties."

**I. DEFINITIONS:**

- A. "Affiliate" is any company that is controlled or wholly owned by another company. Spouses and the minor children of any parent shall also be deemed to be an affiliate for purposes of this Agreement.
- B. "Alternate Price" is the price which shall apply for purposes of Article IV or Article V whenever a party has taken Gas for its account, but has not immediately sold the Gas or where a party has sold its Gas to an Affiliate. Any Gas so taken or sold shall be valued at the monthly spot market price listed for the geographical area where the Unit is located as published by Inside F.E.R.C.'s Gas Market Report, unless a party can show its valuation or affiliate sales price is representative of other arms' length transactions available in the area for the same production month(s) for gas of comparable quality. If a range of prices is published for the geographical area in question, then the value of the Gas shall be calculated by averaging the different prices listed for that geographical area. The Alternate Price shall be adjusted to reflect actual gathering, treating, transportation, or other gas handling costs incurred by parties selling gas from the Unitized Formation. If Inside F.E.R.C.'s Gas Market Report ceases to list monthly spot market prices for the geographical area in question, then a similar publication shall be substituted by mutual consent of the parties.
- C. "Balanced" is that condition which occurs when a party has taken the same percentage of the cumulative volume of Gas production it is entitled to take pursuant to the terms of the Unit Agreement, or when an Underproduced party has had its Gas account balanced by one or more Overproduced parties pursuant to the provisions of Article IV or Article V of this Agreement.
- D. "Btu" means the amount of heat required to raise the temperature of one pound of water from fifty-eight and five-tenths degrees Fahrenheit (58.5°) to fifty-nine and five-tenths degrees Fahrenheit (59.5°) at a pressure of fourteen and sixty-five one hundredths (14.65) pounds per square inch absolute and dry.

- E. "Gas" includes casinghead Gas (which is all Gas produced with crude oil) and natural Gas from Gas wells, but shall not include liquid hydrocarbons recovered by primary separation equipment.
- F. "Overproduced" is the status of a party when the percentage of the cumulative volume of Gas taken by that party exceeds that party's percentage interest, as established by the Unit Agreement, for the cumulative volume of Gas produced from the Unitized Formation.
- G. "Royalty Owner" shall include all owners of royalty interests, overriding royalty interests, production payment interests, and similar interests payable out of production.
- H. "Underproduced" is the status of a party when the percentage of cumulative volume of Gas taken by that party is less than that party's percentage interest, as established by the Unit Agreement, for the cumulative volume of Gas produced from the Unitized Formation.
- I. "Unit" is defined as the West Lovington Strawn Unit Area, Lea County, New Mexico.
- J. "Unit Agreement" refers to the agreement entered into by the Royalty Owners and working interest owners in the Unitized Formation for the West Lovington Strawn Unit Area and approved by the Commissioner of Public Lands of the State of New Mexico, the United States Department of Interior, and the New Mexico Oil Conservation Division.
- K. "Unit Operating Agreement" refers to the agreement entered into by the working interest owners owning an interest in the Unitized Formation for the West Lovington Strawn Unit Area.
- L. "Unit Operator" is defined to coincide with the definition for Unit Operator found in Section 2 of the Unit Agreement for the West Lovington Strawn Unit Area.
- M. "Unitized Formation" is defined as that stratigraphic interval underlying the Unit Area found between the top of the Strawn Formation and the base of the Strawn Formation. The top of the Strawn Formation is defined as all points underlying the Unit Area correlative to the depth of 11,420 feet, and the base of the Strawn Formation is defined as all points underlying the Unit Area correlative to the depth of 11,681 feet, as identified on the Compensated Neutron/Litho-Density Log for the Speight Fee Well No. 1, located in Lot 3 of Section 1, Township 116 South, Range 35 East, NMPM, Lea County, New Mexico.

## **II. APPLICATION OF THIS AGREEMENT:**

The working interest owners subject to the Unit Operating Agreement to which this Agreement is attached own the Gas produced from the Unitized Formation, and are entitled to share in the production as stated in the Unit Agreement. In accordance with the terms of the Unit Agreement, each working interest owner shall have the right to take in kind or separately dispose of its proportionate share of Gas produced from the Unitized Formation. Whenever the Gas accounts of any of the parties are Overproduced or Underproduced, then this Agreement shall be in effect.

Unit Operator shall administer the provisions of this Agreement. To the extent practicable, Unit Operator shall cause deliveries to be made at such rates as may be required to give effect to the intent that the Gas production accounts of all parties are to be, or are to become, Balanced. In so doing, Unit Operator shall not incur any liability to any non-operator.

## **III. STORING AND MAKING UP GAS PRODUCTION:**

### **A. Right to Take and Market Gas.**

During any period or periods when any party does not take, has no market for, or the market of a party is not sufficient to take that party's full share of the Gas produced from any well located within the Unit, or such party's purchaser otherwise fails to take such party's share of Gas produced from the Unitized Formation, the other party or parties shall be entitled, but not required, to produce and take or deliver to their respective purchaser(s) each month the remaining available Gas.

Whenever more than one party wishes to take and/or market the share of Gas owned by another party that is not taking or selling its proportionate share, then, in the absence of any other agreement between them, those parties wishing to take and/or market the Gas shall only be entitled to take such additional amount that is in direct proportion to what their percentage interest bears to the total interest of all parties desiring to take the additional Gas.

All parties shall share in and own the liquid hydrocarbons recovered from such Gas by primary separation equipment in accordance with their respective interests and subject to the terms of the Unit Operating Agreement, whether or not such parties are actually taking and/or marketing Gas at such time.

### **B. Making Up Underproduction.**

Each Underproduced party shall be credited with Gas in storage equal to its percentage share of the total volume of Gas produced under this Agreement, less that portion of the Gas actually marketed or taken by such party and less that portion of Gas used



in operations, vented, or lost.

Each Underproduced party shall endeavor to bring its taking of Gas into a Balanced condition. If Unit Operator has an established Gas nomination procedure, then an Underproduced party may make up Gas consistent with the percentages listed below in this Article III (B), so long as it adheres to Unit Operator's nomination procedure. If Unit Operator has no nomination procedure in place and the Underproduced party has not taken Gas for one or more consecutive months immediately prior to the month in which it wishes to commence making up a share of its Underproduction, then the Underproduced party shall give at least thirty (30) days advance written notice to Unit Operator prior to taking Gas.

An Underproduced party shall be entitled to take or deliver to a purchaser its full share of Gas produced from the Unitized Formation (less any used in operations, vented, or lost) plus, (i) for the months of March, April, May, June, July, August, September, and October only of any calendar year or years during which this Agreement is in effect, an amount up to an additional fifty percent (50%) of the monthly quantity of Gas attributable to the Overproduced party or parties, or (ii) for the months of November, December, January, and February only of any calendar year or years during which this Agreement may be in place, an amount up to an additional twenty percent (20%) of the monthly quantity of Gas attributable to the Overproduced party or parties. If more than one Underproduced party is entitled and desires to take additional Gas, they shall divide the additional Gas in direct proportion to what each such party's percentage interest bears to the total percentage interest of all Underproduced parties desiring to take the additional Gas. The first Gas made up in any Balancing of the accounts shall be considered to be the first Gas Underproduced.

**C. Filing Monthly Statement of Gas Volumes Taken With Unit Operator.**

In the event Gas produced from the Unitized Formation is sold to two or more Gas purchasers, then, within sixty (60) days after the end of each calendar month, each party shall supply a written statement of the volume and the Btu content of the Gas it took from the Unitized Formation and the identity of its Gas purchaser, if any, to Unit Operator at the following address:

Gillespie-Crow, Inc.  
Post Office Box 2557  
Midland, Texas 79702-2557

The above address may be changed from time to time and notice of such change of address shall be deemed to be received when sent by certified mail to each working interest owner's last known mailing address. Unit Operator shall maintain appropriate accounting on a monthly and cumulative basis of the quantities of Gas each party is entitled to take and/or market and the quantities

of Gas actually taken and/or marketed by each of the parties. With respect to Gas purchased from or transported for more than one party by or through any pipeline connected to a Unit well, each party selling to or transporting through such pipeline shall furnish to Unit Operator or cause the pipeline owner to furnish to Unit Operator monthly volume statements showing the split of ownership through such pipeline's sales or pipeline inlet meter for each such well for each calendar month.

In the event Gas taken or sold from the Unitized Formation during any single production month results in an imbalance in the Gas production accounts of the parties, or the accounts of the parties were previously not Balanced, then, within ninety (90) days after the end of each such calendar month, Unit Operator shall furnish each party a statement showing the then current status of the Overproduced and Underproduced accounts of all parties.

If any party does not provide Unit Operator with the monthly statement of volume and the Btu content of the Gas taken when required to do so by the terms of this Agreement, then each such party shall not have the right to balance its account pursuant to the provisions of cash balancing found in Article IV of this Agreement.

To determine respective volumes of Gas taken by separate Gas pipelines connected to Unit wells, measurement of Gas for overproduction and underproduction shall be accomplished by use of sales meters and lease measurement equipment which shall be in accordance with American Gas Association requirements.

Each party agrees that it will not utilize any information obtained hereunder for any purpose other than implementing or administering the terms of this Agreement.

#### **D. Payment of Royalty and Production Taxes.**

At all times while Gas is produced from the Unitized Formation, unless otherwise required by any State or Federal law or regulations, each party shall pay, or cause to be paid, all royalty due and payable on its share of Gas production. Each party agrees to hold each other party harmless from any and all claims for royalty payments asserted by its royalty owners.

Each party taking Gas off the lease or delivering Gas to its Gas purchaser shall pay, or cause to be paid, all production and severance taxes due on all volumes of Gas it takes or sells to a Gas purchaser.

#### **IV. OPTIONAL CASH BALANCING IN THE EVENT OF AN OWNERSHIP CHANGE:**

In the event an Overproduced party intends to sell, assign, exchange, or otherwise transfer any of its interests in the Unitized Formation, it shall notify in writing, sent by certified mail, the other

working interest owners in the Unit of such fact within forty-five (45) days prior to closing the transaction. Within twenty (20) days after receipt of the Overproduced party's notice of its intent to sell, assign, exchange, or otherwise transfer its interests in the Unitized Formation, any Underproduced party may make a written demand upon the Overproduced party in question for cash settlement of the Underproduced party's share of the total Underproduction in the Unitized Formation, not to exceed the Overproduced party's Gas imbalance. If more than one Underproduced party wishes to cash balance its Gas account, then each Underproduced party shall have the right to receive cash settlement of its proportionate share of the total volume of Gas Underproduced by those Underproduced parties seeking a cash settlement until the Gas accounts of all Underproduced parties in question are Balanced or the amount of the Overproduced party's Gas imbalance is Balanced, whichever occurs first. Unit Operator shall immediately be notified of any demand for cash settlement made pursuant to this Article. After a cash settlement has been made, Unit Operator shall be immediately notified and the Gas balance accounts of the parties shall be adjusted accordingly. Any cash settlement made pursuant to this Article shall be on the same basis as is set forth in Article V(B) below.

The provisions of this Article shall not be applicable in the event an Overproduced party has mortgaged its interest, or disposed of its interest by merger, reorganization, consolidation, or sale of substantially all of its assets to a subsidiary or parent company, or to any company in which any parent or subsidiary owns a majority of the voting stock of such company.

**V. FINAL CASH BALANCING:**

**A. Gas Imbalance.**

If, at termination of the Unit, an imbalance in Gas production exists between the parties, then a cash settlement shall be made among the parties for the total volume of the Gas imbalance.

**B. Distribution of Final Gas Balancing Statement and Settlement of Cash Imbalance.**

Within one hundred twenty (120) days after termination of the Unit, Unit Operator shall provide a final accounting of the Gas imbalance to all parties hereto. As part of the final accounting process, Unit Operator shall calculate the amount of Gas (based on volume and Btu content, but not on price, and calculated monthly basis) that each Overproduced party owes to each Underproduced party. If there is more than one Underproduced party, then the total volume of Gas overproduced shall be divided among all of the Underproduced parties in proportion to their percentage interest in said Gas, and each Overproduced party shall calculate its cash payment to each Underproduced party based on either:

- (1) the volume of Gas remaining in the Overproduced party's Gas account immediately after the last cash settlement made with

any party or parties pursuant to the provisions of Article IV above; or

- (2) if there has been no prior cash settlement made pursuant to the provisions of Article IV above, then the actual proceeds received by the Overproduced party or parties for the Overproduced share of Gas.

Where applicable, the value of the Gas Overproduced shall be based on the Alternate Price established pursuant to Article I(B) above. Each Overproduced party shall make settlement directly to each underproduced party.

Each Overproduced party shall cash settle with each Underproduced party within thirty (30) days after receipt from the Unit Operator of the statement showing the Overproduced party's volumetric and Btu content overproduction in the Unitized Formation. Payments made by an Overproduced party to an Underproduced party shall relieve the Overproduced party of liability to any other party for the sums actually paid. Unit Operator shall not be liable to any party for the failure of any Overproduced party to pay any amounts owed pursuant to the terms hereof.

#### **VI. DEDUCTIONS FROM CASH SETTLEMENT:**

When preparing a cash settlement with any Underproduced party, an Overproduced party may deduct actual costs incurred for the following items, but only to the extent they have not been previously deducted from a previous cash settlement: Gathering and transportation charges, compression, dehydration and any applicable treating charges, and production and severance taxes paid by, or on behalf of, such Overproduced party. Royalty payments may be deducted from such proceeds attributable to the overproduction only if actually paid to royalty owners by, or on behalf of, an Overproduced party, and then only to the extent the amount of royalty paid is not in excess of the royalty owners' share of royalty.

#### **VII. MISCELLANEOUS:**

##### **A. Term.**

This Agreement shall remain in effect until the Gas balance accounts between the parties are settled in full, and the two year audit period provided for in Article VII(E) below has ended. This agreement shall inure to the benefit of and be binding upon the parties, their heirs, devisees, successors, legal representatives, and assigns.

##### **B. Intent of the Parties.**

Subject to the provisions of Article IV above, it is the intent of the parties to only cash balance the Gas imbalance of the

parties when the Unit is terminated.

**C. Expenses.**

Nothing herein shall change or affect each party's obligation to pay its proportionate share of all costs and liabilities incurred for operations pursuant to the Unit Operating Agreement.

**D. Interest.**

No interest shall be payable in any cash settlement made pursuant to the provisions of this Agreement, except in the event an Overproduced party fails to remit payment to an Underproduced party within forty-five (45) days after Unit Operator has mailed notice to said Overproduced party that an Underproduced party wishes to cash balance pursuant to the provisions of Article IV or Article V(B) above. If payment is not made to the Underproduced party within said forty-five (45) day period, interest shall accrue on the unpaid balance at a rate of two percent (2%) above the prime rate at Citibank, N.A. of New York, New York, or any successor bank, or the maximum interest rate allowed by law in the jurisdiction where the Unit is located, whichever is the lesser percentage, from a date commencing forty-five (45) days after Unit Operator has mailed notice to the Overproduced party until payment is actually made by the Overproduced party.

**E. Audits.**

Notwithstanding any provision to the contrary found in the Unit Operating Agreement or any other exhibit attached thereto, any party shall have the right to audit the records of any other party for the following length of time:

For any cash payment made pursuant to the provisions of this Agreement, each party shall have the right for a period of two (2) years following the date of the final cash settlement to audit the records relating to price and volume of all Gas taken or sold, including Btu adjustments, of any other party.

Each party agrees to retain information on the volume of Gas taken or sold each month from the Unitized Formation, the Btu content of such Gas, and the price per MCF he or it received for such Gas for the period of time stated immediately above.

**F. Well Tests.**

Nothing herein shall be construed to deny any party the right, from time to time, to produce and take or deliver to its Gas purchaser up to one hundred percent (100%) of the entire well stream of any well producing from the Unitized Formation to meet a deliverability test required by its Gas purchaser, provided such tests are reasonable in light of overall industry standards.

**G. Monitoring of Takes of Production.**

Each party shall at all times use its best efforts to regulate its takes and deliveries from each Gas well producing from the Unitized Formation so that, where applicable, the Unit will not be shut-in for overproducing the allowable assigned to it by the regulatory body having jurisdiction. Additionally, each party shall communicate, as necessary, the contents of this Agreement to its respective Gas purchaser(s) or transporter(s) so as to ensure, to the greatest extent practicable, that its Gas purchaser(s) or transporter(s) does not take Gas in excess of the quantities provided for herein.

**H. Monies Subject to Refund.**

In any cash settlement made pursuant to the terms of this Agreement, that portion of the monies received by an Overproduced party which is subject to refund by order of the Federal Energy Regulatory Commission ("FERC") or any other governmental authority may be withheld by the Overproduced party until such prices are fully approved by the governmental agency in question, unless an Underproduced party furnishes an undertaking acceptable to the Overproduced party or parties, agreeing to hold the Overproduced party or parties harmless from financial loss due to the pending refund. If any refund is required by any governmental authority after a cash settlement has been made pursuant to the terms of this Agreement, each party agrees to account for its respective share of such refund.

**I. Sales to an Affiliate, and Valuation of Stored Gas or Gas Used Off Lease.**

If an Overproduced party has sold Gas to an Affiliate, or stored Gas or used Gas off lease, then for the purposes of Article IV and Article V of this Agreement, any Gas so sold, stored, or used off lease shall be valued at the Alternate Price as such term is defined in Article I(B) of this Agreement.

**J. Attorney Fees and Court Costs.**

The party who prevails or substantially prevails in any lawsuit or other proceeding brought to enforce any provision of this Agreement shall be entitled to receive reimbursement from the losing party for all court costs and reasonable attorney fees incurred in connection with said action.

**K. Governing Law.**

This Agreement and all matters pertaining hereto, including, but not limited to, matters of performance, non-performance, breach, remedies, rights, duties, and the interpretation or construction, shall be construed and enforced in accordance with the laws of the jurisdiction in which the Unit is located.

**L. Overproduced Party Shall Notify Unit Operator that Payment Has Been Made.**

Within thirty (30) days after an Overproduced party has paid an Underproduced party for all or a portion of the value of the Overproduced party's overproduction pursuant to the provisions of Article IV or Article V(B) of this Agreement, the Overproduced party shall notify Unit Operator in writing of the volume of Gas (expressed in MCF and the corresponding Btu content) covered by the payment and the party to whom such payment was made, so Unit Operator may maintain a current and accurate gas balancing statement for all parties.

h.exh

**AMENDED ADVERTISEMENT**

Case 11195: Application of Gillespie-Crow, Inc. for statutory unitization, Lea County, New Mexico. Applicant, in the above-styled cause, seeks an order unitizing, for the purpose of establishing a pressure maintenance project, all mineral interests in the designated and Undesignated West Lovington-Strawn Pool underlying its proposed West Lovington Strawn Unit Area encompassing some 1458.95-acres, more or less, of Federal, State, and Fee lands comprising all of Section 33 and the W½ of Section 34, Township 15 South, Range 35 East, a portion of Section 1, Township 16 South, Range 35 East, and a portion of Section 6, Township 16 South, Range 36 East. Among the matters to be considered at the hearing, pursuant to the "New Mexico Statutory Unitization Act," Sections 70-7-1 et. seq., NMSA, will be the necessity of unit operations; the designation of a unit operator; the determination of horizontal and vertical limits of the unit area; the determination of the fair, reasonable and equitable allocation of production and costs of production, including capital investments, to each of the various tracts in the unit area; the determination of credits and changes to be made among the various owners in the unit area of their investment in wells and equipment; and such other matters as may be necessary and appropriate for carrying on efficient unit operations, including, but not necessarily limited to unit voting procedures, selection, removal or substitution of the unit operator, and time of commencement and termination of unit operations. Said unit area is centered approximately 4.5 miles West-Northwest of Lovington, New Mexico.