

Section 6

Existing MMS Payment Regulations Valuation Standards (*CFR Ch II 206.102*)

(h):

“Notwithstanding any other provision of this section, under no circumstances shall the value of production, for royalty purposes, be less than the gross proceeds accruing to the lessee ...”

Gross Proceeds: “... the total monies and other consideration accruing to an oil and gas lessee ...”

(j):

“Value shall be based on the highest price a prudent lessee can receive ...”



United States Crude Oil Royalty Payment Regulations

Suggested Modifications Presented 9/5/96

J. Benjamin Johnson

Summit Resource Management, Inc.

MMS Crude Oil Payment Regulation Meeting: 9/5/96



Payment Regulation Discussion Outline

- **Current Crude Oil Marketing Practices**
- **Goals of New Payment Regulations**
- **Conceptual Basis**
- **Suggested Changes to Existing Regulations**
- **Implementation of Suggested Changes**
- **Administration of New System**

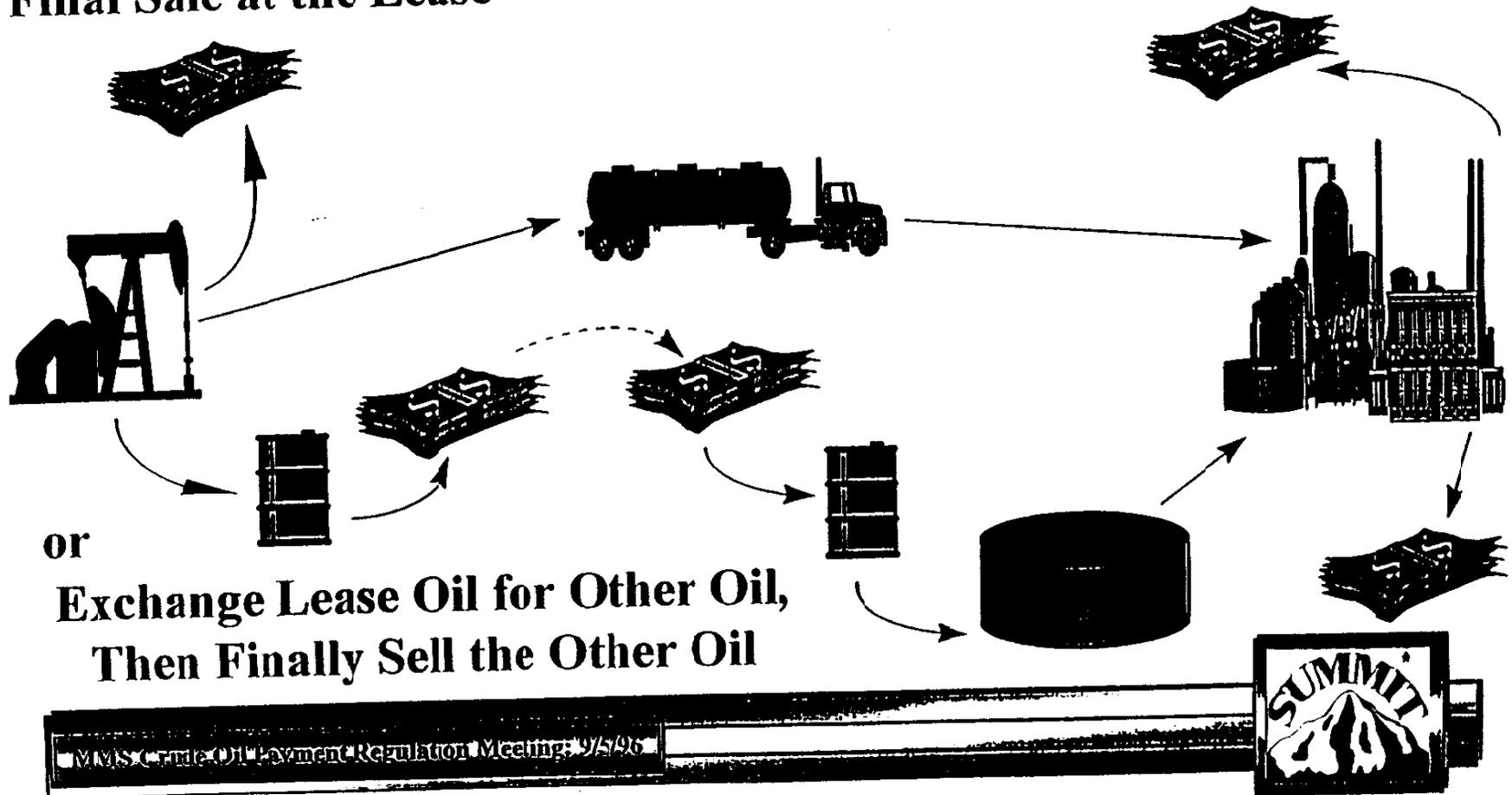


Three Basic Methods to Market Lease Crude Oil

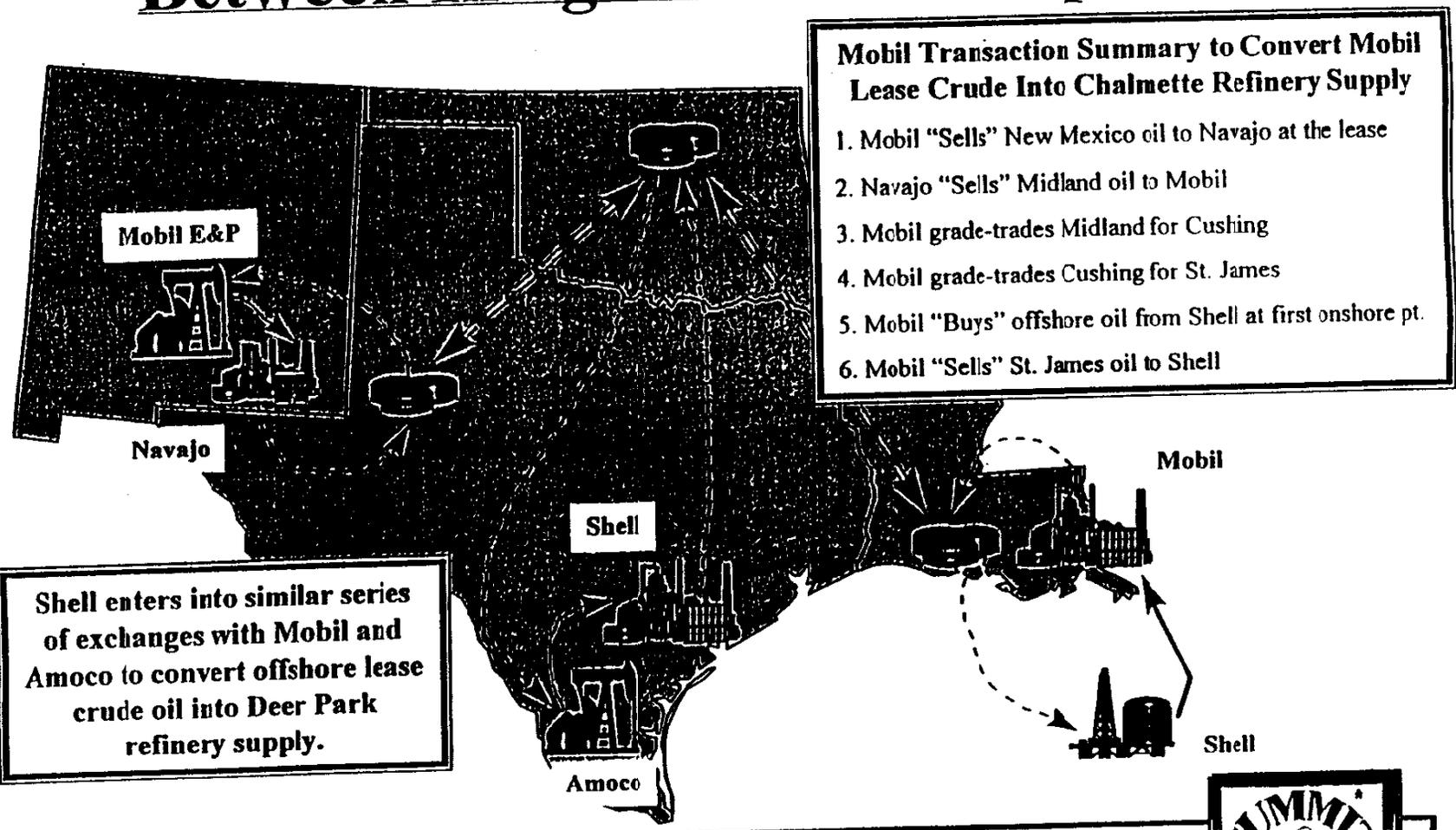
Final Sale at the Lease

or

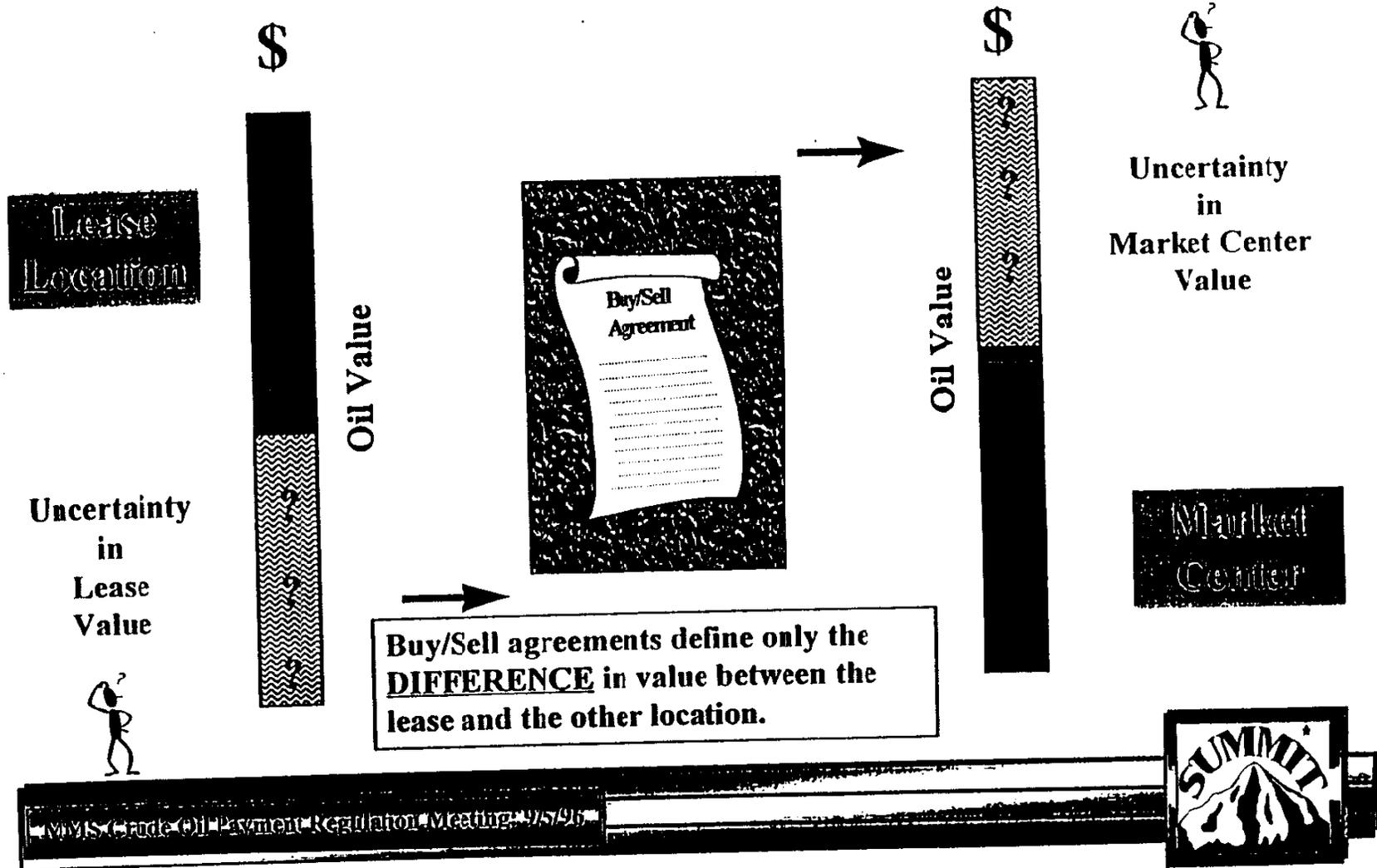
Transport to a
Purchaser, Then Sell



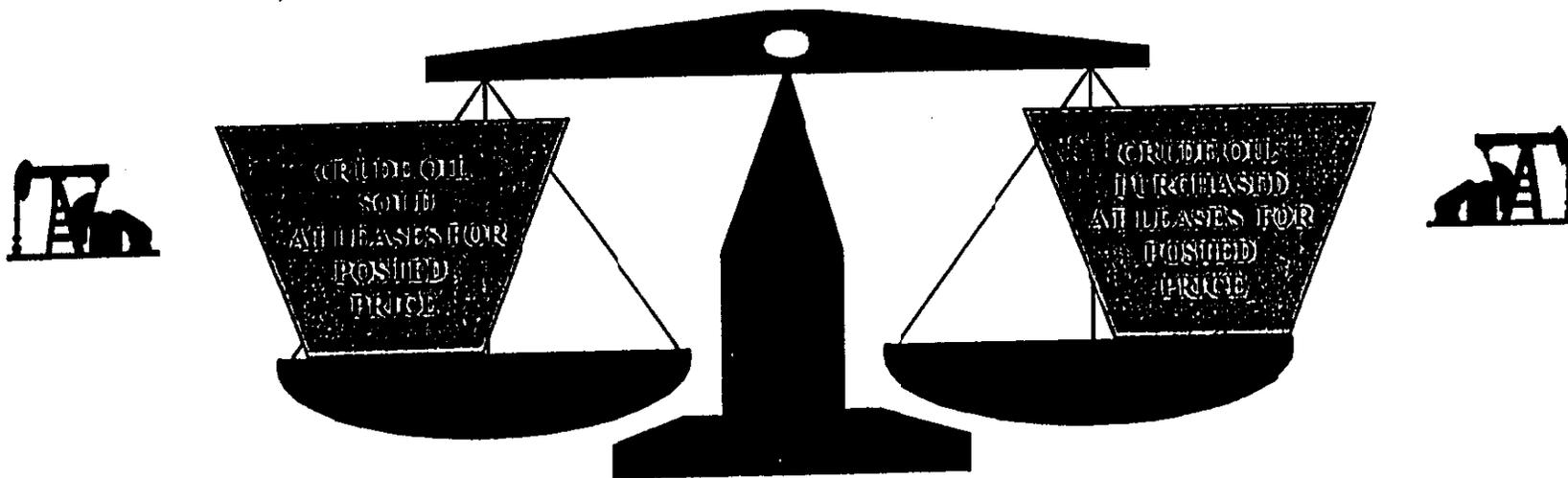
Typical Crude Oil Marketing Relationships Between Integrated Oil Companies



Buy/Sell Agreements Do Not Show Actual Market Value



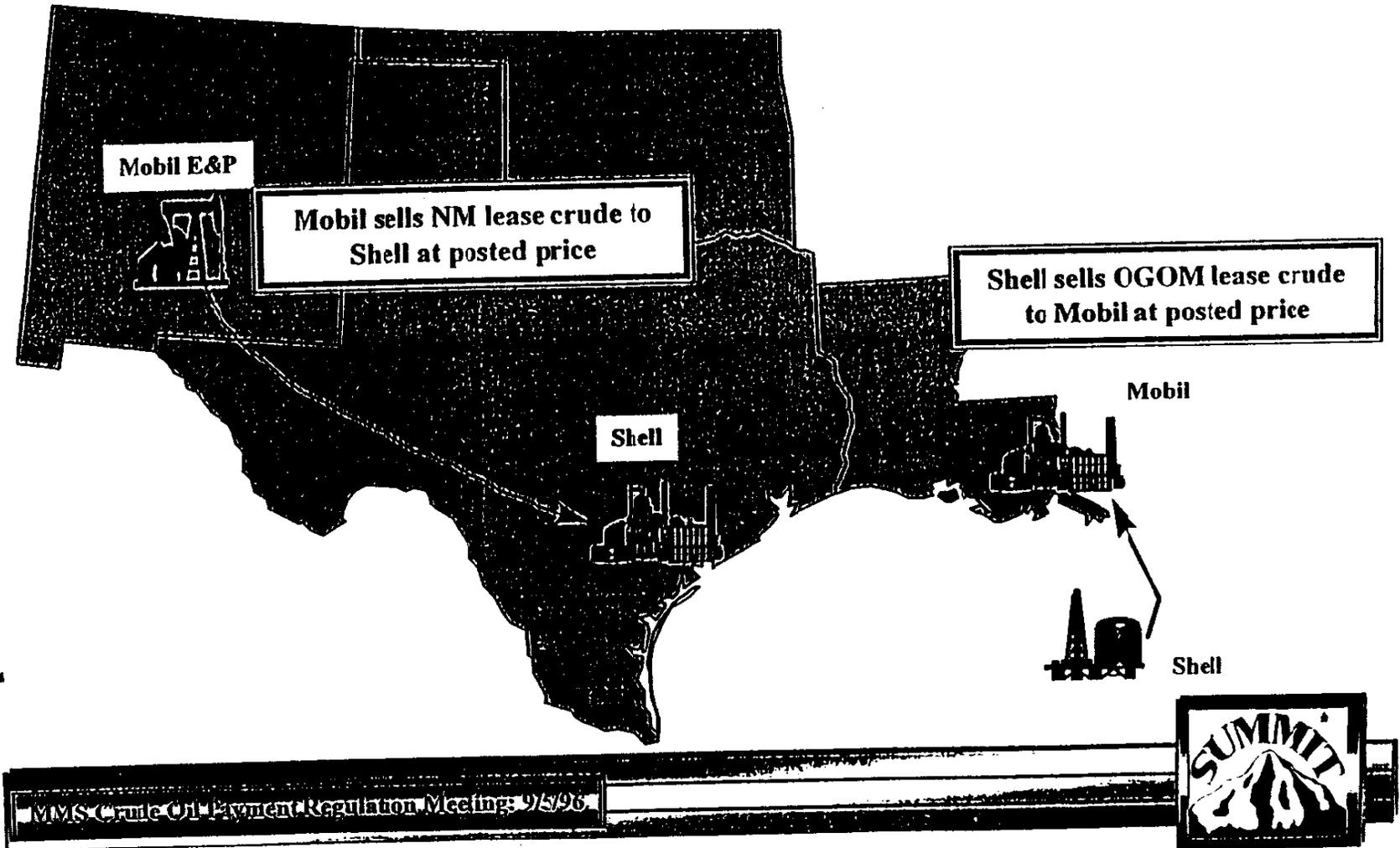
“Overall Balance”: Implied Exchange Transaction



As long as two companies sell approximately equal volumes to each other, the *absolute* price isn't important. In fact, because of reduced royalty and severance tax payments, the volumes don't even have to be exactly equal for both parties to benefit from setting the posted lease prices below full value. There may not even be written contracts reflecting the exchanges.



Example of Overall Balance



Crude Oil Value Affected By Quality

- API gravity scales in Posted Prices are sometimes used
- Most actual lease marketing contracts “*deem*” API gravity when deductions are applied to posted price bases
- Actual deductions for crude oil quality are usually negotiated
- Some market centers have “gravity banks” to adjust price for quality



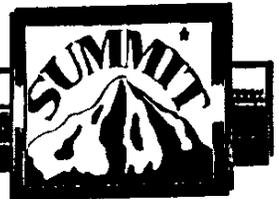
Summary of Current Crude Oil Marketing Practices

- **Few truly outright sales by major producers**
- **Independents commonly sell outright**
 - Many Independents use sophisticated sales
- **Most Majors utilize buy/sell exchanges**
- **Overall Balance concept used by several Majors**
- **Price adjustments for quality are commonly negotiated on each contract**



Goals of Revised Regulations

- **Fair to Payors and Federal Government**
 - Meets obligations of lease agreements
- **Understandable**
 - To Payors
 - To MMS Auditors
- **Minimal changes to existing system**
- **Compatible with Payors' existing systems**
- **Compatible with actual marketplace**
- **Difficult for Payors to manipulate**



Current MMS Crude Oil Payment Regulations - Issues

- **Current regulations require payment on full value received, but changes could better reflect actual marketing practices**
 - **Current reg's seem to assume that posted prices may represent "market value" of lease crude oil**
 - **Posted prices can be arbitrarily set by Payors**
 - **Current reg's do not readily acknowledge common buy/sell contracts or non-arms-length sales**
 - **"First Sale" price can easily be manipulated to hide actual value received for lease crude oil**



Challenges in Developing Revised Payment Regulations

- Any system can be manipulated
- There is no “perfect” system
- Balance between:
 - Accuracy in recognizing full value received
 - Ease in auditing and compliance monitoring



Two Conceptual Approaches to Royalty Payment Obligations:

- **Actual value received for oil at the lease:**
 - Recognizes full value obtained by prudent oil producers
 - Difficult to audit and detect underpayments
- **General “Market Value” basis:**
 - Easy to ensure that payments equal value basis
 - Difficult or impossible to determine the appropriate “Market Value” without access to actual marketing arrangements



“Actual Value” Payment Issues

- **Requires complete disclosure of marketing arrangements by Payor**
 - **Ensure that sales were arms-length**
 - **No other value received in return for lease crude oil**
 - **Includes service discounts, discounts on other sales, etc.**
 - **No affiliation between Buyer and Seller**
- **Actual Value may be sales or exchanges**
 - **How far downstream to follow exchanges?**
- **Easy compliance for some payors**



“Actual Value” Payment Issues

(cont.)

- **Reporting and paying federal royalties on actual receipts may divulge proprietary marketing arrangements**
 - **Some states require payment of all royalties on the same price**
- **Burden of Proof must be on Payor to show actual value received**
 - **Marketing arrangements must meet several strict audit tests**



“Market Value” Payment Issues

- **Option 1: Purely theoretical application**
 - **“Net-back” calculation**
 - **Market center spot value**
 - What basis?
 - **Published transportation deduction**
 - Potential overstatement of transport deduction
 - **Quality deduction**
 - What basis for determining quality valuation?
 - **Assumes that MMS knows at least as much about specific lease crude oil value as the producers**
 - **Difficult without access to actual market data**



“Market Value” Payment Issues

(cont.)

- **Option 2 (*recommended*): Use of Actual data to compile an “average” for each area**
 - **Should be based on “exchange pricing” rather than absolute**
 - **Exchange differences do not change often**
 - **Actual market factors in known areas can be extended to develop theoretical values for application in cases where no actual values are reported**



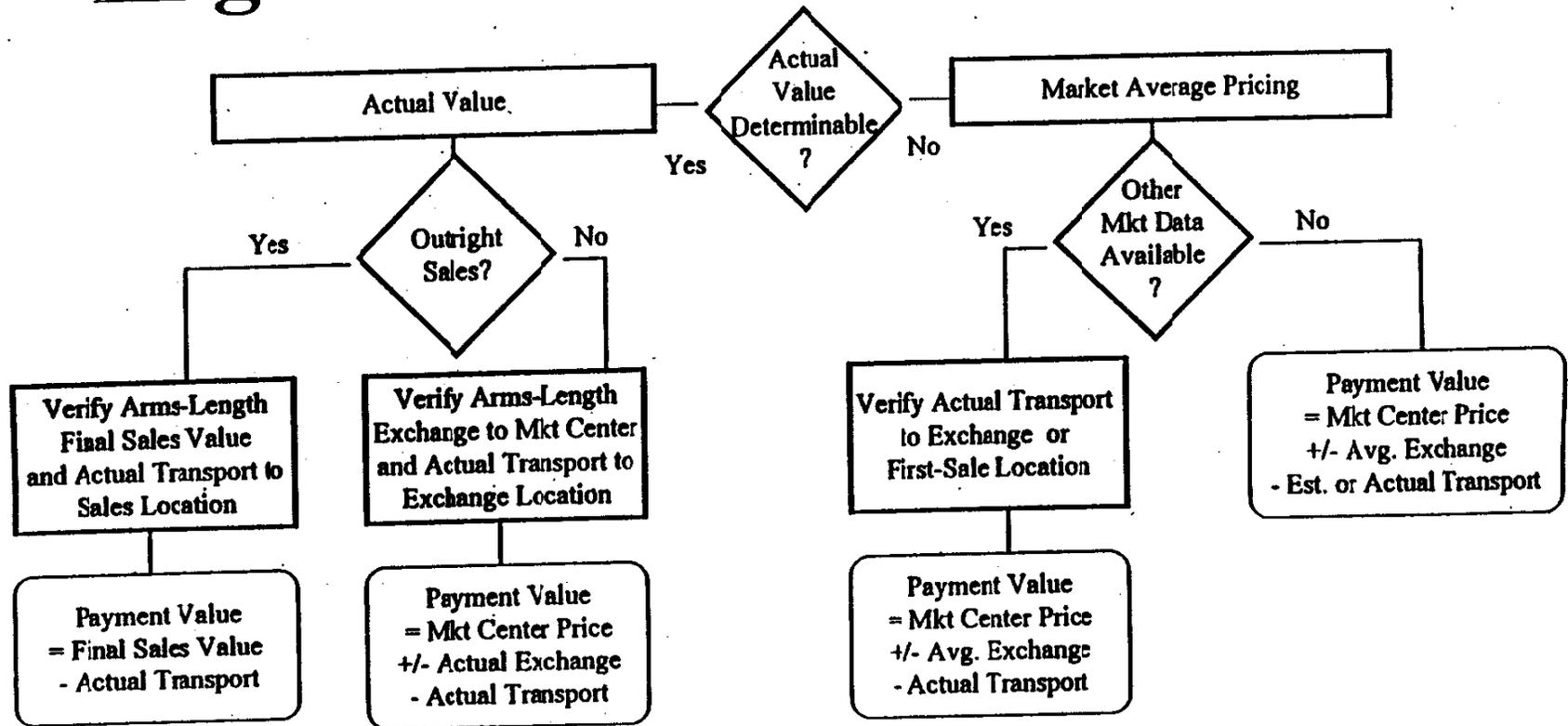
Suggested Revised Payment Basis

Summary

- All payors provide MMS with complete marketing information
 - Kept confidential by MMS
- Valuation basis:
 - If actual value or actual exchange to market center is known, use actual value received:
 - Outright sale
 - Exchange to market center
 - If actual value or exchange not known, use Market Average Pricing
 - Established by MMS based on actual reported data



Suggested Revised Payment Regulation Flow Chart Summary



Required Data Provided to MMS

- **Outright sale terms**
 - **Declare if arms-length sale**
 - **Define price basis and premiums**
 - **Include all formulae used**
 - **Define actual transportation costs from lease to sale location**
 - **If using buy/sell for transport, define all buy/sell terms**
 - **Define actual quality adjustment terms**
 - **List actual quality parameters (API, S, ...) if using a “deemed” price adjustment factor**



Required Data Provided to MMS (cont.)

- **Exchange terms**
 - Declare if arms-length exchange
 - All pricing terms and formulae for all locations
 - Location of each exchange point
 - Define actual transportation costs from lease to first-sale location
 - If using buy/sell for transport, define all buy/sell terms
 - Define actual quality adjustment terms
 - List actual quality parameters (API, S, ...) if using a “deemed” price adjustment factor



Market Average Price Basis Recommendation

- Use “Adjusted NYMEX Settle” or “Posting-Plus” as Basis for Cushing, OK Delivery Price
 - “Adjusted NYMEX Settle” is similar to “Posting-Plus”, except that no posted prices are required
 - Continues natural hedge for refiners like posting
 - Oil conceptually priced during delivery like posting
 - Can be exactly bought/hedged/traded/sold on the NYMEX settle prices
 - Corrects arbitrage potential from simply using NYMEX settle prices alone



“Adjusted NYMEX Settle”

Calculation

- **NYMEX Time Factor Differential (“TFD”)** determined every trading day while the delivery month is prompt month on NYMEX
- **Daily TFD’s averaged together to determine appropriate average TFD**
 - Average TFD determined prior to delivery month
- **Actual delivery price is average of NYMEX Prompt settle during delivery month, plus or minus average TFD**



Time Factor Differential Formula

$$\text{TFD} = \text{MTM}_{(1-2)} \times A/D + \text{MTM}_{(1-3)} \times B/D$$

Where:

MTM₍₁₋₂₎ = NYMEX settle price for Prompt month, minus settle price for 2nd month on strip

MTM₍₁₋₃₎ = NYMEX settle price for Prompt month, minus settle price for 3rd month on strip

A = Number of days in delivery month when Prompt month traded on NYMEX is the first calendar month following trading month

B = Number of days in delivery month when Prompt month traded on NYMEX is the second calendar month following trading month

D = Number of days in delivery month



Example of Time Factor Differential Calculation

Performed on September 3, 1996 for October 1996 Deliveries

NYMEX Settle Prices on September 3, 1996:

Oct 96: \$23.40, Nov 96: \$22.66, Dec 1996: \$22.05

During October delivery month, November will trade as prompt through October 22, then December will trade as prompt. October has 31 days.

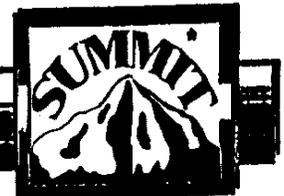
$$\text{TFD} = (23.40 - 22.66)(22/31) + (23.40 - 22.05)(9/31) = \$0.917/\text{BBL}$$

This means that a party selling October crude oil based on the NYMEX settle prices during the month of October could receive \$0.917/BBL over the average of the NYMEX prompt settle prices during October, including weekends and holidays in the average at the same NYMEX value as the previous trading day.

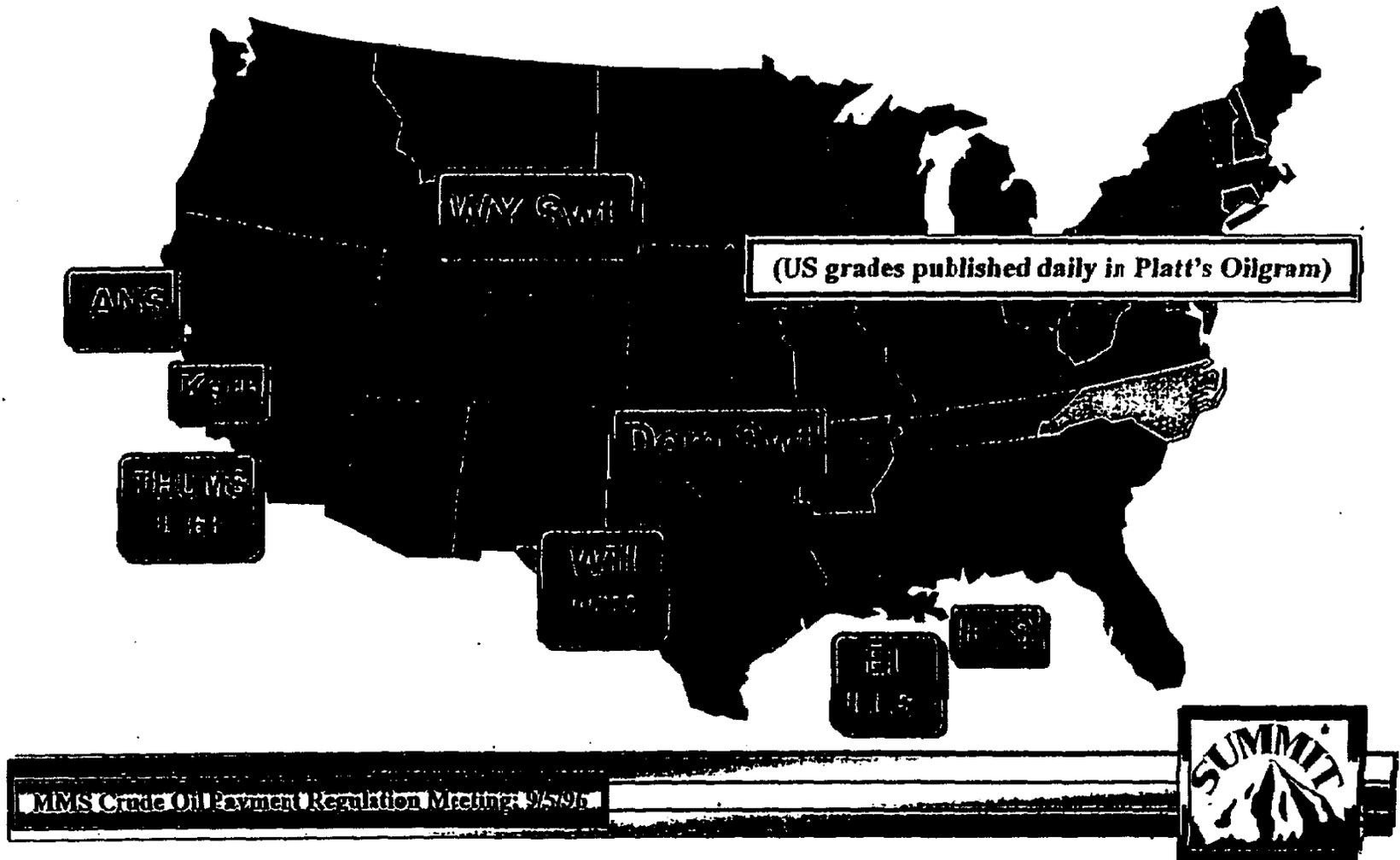


Market Average Price Basis Recommendation (cont.)

- Use Platt's Oilgram differentials for grade trade differentials between Cushing and major market centers
 - Using average of trading days while delivery month is prompt on cash market
 - From 26th day of two months prior to delivery, through 25th day of one month prior to delivery
 - Platt's is not perfect, but currently best reflects actual market values
 - Recognize potential to evolve/improve



US Grade Trading Locations Published in Platt's Oilgram



Market Average Exchange Differential Establishment Procedure

- Payors report actual exchange terms
- MMS calculates and publishes market average every 6 months ✓
 - Based on common aggregation points to public spot market centers
 - MMS establishes market differentials in areas where no reported data is available
 - Extrapolating from known areas
- Payors can challenge MMS differentials



Procedure for Challenging MMS Market Average Exchange Differential

- **Burden of proof on challenger to show that MMS differential is not reasonable**
 - (If a party has actual exchange values, then it is supposed to pay based on those values)
- **If MMS agrees with challenger, after reviewing actual data, it has two choices:**
 - Apply to challenger only
 - Modify Average Exchange Differential for all affected parties

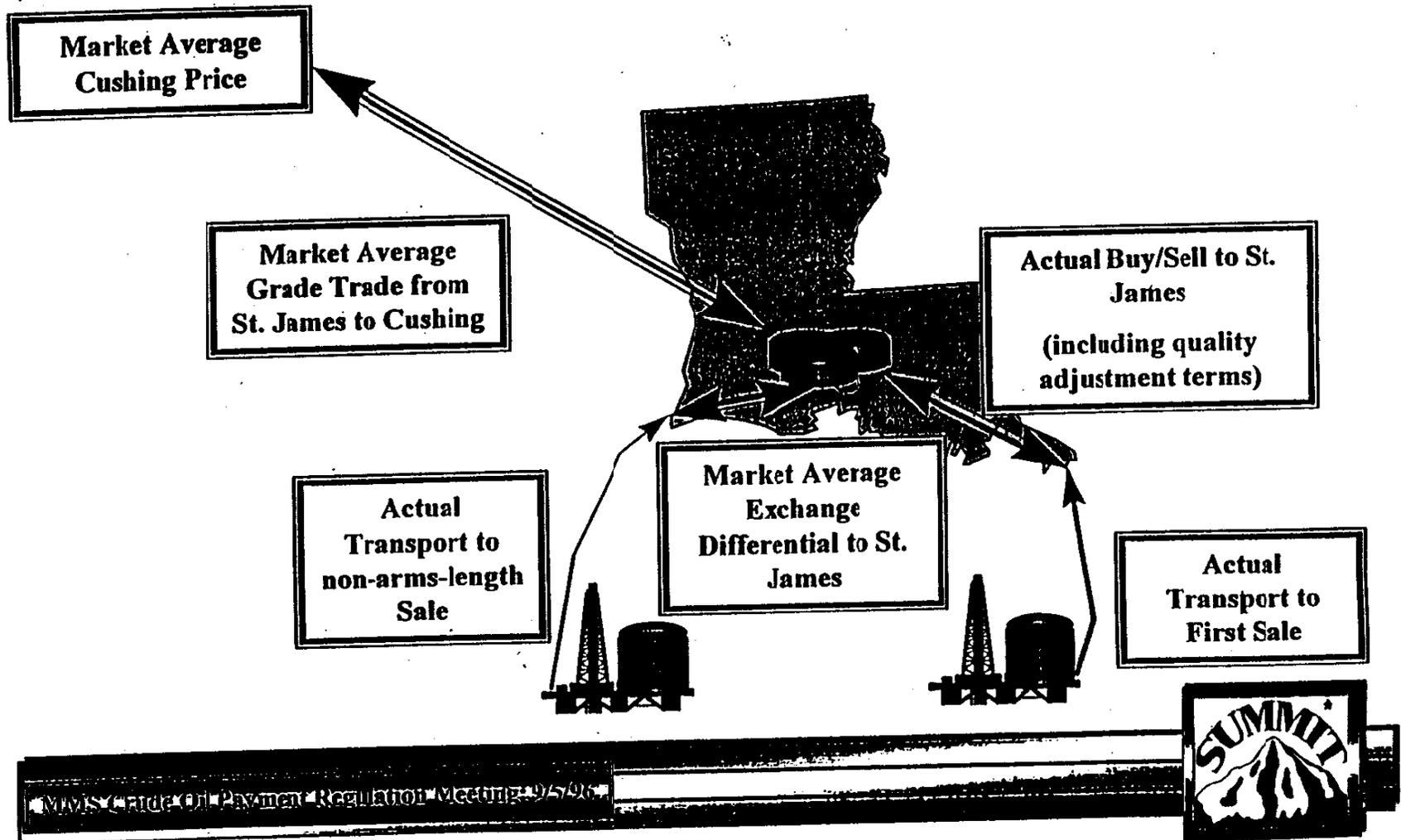


Use of Mean or Median for Average Exchange Differential

- Should be volume weighted calculation
- Use of the Mean should provide best approximation to total value which would have been received by MMS if all parties had paid on actual receipts.



Conceptual Summary of Suggested Revised MMS Payment Regulations



Attributes of New Suggested MMS Crude Oil Payment Regulations

- Matches payment regulations to typical crude oil marketing practices
- ✓ • Allows companies to continue paying on actual receipts where appropriate
- Market average price differentials could be used to establish “pseudo-postings” to fit into existing oil company payment systems with essentially no system modifications required



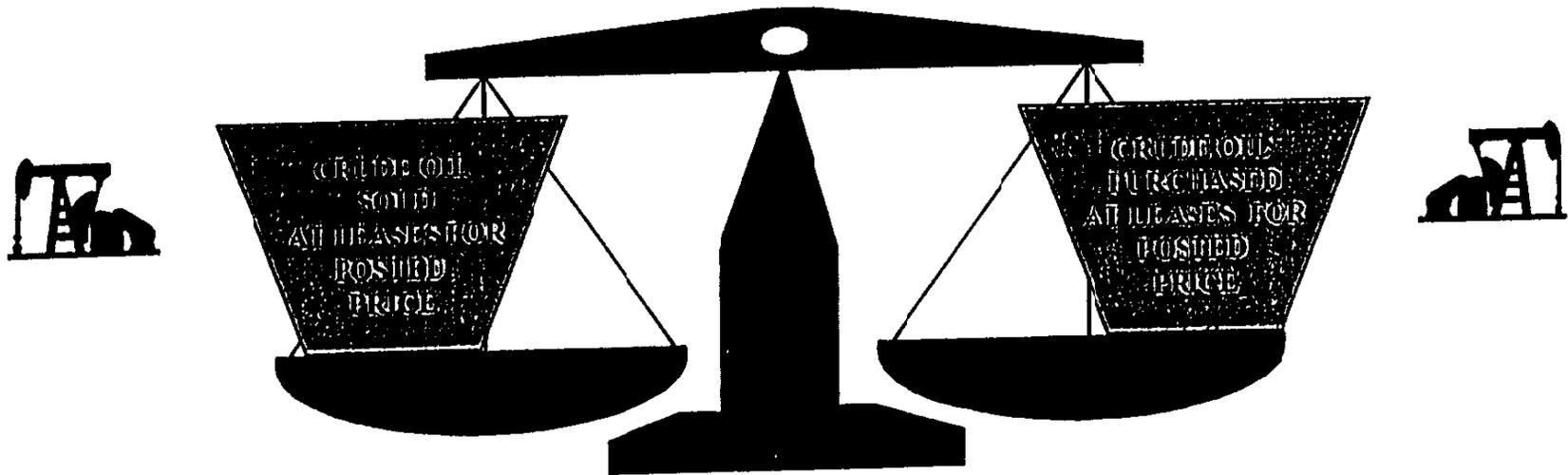
Section 7

Summary of Current Crude Oil Marketing Practices

- **Few truly outright sales by major producers**
- **Independents commonly sell outright**
 - Many Independents use sophisticated sales
- **Most Majors utilize buy/sell exchanges**
- **Overall Balance concept used by several Majors**
- **Price adjustments for quality are commonly negotiated on each contract**



“Overall Balance”: Implied Exchange Transaction



As long as two companies sell approximately equal volumes to each other, the *absolute* price isn't important. In fact, because of reduced royalty and severance tax payments, the volumes don't even have to be exactly equal for both parties to benefit from setting the posted lease prices below full value. There may not even be written contracts reflecting the exchanges.



Section 8

Exhibit "C3"

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

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

_____, 19____,

OPERATOR _____

CONTRACT AREA _____

COUNTY OR PARISH OF _____ STATE OF _____

COPYRIGHT 1977 -- ALL RIGHTS RESERVED
AMERICAN ASSOCIATION OF PETROLEUM LANDMEN
APPROVED FORM A.A.P.L. NO. 610 1977 REVISED
MAY BE ORDERED DIRECTLY FROM THE PUBLISHER
KRAFTBLT PRODUCTS, BOX 800, TULSA, OK 74101

TABLE OF CONTENTS

<u>Article</u>	<u>Title</u>	<u>Page</u>
I.	DEFINITIONS	1
II.	EXHIBITS	1
III.	INTERESTS OF PARTIES	2
	A. OIL AND GAS INTERESTS	2
	B. INTEREST OF PARTIES IN COSTS AND PRODUCTION	2
IV.	TITLES	2
	A. TITLE EXAMINATION	2
	B. LOSS OF TITLE	2-3
	1. Failure of Title	3
	2. Loss by Non-Payment or Erroneous Payment of Amount Due	3
	3. Other Losses	3
V.	OPERATOR	3
	A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR	4
	B. RESIGNATION OR REMOVAL OF OPERATOR AND SELECTION OF SUCCESSOR	4
	1. Resignation or Removal of Operator	4
	2. Selection of Successor Operator	4
	C. EMPLOYEES	4
	D. DRILLING CONTRACTS	4
VI.	DRILLING AND DEVELOPMENT	4
	A. INITIAL WELL	5
	B. SUBSEQUENT OPERATIONS	5
	1. Proposed Operations	5-6
	2. Operations by Less than All Parties	6-7
	C. RIGHT TO TAKE PRODUCTION IN KIND	7
	D. ACCESS TO CONTRACT AREA AND INFORMATION	7
	E. ABANDONMENT OF WELLS	7
	1. Abandonment of Dry Holes	7-8
	2. Abandonment of Wells that have Produced	8
VII.	EXPENDITURES AND LIABILITY OF PARTIES	8
	A. LIABILITY OF PARTIES	8
	B. LIENS AND PAYMENT DEFAULTS	8
	C. PAYMENTS AND ACCOUNTING	9
	D. LIMITATION OF EXPENDITURES	9
	1. Drill or Deepen	9
	2. Rework or Plug Back	9
	3. Other Operations	9
	E. ROYALTIES, OVERRIDING ROYALTIES AND OTHER PAYMENTS	9-10
	F. RENTALS, SHUT-IN WELL PAYMENTS AND MINIMUM ROYALTIES	10
	G. TAXES	10
	H. INSURANCE	10
VIII.	ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST	10-11
	A. SURRENDER OF LEASES	11
	B. RENEWAL OR EXTENSION OF LEASES	11
	C. ACREAGE OR CASH CONTRIBUTION	11-12
	D. SUBSEQUENTLY CREATED INTEREST	12
	E. MAINTENANCE OF UNIFORM INTEREST	12
	F. WAIVER OF RIGHT TO PARTITION	12
	G. PREFERENTIAL RIGHT TO PURCHASE	12-13
IX.	INTERNAL REVENUE CODE ELECTION	13
X.	CLAIMS AND LAWSUITS	13
XI.	FORCE MAJEURE	13
XII.	NOTICES	13-14
XIII.	TERM OF AGREEMENT	14
XIV.	COMPLIANCE WITH LAWS AND REGULATIONS	14
	A. LAWS, REGULATIONS AND ORDERS	14
	B. GOVERNING LAW	14
XV.	OTHER PROVISIONS	14
XVI.	MISCELLANEOUS	15

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

4
5 Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's
6 election, shall be sold to its purchaser, if available, under the terms of its existing gas sales con-
7 tract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from
8 such sale direct to the Consenting Parties until the amounts provided for in this Article are recov-
9 ered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not
10 contracted for sale of its gas at the time such gas is available for delivery, or has not made the elec-
11 tion as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-
12 Consenting Party's share of gas as hereinabove provided during the recoupment period.

13
14 During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share
15 of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of
16 all production, severance, gathering and other taxes, and all royalty, overriding royalty and other
17 burdens applicable to Non-Consenting Party's share of production.

18
19 In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall
20 be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of
21 all such equipment shall remain unchanged; and upon abandonment of a well after such reworking,
22 plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the
23 owners thereof, with each party receiving its proportionate part in kind or in value, less cost of
24 salvage.

25
26 Within sixty (60) days after the completion of any operation under this Article, the party con-
27 ducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an in-
28 ventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling,
29 deepening, plugging back, testing, completing, and equipping the well for production; or, at its option,
30 the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed
31 statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being
32 reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furn-
33 ish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the
34 operation of the well, together with a statement of the quantity of oil and gas produced from it and the
35 amount of proceeds realized from the sale of the well's working interest production during the preceding
36 month. In determining the quantity of oil and gas produced during any month, Consenting Parties
37 shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any
38 amount realized from the sale or other disposition of equipment newly acquired in connection with any
39 such operation which would have been owned by a Non-Consenting Party had it participated therein
40 shall be credited against the total unreturned costs of the work done and of the equipment purchased,
41 in determining when the interest of such Non-Consenting Party shall revert to it as above provided;
42 and if there is a credit balance, it shall be paid to such Non-Consenting party.

43
44 If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest
45 the amounts provided for above, the relinquished interests of such Non-Consenting Party shall auto-
46 matically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same
47 interest in such well, the material and equipment in or pertaining thereto, and the production there-
48 from as such Non-Consenting Party would have been entitled to had it participated in the drilling,
49 reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be
50 charged with and shall pay its proportionate part of the further costs of the operation of said well in
51 accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

52
53 Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent
54 of all parties, no wells shall be completed in or produced from a source of supply from which a well
55 located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing
56 well spacing pattern for such source of supply.

57
58 The provisions of this Article shall have no application whatsoever to the drilling of the initial
59 well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b)
60 to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall
61 prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article
62 VI.A.

63 64 **C. Right to Take Production in Kind:**

65
66 Each party shall have the right to take in kind or separately dispose of its proportionate share of
67 all oil and gas produced from the Contract Area, exclusive of production which may be used in de-
68 velopment and producing operations and in preparing and treating oil for marketing purposes and
69 production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate dispo-
70 sition by any party of its proportionate share of the production shall be borne by such party. Any

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

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

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

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

29 D. Access to Contract Area and Information:

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

41 E. Abandonment of Wells:

43 1. Abandonment of Dry Holes: Except for any well drilled pursuant to Article VI.B.2., any well
 44 which has been drilled under the terms of this agreement and is proposed to be completed as a dry hole
 45 shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent
 46 effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours
 47 (exclusive of Saturday, Sunday or legal holidays) after receipt of notice of the proposal to plug and
 48 abandon such well, such party shall be deemed to have consented to the proposed abandonment. All
 49 such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost,
 50 risk and expense of the parties who participated in the cost of drilling of such well. Any party who ob-
 51 jects to the plugging and abandoning such well shall have the right to take over the well and conduct
 52 further operations in search of oil and or gas subject to the provisions of Article VI.B.

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

Section 9

A.A.P.L. FORM 610-1982

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

_____, 19 ____.

OPERATOR _____

CONTRACT AREA _____

COUNTY OR PARISH OF _____ **STATE OF** _____

GUIDANCE IN THE PREPARATION OF THIS AGREEMENT:

1. Title Page - Fill in blanks as applicable.
2. Preamble, Page 1 - Enter name of Operator.
3. Article II - Exhibits:
 - (a) Indicate Exhibits to be attached.
 - (b) If it is desired that no reference be made to non-discrimination, the reference to Exhibit "F" should be deleted.
4. Article III.B. - Interests of Parties in Costs and Production - Enter royalty fraction as agreed to by parties.
5. Article IV.A. - Title Examination - Select option as agreed to by the parties.
6. Article IV.B. - Loss of Title - If "Joint Loss" of Title is desired, the following changes should be made:
 - (a) Delete Articles IV.B.1 and IV.B.2.
 - (b) Article IV.B.3 - Delete phrase "other than those set forth in Articles IV.B.1 and IV.B.2 above."
 - (c) Article VII.E. - Change reference at end of the first grammatical paragraph from "Article IV.B.2" to "Article IV.B.3."
 - (d) Article X. - Add as the concluding sentence - "All claims or suits involving title to any interest subject to this agreement shall be treated as a claim or a suit against all parties hereto."
7. Article V - Operator - Enter name of Operator.
8. Article VI.A. - Initial Well:
 - (a) Date of commencement of drilling.
 - (b) Location of well.
 - (c) Obligation depth.
9. Article VI.B.2.(b) - Subsequent Operations - Enter penalty percentage as agreed to by parties.
10. Article VI.C. - Taking Production in Kind - If a Gas Balancing Agreement is not in existence nor attached hereto as Exhibit "E", then use Alternate Page 8.
11. Article VII.D.1. - Limitation of Expenditures - Select option as agreed to by parties.
12. Article VII.D.3. - Limitation of Expenditures - Enter limitation of expenditure of Operator for single project and amount above which Operator may furnish information AFE.
13. Article IX. - Internal Revenue Code Election - Delete this article in the event the agreement is a Tax Partnership and Exhibit "G" is attached.
14. Article X. - Claims and Lawsuits - Enter claim limit as agreed to by parties.
15. Article XIII. - Term of Agreement:
 - (a) Select Option as agreed to by parties.
 - (b) If Option No. 2 is selected, enter agreed number of days in two (2) blanks.
16. Article XIV.B - Governing Law - Enter state as agreed to by parties.
17. Signature Page - Enter effective date.

TABLE OF CONTENTS

<u>Article</u>	<u>Title</u>	<u>Page</u>
I.	<u>DEFINITIONS</u>	1
II.	<u>EXHIBITS</u>	1
III.	<u>INTERESTS OF PARTIES</u>	2
	A. OIL AND GAS INTERESTS	2
	B. INTERESTS OF PARTIES IN COSTS AND PRODUCTION	2
	C. EXCESS ROYALTIES, OVERRIDING ROYALTIES AND OTHER PAYMENTS	2
	D. SUBSEQUENTLY CREATED INTERESTS	2
IV.	<u>TITLES</u>	2
	A. TITLE EXAMINATION	2-3
	B. LOSS OF TITLE	3
	1. Failure of Title	3
	2. Loss by Non-Payment or Erroneous Payment of Amount Due	3
	3. Other Losses	3
V.	<u>OPERATOR</u>	4
	A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR	4
	B. RESIGNATION OR REMOVAL OF OPERATOR AND SELECTION OF SUCCESSOR	4
	1. Resignation or Removal of Operator	4
	2. Selection of Successor Operator	4
	C. EMPLOYEES	4
	D. DRILLING CONTRACTS	4
VI.	<u>DRILLING AND DEVELOPMENT</u>	4
	A. INITIAL WELL	4-5
	B. SUBSEQUENT OPERATIONS	5
	1. Proposed Operations	5
	2. Operations by Less than All Parties	5-6-7
	3. Stand-By Title	7
	4. Sidetracking	7
	C. TAKING PRODUCTION IN KIND	7
	D. ACCESS TO CONTRACT AREA AND INFORMATION	8
	E. ABANDONMENT OF WELLS	8
	1. Abandonment of Dry Holes	8
	2. Abandonment of Wells that have Produced	8-9
	3. Abandonment of Non-Consent Operations	9
VII.	<u>EXPENDITURES AND LIABILITY OF PARTIES</u>	9
	A. LIABILITY OF PARTIES	9
	B. LIENS AND PAYMENT DEFAULTS	9
	C. PAYMENTS AND ACCOUNTING	9
	D. LIMITATION OF EXPENDITURES	9-10
	1. Drill or Deepen	9-10
	2. Rework or Plug Back	10
	3. Other Operations	10
	E. RENTALS, SHUT-IN WELL PAYMENTS AND MINIMUM ROYALTIES	10
	F. TAXES	10
	G. INSURANCE	11
VIII.	<u>ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST</u>	11
	A. SURRENDER OF LEASES	11
	B. RENEWAL OR EXTENSION OF LEASES	11
	C. ACREAGE OR CASH CONTRIBUTIONS	11-12
	D. MAINTENANCE OF UNIFORM INTEREST	12
	E. WAIVER OF RIGHTS TO PARTITION	12
	F. PREFERENTIAL RIGHT TO PURCHASE	12
IX.	<u>INTERNAL REVENUE CODE ELECTION</u>	12
X.	<u>CLAIMS AND LAWSUITS</u>	13
XI.	<u>FORCE MAJEURE</u>	13
XII.	<u>NOTICES</u>	13
XIII.	<u>TERM OF AGREEMENT</u>	13
XIV.	<u>COMPLIANCE WITH LAWS AND REGULATIONS</u>	14
	A. LAWS, REGULATIONS AND ORDERS	14
	B. GOVERNING LAW	14
	C. REGULATORY AGENCIES	14
XV.	<u>OTHER PROVISIONS</u>	14
XVI.	<u>MISCELLANEOUS</u>	15

ARTICLE VI
continued

1 If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amount provided for above,
2 the relinquished interests of such Non-Consenting Party shall automatically revert to it, and, from and after such reversion, such Non-
3 Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production
4 therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, reworking, deepening or plugging
5 back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of
6 the operation of said well in accordance with the terms of this agreement and the Accounting Procedure attached hereto.

8
9
10 Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent of all parties, no wells shall
11 be completed in or produced from a source of supply from which a well located elsewhere on the Contract Area is producing, unless such
12 well conforms to the then-existing well spacing pattern for such source of supply.

13
14
15
16 The provisions of this Article shall have no application whatsoever to the drilling of the initial well described in Article VI.A.
17 except (a) as to Article VII.D.1. (Option No. 2), if selected, or (b) as to the reworking, deepening and plugging back of such initial well
18 after it has been drilled to the depth specified in Article VI.A. if it shall thereafter prove to be a dry hole or, if initially completed for pro-
19 duction, ceases to produce in paying quantities.

20
21
22
23 3. Stand-By Time: When a well which has been drilled or deepened has reached its authorized depth and all tests have been
24 completed, and the results thereof furnished to the parties, stand-by costs incurred pending response to a party's notice proposing a
25 reworking, deepening, plugging back or completing operation in such a well shall be charged and borne as part of the drilling or deepening
26 operation just completed. Stand-by costs subsequent to all parties responding, or expiration of the response time permitted, whichever
27 first occurs, and prior to agreement as to the participating interests of all Consenting Parties pursuant to the terms of the second gram-
28 matical paragraph of Article VI.B.2, shall be charged to and borne as part of the proposed operation, but if the proposal is subsequently
29 withdrawn because of insufficient participation, such stand-by costs shall be allocated between the Consenting Parties in the proportion
30 each Consenting Party's interest as shown on Exhibit "A" bears to the total interest as shown on Exhibit "A" of all Consenting Par-
31 ties.

32
33
34
35 4. Sidetracking: Except as hereinafter provided, those provisions of this agreement applicable to a "deepening" operation shall
36 also be applicable to any proposal to directionally control and intentionally deviate a well from vertical so as to change the bottom hole
37 location (herein called "sidetracking"), unless done to straighten the hole or to drill around junk in the hole or because of other
38 mechanical difficulties. Any party having the right to participate in a proposed sidetracking operation that does not own an interest in the
39 affected well bore at the time of the notice shall, upon electing to participate, tender to the well bore owners its proportionate share (equal
40 to its interest in the sidetracking operation) of the value of that portion of the existing well bore to be utilized as follows:

41
42
43
44 (a) If the proposal is for sidetracking an existing dry hole, reimbursement shall be on the basis of the actual costs incurred in
45 the initial drilling of the well down to the depth at which the sidetracking operation is initiated.

46
47
48
49 (b) If the proposal is for sidetracking a well which has previously produced, reimbursement shall be on the basis of the well's
50 salvageable materials and equipment down to the depth at which the sidetracking operation is initiated, determined in accordance with the
51 provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning.

52
53
54
55 In the event that notice for a sidetracking operation is given while the drilling rig to be utilized is on location, the response period
56 shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday and legal holidays; provided, however, any party may request and
57 receive up to eight (8) additional days after expiration of the forty-eight (48) hours within which to respond by paying for all stand-by time
58 incurred during such extended response period. If more than one party elects to take such additional time to respond to the notice, stand-
59 by costs shall be allocated between the parties taking additional time to respond on a day-to-day basis in the proportion each electing par-
60 ty's interest as shown on Exhibit "A" bears to the total interest as shown on Exhibit "A" of all the electing parties. In all other in-
61 stances the response period to a proposal for sidetracking shall be limited to thirty (30) days.

62
63
64
65 **C. TAKING PRODUCTION IN KIND:**

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

ARTICLE VI

continued

1 required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.
2

3 Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from
4 the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment directly from the purchaser thereof for
5 its share of all production.
6

7 In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of
8 the oil produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not
9 the obligation, to purchase such oil or sell it to others at any time and from time to time, for the account of the non-taking party at the
10 best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to the right of the
11 owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil not previously
12 delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil shall be only for such reasonable periods of
13 time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess
14 of one (1) year.
15

16 In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and/or
17 deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportionate share of total gas sales to
18 be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any gas balancing
19 agreement between the parties hereto, whether such an agreement is attached as Exhibit "E", or is a separate agreement.
20

21 D. Access to Contract Area and Information:

22
23 Each party shall have access to the Contract Area at all reasonable times, at its sole cost and risk to inspect or observe operations,
24 and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books
25 and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with
26 governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of
27 each month, and shall make available samples or any cores or cuttings taken from any well drilled on the Contract Area. The cost of
28 gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that re-
29 quests the information.
30

31 F. Abandonment of Wells:

32
33 1. Abandonment of Dry Holes: Except for any well drilled or deepened pursuant to Article VI.B.2., any well which has been
34 drilled or deepened under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned
35 without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply
36 within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of notice of the proposal to plug and abandon
37 such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in
38 accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling or deepening
39 such well. Any party who objects to plugging and abandoning such well shall have the right to take over the well and conduct further
40 operations in search of oil and/or gas subject to the provisions of Article VI.B.
41

42 2. Abandonment of Wells that have Produced: Except for any well in which a Non-Consent operation has been conducted
43 hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has been completed as a
44 producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall
45 be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within
46 thirty (30) days after receipt of notice of the proposed abandonment of any well, all parties do not agree to the abandonment of such well,
47 those wishing to continue its operation from the interval(s) of the formation(s) then open to production shall tender to each of the other
48 parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of
49 Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign
50 the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and
51 material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the in-
52 terval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and
53 gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or in-
54 tervals of the formation or formations then open to production, for a term of one (1) year and so long thereafter as oil and/or gas is pro-
55 duced from the interval or intervals of the formation, or formations covered thereby, such lease to be on the form attached as Exhibit
56
57
58
59
60
61
62
63
64
65
66
67
68
69
70

ARTICLE VI

continued

1 required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.
2

3 Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from
4 the Contract Area, and, except as provided in Article VII B., shall be entitled to receive payment directly from the purchaser thereof for
5 its share of all production.
6

7
8 In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of
9 the oil and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it,
10 but not the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-
11 taking party at the best price obtainable in the area for such production. Any such purchase or sale by Operator shall be subject always to
12 the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and gas
13 not previously delivered to a purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for such
14 reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event
15 for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate com-
16 merce, of any other party's share of gas production without first giving such other party thirty (30) days notice of such intended sale.

D. Access to Contract Area and Information:

17
18
19 Each party shall have access to the Contract Area at all reasonable times, at its sole cost and risk to inspect or observe operations,
20 and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books
21 and records relating thereto. Operator, upon request, shall furnish each of the other parties with copies of all forms or reports filed with
22 governmental agencies, daily drilling reports, well logs, tank tables, daily usage and run tickets and reports of stock on hand at the end of
23 each month, and shall make available samples of any cores or cuttings taken from any well drilled on the Contract Area. The cost of
24 gathering and furnishing information to Non-Operator, other than that specified above, shall be charged to the Non-Operator that
25 requests the information.
26

E. Abandonment of Wells:

27
28
29 1. Abandonment of Dry Holes: Except for any well drilled or deepened pursuant to Article VI.B.2., any well which has been
30 drilled or deepened under the terms of this agreement and is proposed to be completed as a dry hole shall not be plugged and abandoned
31 without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply
32 within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of notice of the proposal to plug and abandon
33 such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in
34 accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling or deepening
35 such well. Any party who objects to plugging and abandoning such well shall have the right to take over the well and conduct further
36 operations in search of oil and/or gas subject to the provisions of Article VI.B.
37

38
39 2. Abandonment of Wells that have Produced: Except for any well in which a Non-Consent operation has been conducted
40 hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has been completed as a
41 producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall
42 be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within
43 thirty (30) days after receipt of notice of the proposed abandonment of any well, all parties do not agree to the abandonment of such well,
44 those wishing to continue its operation from the interval(s) of the formation(s) then open to production shall tender to each of the other
45 parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of
46 Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign
47 the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and
48 material, all of its interest in the well and related equipment, together with its interest in the leasehold estate as to, but only as to, the in-
49 terval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and
50 gas interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the interval or in-
51 tervals of the formation or formations then open to production, for a term of one (1) year and so long thereafter as oil and/or gas is pro-
52 duced from the interval or intervals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit
53
54
55
56
57
58
59
60
61
62
63
64
65
66
67
68
69
70

Section 10

A.A.P.L. FORM 610 - 1989

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

_____, 19____,

OPERATOR _____

CONTRACT AREA _____

COUNTY OR PARISH OF _____, **STATE OF** _____

COPYRIGHT 1989 — ALL RIGHTS RESERVED
AMERICAN ASSOCIATION OF PETROLEUM
LANDMEN, 4100 FOSSIL CREEK BLVD.
FORT WORTH, TEXAS, 76137, APPROVED FORM.
A.A.P.L. NO. 610 - 1989

TABLE OF CONTENTS

<u>Article</u>	<u>Title</u>	<u>Page</u>
I.	DEFINITIONS	1
II.	EXHIBITS	1
III.	INTERESTS OF PARTIES	2
	A. OIL AND GAS INTERESTS:	2
	B. INTERESTS OF PARTIES IN COSTS AND PRODUCTION:	2
	C. SUBSEQUENTLY CREATED INTERESTS:	2
IV.	TITLES	2
	A. TITLE EXAMINATION:	2
	B. LOSS OR FAILURE OF TITLE:	3
	1. Failure of Title	3
	2. Loss by Non-Payment or Erroneous Payment of Amount Due	3
	3. Other Losses	3
	4. Curing Title	3
V.	OPERATOR	4
	A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:	4
	B. RESIGNATION OR REMOVAL OF OPERATOR AND SELECTION OF SUCCESSOR:	4
	1. Resignation or Removal of Operator	4
	2. Selection of Successor Operator	4
	3. Effect of Bankruptcy	4
	C. EMPLOYEES AND CONTRACTORS:	4
	D. RIGHTS AND DUTIES OF OPERATOR:	4
	1. Competitive Rates and Use of Affiliates	4
	2. Discharge of Joint Account Obligations	4
	3. Protection from Liens	4
	4. Custody of Funds	5
	5. Access to Contract Area and Records	5
	6. Filing and Furnishing Governmental Reports	5
	7. Drilling and Testing Operations	5
	8. Cost Estimates	5
	9. Insurance	5
VI.	DRILLING AND DEVELOPMENT	5
	A. INITIAL WELL:	5
	B. SUBSEQUENT OPERATIONS:	5
	1. Proposed Operations	5
	2. Operations by Less Than All Parties	6
	3. Stand-By Costs	7
	4. Deepening	8
	5. Sidetracking	8
	6. Order of Preference of Operations	8
	7. Conformity to Spacing Pattern	9
	8. Paying Wells	9
	C. COMPLETION OF WELLS; REWORKING AND PLUGGING BACK:	9
	1. Completion	9
	2. Rework, Recomplete or Plug Back	9
	D. OTHER OPERATIONS:	9
	E. ABANDONMENT OF WELLS:	9
	1. Abandonment of Dry Holes	9
	2. Abandonment of Wells That Have Produced	10
	3. Abandonment of Non-Consent Operations	10
	F. TERMINATION OF OPERATIONS:	10
	G. TAKING PRODUCTION IN KIND	10
	(Option 1) Gas Balancing Agreement	10
	(Option 2) No Gas Balancing Agreement	11
VII.	EXPENDITURES AND LIABILITY OF PARTIES	11
	A. LIABILITY OF PARTIES:	11
	B. LIENS AND SECURITY INTERESTS:	11
	C. ADVANCES:	12
	D. DEFAULTS AND REMEDIES:	12
	1. Suspension of Rights	13
	2. Suit for Damages	13
	3. Deemed Non-Consent	13
	4. Advance Payment	13
	5. Costs and Attorneys' Fees	13
	E. RENTALS, SHUT-IN WELL PAYMENTS AND MINIMUM ROYALTIES:	13
	F. TAXES:	13
VIII.	ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST	14
	A. SURRENDER OF LEASES:	14
	B. RENEWAL OR EXTENSION OF LEASES:	14
	C. ACREAGE OR CASH CONTRIBUTIONS:	14

1 plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any
 2 party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after
 3 delivery of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the
 4 proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the
 5 cost, risk and expense of the parties who participated in the cost of drilling or Deepening such well. Any party who objects to
 6 plugging and abandoning such well by notice delivered to Operator within forty-eight (48) hours (exclusive of Saturday,
 7 Sunday and legal holidays) after delivery of notice of the proposed plugging shall take over the well as of the end of such
 8 forty-eight (48) hour notice period and conduct further operations in search of Oil and/or Gas subject to the provisions of
 9 Article VI.B.; failure of such party to provide proof reasonably satisfactory to Operator of its financial capability to conduct
 10 such operations or to take over the well within such period or thereafter to conduct operations on such well or plug and
 11 abandon such well shall entitle Operator to retain or take possession of the well and plug and abandon the well. The party
 12 taking over the well shall indemnify Operator (if Operator is an abandoning party) and the other abandoning parties against
 13 liability for any further operations conducted on such well except for the costs of plugging and abandoning the well and
 14 restoring the surface, for which the abandoning parties shall remain proportionately liable.

15 2. Abandonment of Wells That Have Produced: Except for any well in which a Non-Consent operation has been
 16 conducted hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has
 17 been completed as a producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to
 18 such abandonment, the well shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk
 19 and expense of all the parties hereto. Failure of a party to reply within sixty (60) days of delivery of notice of proposed
 20 abandonment shall be deemed an election to consent to the proposal. If, within sixty (60) days after delivery of notice of the
 21 proposed abandonment of any well, all parties do not agree to the abandonment of such well, those wishing to continue its
 22 operation from the Zone then open to production shall be obligated to take over the well as of the expiration of the
 23 applicable notice period and shall indemnify Operator (if Operator is an abandoning party) and the other abandoning parties
 24 against liability for any further operations on the well conducted by such parties. Failure of such party or parties to provide
 25 proof reasonably satisfactory to Operator of their financial capability to conduct such operations or to take over the well
 26 within the required period or thereafter to conduct operations on such well shall entitle Operator to retain or take possession
 27 of such well and plug and abandon the well.

28 Parties taking over a well as provided herein shall tender to each of the other parties its proportionate share of the value of
 29 the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C," less the estimated cost
 30 of salvaging and the estimated cost of plugging and abandoning and restoring the surface; provided, however, that in the event
 31 the estimated plugging and abandoning and surface restoration costs and the estimated cost of salvaging are higher than the
 32 value of the well's salvable material and equipment, each of the abandoning parties shall tender to the parties continuing
 33 operations their proportionate shares of the estimated excess cost. Each abandoning party shall assign to the non-abandoning
 34 parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and material, all
 35 of its interest in the wellbore of the well and related equipment, together with its interest in the Leasehold insofar and only
 36 insofar as such Leasehold covers the right to obtain production from that wellbore in the Zone then open to production. If the
 37 interest of the abandoning party is or includes an Oil and Gas Interest, such party shall execute and deliver to the non-
 38 abandoning party or parties an oil and gas lease, limited to the wellbore and the Zone then open to production, for a term of
 39 one (1) year and so long thereafter as Oil and/or Gas is produced from the Zone covered thereby, such lease to be on the form
 40 attached as Exhibit "B." The assignments or leases so limited shall encompass the Drilling Unit upon which the well is located.
 41 The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon the relationship of their
 42 respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract
 43 Area of all assignees. There shall be no readjustment of interests in the remaining portions of the Contract Area.

44 Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production
 45 from the well in the Zone then open other than the royalties retained in any lease made under the terms of this Article. Upon
 46 request, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and
 47 charges contemplated by this agreement, plus any additional cost and charges which may arise as the result of the separate
 48 ownership of the assigned well. Upon proposed abandonment of the producing Zone assigned or leased, the assignor or lessor
 49 shall then have the option to repurchase its prior interest in the well (using the same valuation formula) and participate in
 50 further operations therein subject to the provisions hereof.

51 3. Abandonment of Non-Consent Operations: The provisions of Article VI.E.1. or VI.E.2. above shall be applicable as
 52 between Consenting Parties in the event of the proposed abandonment of any well excepted from said Articles; provided,
 53 however, no well shall be permanently plugged and abandoned unless and until all parties having the right to conduct further
 54 operations therein have been notified of the proposed abandonment and afforded the opportunity to elect to take over the well
 55 in accordance with the provisions of this Article VI.E.; and provided further, that Non-Consenting Parties who own an interest
 56 in a portion of the well shall pay their proportionate shares of abandonment and surface restoration costs for such well as
 57 provided in Article VI.B.2.(b).

58 F. Termination of Operations:

59 Upon the commencement of an operation for the drilling, Reworking, Sidetracking, Plugging Back, Deepening, testing,
 60 Completion or plugging of a well, including but not limited to the Initial Well, such operation shall not be terminated without
 61 consent of parties bearing _____ % of the costs of such operation; provided, however, that in the event granite or other
 62 practically impenetrable substance or condition in the hole is encountered which renders further operations impractical,
 63 Operator may discontinue operations and give notice of such condition in the manner provided in Article VI.B.1. and the
 64 provisions of Article VI.B. or VI.E. shall thereafter apply to such operation, as appropriate.

65 G. Taking Production in Kind:

66 Option No. 1: Gas Balancing Agreement Attached

67 Each party shall take in kind or separately dispose of its proportionate share of all Oil and Gas produced from the
 68 Contract Area, exclusive of production which may be used in development and producing operations and in preparing and
 69 treating Oil and Gas for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking
 70 in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any
 71 party taking its share of production in kind shall be required to pay for only its proportionate share of such part of
 72 Operator's surface facilities which it uses.

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

1 directly from the purchaser thereof for its share of all production.

2 If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate
3 share of the Oil produced from the Contract Area, Operator shall have the right, subject to the revocation at will by
4 the party owning it, but not the obligation, to purchase such Oil or sell it to others at any time and from time to
5 time, for the account of the non-taking party. Any such purchase or sale by Operator may be terminated by
6 Operator upon at least ten (10) days written notice to the owner of said production and shall be subject always to
7 the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise at any
8 time its right to take in kind, or separately dispose of, its share of all Oil not previously delivered to a purchaser.
9 Any purchase or sale by Operator of any other party's share of Oil shall be only for such reasonable periods of time
10 as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a
11 period in excess of one (1) year.

12 Any such sale by Operator shall be in a manner commercially reasonable under the circumstances but Operator
13 shall have no duty to share any existing market or to obtain a price equal to that received under any existing
14 market. The sale or delivery by Operator of a non-taking party's share of Oil under the terms of any existing
15 contract of Operator shall not give the non-taking party any interest in or make the non-taking party a party to said
16 contract. No purchase shall be made by Operator without first giving the non-taking party at least ten (10) days
17 written notice of such intended purchase and the price to be paid or the pricing basis to be used.

18 All parties shall give timely written notice to Operator of their Gas marketing arrangements for the following
19 month, excluding price, and shall notify Operator immediately in the event of a change in such arrangements.
20 Operator shall maintain records of all marketing arrangements, and of volumes actually sold or transported, which
21 records shall be made available to Non-Operators upon reasonable request.

22 In the event one or more parties' separate disposition of its share of the Gas causes split-stream deliveries to separate
23 pipelines and/or deliveries which on a day-to-day basis for any reason are not exactly equal to a party's respective proportion-
24 ate share of total Gas sales to be allocated to it, the balancing or accounting between the parties shall be in accordance with
25 any Gas balancing agreement between the parties hereto, whether such an agreement is attached as Exhibit "E" or is a
26 separate agreement. Operator shall give notice to all parties of the first sales of Gas from any well under this agreement.

27 **Option No. 2: No Gas Balancing Agreement:**

28 Each party shall take in kind or separately dispose of its proportionate share of all Oil and Gas produced from
29 the Contract Area, exclusive of production which may be used in development and producing operations and in
30 preparing and treating Oil and Gas for marketing purposes and production unavoidably lost. Any extra expenditure
31 incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall
32 be borne by such party. Any party taking its share of production in kind shall be required to pay for only its
33 proportionate share of such part of Operator's surface facilities which it uses.

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

37 If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate
38 share of the Oil and/or Gas produced from the Contract Area, Operator shall have the right, subject to the
39 revocation at will by the party owning it, but not the obligation, to purchase such Oil and/or Gas or sell it to others
40 at any time and from time to time, for the account of the non-taking party. Any such purchase or sale by Operator
41 may be terminated by Operator upon at least ten (10) days written notice to the owner of said production and shall
42 be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator
43 to exercise its right to take in kind, or separately dispose of, its share of all Oil and/or Gas not previously delivered
44 to a purchaser; provided, however, that the effective date of any such revocation may be deferred at Operator's
45 election for a period not to exceed ninety (90) days if Operator has committed such production to a purchase
46 contract having a term extending beyond such ten (10) -day period. Any purchase or sale by Operator of any other
47 party's share of Oil and/or Gas shall be only for such reasonable periods of time as are consistent with the
48 minimum needs of the industry under the particular circumstances, but in no event for a period in excess of (1)
49 year.

50 Any such sale by Operator shall be in a manner commercially reasonable under the circumstances, but Operator
51 shall have no duty to share any existing market or transportation arrangement or to obtain a price or transportation
52 fee equal to that received under any existing market or transportation arrangement. The sale or delivery by
53 Operator of a non-taking party's share of production under the terms of any existing contract of Operator shall not
54 give the non-taking party any interest in or make the non-taking party a party to said contract. No purchase of Oil
55 and Gas and no sale of Gas shall be made by Operator without first giving the non-taking party ten days written
56 notice of such intended purchase or sale and the price to be paid or the pricing basis to be used. Operator shall give
57 notice to all parties of the first sale of Gas from any well under this Agreement.

58 All parties shall give timely written notice to Operator of their Gas marketing arrangements for the following
59 month, excluding price, and shall notify Operator immediately in the event of a change in such arrangements.
60 Operator shall maintain records of all marketing arrangements, and of volumes actually sold or transported, which
61 records shall be made available to Non-Operators upon reasonable request.

62 **ARTICLE VII.**

63 **EXPENDITURES AND LIABILITY OF PARTIES**

64 **A. Liability of Parties:**

65 The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations,
66 and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the
67 liens granted among the parties in Article VII.B. are given to secure only the debts of each severally, and no party shall have
68 any liability to third parties hereunder to satisfy the default of any other party in the payment of any expense or obligation
69 hereunder. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other
70 partnership, joint venture, agency relationship or association, or to render the parties liable as partners, co-venturers, or
71 principals. In their relations with each other under this agreement, the parties shall not be considered fiduciaries or to have
72 established a confidential relationship but rather shall be free to act on an arm's-length basis in accordance with their own
73 respective self-interest, subject, however, to the obligation of the parties to act in good faith in their dealings with each other
74 with respect to activities hereunder.

Section 11

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

The following Special Provisions and the attached [REDACTED] General Provisions [REDACTED] constitute the entire agreement (the "Agreement") whereby [REDACTED] and [REDACTED] agree to sell and deliver (each hereinafter referred to as "Seller" in such instance), and to purchase and receive (each hereinafter referred to as "Buyer" in such instance), crude oil and/or condensate under the terms and conditions as set forth below.

SPECIAL PROVISIONS

A. [REDACTED] Sale and Delivery [REDACTED]

QUALITY: Crude oil as described in the attached Exhibit "A".

QUANTITY: Equal to 20% of Seller's interest in the crude oil production from the properties/leases described in the attached Exhibit "A".

PRICE: As described in the attached Exhibit "A".

TERM: Effective [REDACTED] and continuing month to month thereafter unless either party cancels with thirty (30) days prior written notice. Cancellation shall become effective on the first day of the month following such notice period.

DELIVERY: Delivered into Buyer designated carriers from the properties/leases described in Exhibit "A".

PAYMENT: Payment shall be made to Seller by wire transfer on the 20th day of the month following the month of delivery. (See paragraph 3 of the General Provisions attached hereto.)

CREDIT TERMS: As mutually agreed between Buyer and Seller.

B. [REDACTED] Sale and Delivery to [REDACTED]

QUALITY: Crude oil as described in the attached Exhibit "A".

QUANTITY: Equal to QUANTITY in Section A.

PRICE: As described in the attached Exhibit "A".

TERM: Effective [REDACTED] and continuing month to month thereafter unless either party cancels with thirty (30) days prior written notice. Cancellation shall become effective on the first day of the month following such notice period.

DELIVERY: Delivered into connecting carriers at St. James, Louisiana and/or delivered into the facilities of Chevron Pipe Line, Empire, Louisiana as indicated in the attached Exhibit "A".

PAYMENT: Payment shall be made to Seller by wire transfer on the 20th day of the month following the month of delivery. (See paragraph 3 of the General Provisions attached hereto.)

CREDIT TERMS: As mutually agreed between Buyer and Seller.

RE: [REDACTED]

The following constitutes the entire agreement (the "Agreement") whereby [REDACTED] "Buyer," agrees to buy and [REDACTED] "Seller," agrees to sell crude oil and/or condensate under the terms and conditions as set forth below.

This contract agreement is in conjunction with the Minerals Management Services (MMS) twenty percent "set-aside" program as defined under Section 8 (b) (7) of the Outer Continental Shelf Lands Act Amendments of 1978.

TERM:
Effective [REDACTED] and continuing month to month thereafter until cancelled by mutual consent. Cancellation shall become effective on the first day of the month following such notice period.

QUANTITY:
Buyer to purchase a volume equal to twenty percent of Seller's interest in the crude oil production from the properties described in the attached Exhibit "A".

QUALITY:
Crude Oil quality to be consistent with the common stream quality of the delivering oil producing property or transfer location as described in Exhibit "A".

DELIVERY POINT:
Delivery shall be at the Delivery Location as outlined in Exhibit "A".

PRICE:
The price is equal to the average of Seller's sales price for each lease for non "set-aside" volume, calculated at the Delivery Location to Buyer as outlined in Exhibit "A".

CREDIT:
Buyer shall provide Seller with a Letter of Credit in a form and amount acceptable to Seller's credit department.

PAYMENT:
Payment shall be made to Seller by wire transfer on the 20th day of the month following the month of delivery (see paragraph 3 of the General Provisions attached hereto).

GENERAL PROVISIONS:
Where not specifically addressed, [REDACTED] General Provisions dated [REDACTED] will govern this agreement.

- SPECIAL PROVISIONS:**
1. Buyer may elect to take delivery of the crude oil at the off-shore production facility at a mutually agreed price. the seller's average sales price for such lease for non set-a-side volumes. [REDACTED]
 2. Buyer must notify Seller if they intend not to purchase the "set-aside" barrels the following month by the latest of: A) the first day of the month prior to delivery, or B) the first business day following notification by Seller of the price of the crude oil.
 3. Any new oil production by Seller or its affiliates subject to the "set aside" program after the initiation of this agreement is subject to this agreement.
 4. If subject volume cannot be shipped from the offshore production facility to a satisfactory trade location, Buyer must take delivery at the off-shore production facility location at a mutually agreed price. the seller's average sales price for such lease for non set-a-side volumes. [REDACTED]
 5. Should Buyer elect not to purchase production for any given month, Buyer shall still have the right to purchase volumes hereunder in future months. Seller shall, however, not be obligated to deliver to Buyer volumes produced in months in which Buyer elected not to purchase.
 6. Buyer shall retain a first right to purchase one hundred percent of Seller's available crude oil which is subject to the twenty percent "set-aside" program as defined under section 8(b)(7) of the Outer Continental Shelf Lands Act Amendments of 1978

Section 12



United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

MAY 31 1996

Memorandum

To: Assistant Secretary, Land and Minerals Management

From: Cynthia Quarterman Cynthia Quarterman
Director, Minerals Management Service

Subject: April 4, 1996, Letter from Congresswoman Carolyn B. Maloney

In a letter of April 4, 1996, Congresswoman Carolyn B. Maloney asked that the Minerals Management Service (MMS) look into the contract and invoices between Tosco Corporation and Texaco as a possible example that oil companies are not making the correct oil royalty payments to the Federal Government. In the course of MMS audit work investigating allegations of underpricing of crude oil in California, auditors examined Texaco sales for 1989 and 1993. The MMS auditors have identified a small amount of Texaco's production (6,700 barrels per day) that was sold to Tosco in November 1993. Tosco paid more than posted price for this oil; however, part of the incremental value may relate to transportation costs. MMS considers these payments above postings to be a combination of transportation costs and premiums. Texaco will have the opportunity to explain these payments above postings costs in the audit review process.

The letter also requested that we compare the price of oil produced from the Elk Hills Naval Petroleum Reserve (Elk Hills) with that of privately-owned oil and gas producers. The letter stated that Elk Hills would have the correct posted price. However, there is no posted price for crude oil produced from the Elk Hills field. There are a number of postings for other nearby San Joaquin Valley fields (e.g., Midway-Sunset, Buena Vista, Lost Hills, etc). The value of the Elk Hills crude oil is determined based on a sealed bid using posted prices as the base price. Elk Hills almost always receives a premium above posted price.

According to Innovation and Information Consultants (IIC), a consultant we hired on the California undervaluation issue, the average premium above bid minimum "base price" (based on the three highest postings in nearby fields) for Elk Hills production in 1984 was \$1.81/bbl. Also, the average Elk Hills premium over a local posting was \$0.39/bbl in 1989. Elk Hills oil is a higher quality crude (27-35 degrees API), which is more desirable for mixing with other crudes during transportation than the heavy crudes predominantly found in the San Joaquin Valley. This quality can avoid the need to access the few, more expensive heated pipelines available to transport heavy crude. Thus, any comparison to Elk Hill crude oil prices must consider its advantage in blending with various crudes as well as the quality adjustment for its relative gravity.

While we have examined information regarding Elk Hills pricing during our study, a comparison of the price of oil produced from Elk Hills to the royalty value of crude oil from Federal leases is not necessarily meaningful. The Elk Hills crude is in high demand in the San Joaquin Valley because it is much lighter than other crude in that area and can be used for blending. Finally, Elk Hills crude comprises a large portion of the limited amount of crude oil available to small refiners on the open market in California; therefore, it commands a higher price.

Section 13

3. Conversion of Overriding Royalty Interest. If and when the Farmee's revenue equals the Farmee's cost, as shown by Farmee's monthly statements, the Earning Well shall be considered as having achieved "payout" status. If Farmor is granted the right hereunder to convert its reserved overriding royalty interest to a working interest, the Farmor may exercise such right by written notice to Farmee within 60 days after receipt of Farmee's written advice to Farmor stating that payout status has been achieved, accompanied by Farmee's monthly statement in support thereof; provided, however, within such 60 day period, Farmee shall provide Farmor all pertinent well production history and most recent test data requested by Farmor, and Farmor shall have the right to exercise its conversion privilege within 30 days after its receipt of all such data, notwithstanding any term or provision of this Farmout Agreement to the contrary. Upon receipt of Farmor's conversion notice, Farmee shall promptly reassign to Farmor the working interest Farmor is entitled to receive hereunder, including an equivalent interest in the Earning Well, the equipment and equipment attributable thereto, and all subsequent production therefrom effective as of 7:00 a.m. of the day following the date of payout, and Farmor's overriding royalty shall thereupon be extinguished. The reassignment of Farmor's working interest shall be without warranty of title, express or implied, and shall be free and clear of all royalties, overriding royalties and other payments out of production, and all claims, liabilities and other encumbrances except those in existence as of the effective date of this Farmout Agreement. The foregoing conversion of overriding royalty interest option shall apply in like manner to any other well drilled on the Farmout Lands by Farmee wherein Farmor has reserved such conversion option.

4.4 Audits. Upon written notice to Farmee, Farmor may audit Farmee's books and records relating to overriding royalty payments and/or the calculation of payout. Such audit rights may be exercised at any time while overriding royalties are payable and for a period of 24 months after payout status has been achieved, notwithstanding an earlier termination of this Farmout Agreement.

5. Liability and Insurance.

5.1 Relationship of Parties. In performing its obligations hereunder, Farmee shall be an independent contractor, and not the agent of Farmor. Nothing herein shall be construed as creating a partnership or otherwise establishing joint or collective liability. The relationship of the parties for federal and state income tax purposes shall be as set forth in Exhibit D to this Farmout Agreement, or if no Exhibit D is attached, shall be as set forth in Paragraph 11.2 below and shall be effective from and after the effective date of this Farmout Agreement.

5.2 Farmee's Indemnity. Farmee shall indemnify and hold harmless Farmor and its employees and agents from all claims, demands, losses and liabilities of every kind and character arising out of Farmee's performance or failure to perform hereunder, or the acts of or failure to act by Farmee's employees, agents, contractors and subcontractors.

5.3 Required Insurance Coverage. At all times while Farmee has the right to earn an assignment of interest hereunder or is conducting operations on the Farmout Lands, Farmee shall maintain at its sole cost the following insurance coverage for its operations:

(a) Worker's Compensation Insurance and Employer's Liability Insurance with such limits as are specified by law in the jurisdiction in which the Farmout Lands are located.

(b) Comprehensive General Public Liability Insurance, including Contractual Liability coverage, with a combined single limit of \$1,000,000 for bodily injury and property damage.

(c) Automobile Liability Insurance with the same limits as prescribed above for Comprehensive General Public Liability insurance.

5.4 Proof of Coverage. Prior to the commencement of operations hereunder, Farmee shall furnish Farmor one or more certificates signed by the insurance carrier or carriers showing to Farmor's satisfaction that the required insurance coverage described above is then in force, and stating that such coverage shall not be cancelled or materially altered without at least 10 days advance written notice to Farmor. Such cancellation or material alteration, if not accompanied by new insurance coverage satisfactory to Farmor, shall constitute a default by Farmee under Paragraph 3.3 above. Each certificate shall also contain a waiver by the insurance carrier of any right to be subrogated to the rights of any claimant against Farmor or Farmor's employees and agents, except that the carrier shall be subrogated to the rights of Farmee against Farmor with respect to any risk expressly assumed by Farmor hereunder.

6. Option to Purchase or Process Production.

6.1 Oil Production. Farmor shall have a continuing option to purchase Farmee's share of oil and liquid hydrocarbons produced and saved from the Farmout Lands through standard lease separator facilities, to the extent such production is attributable to the interest assigned to Farmee hereunder. The option may be exercised by Farmor at any time and from time to time while such production continues, by giving written notice thereof to Farmee not less than 30 days before the date on which Farmor's purchases are to commence. The price paid by Farmor for such production shall be equal to the prevailing wellhead market price then being paid in the same field for production of the same or similar grade and gravity, or if there is no such prevailing price being paid in the same field, the prevailing price being paid in the nearest field. Farmor may terminate its purchases by giving written notice thereof to Farmee not less than 30 days before the date of termination.

6.2 Gas Production. Farmor shall have the option to purchase Farmee's share of gas, including casinghead gas, produced and saved from the Farmout Lands through standard lease separator facilities, to the extent such production is attributable to the interest assigned to Farmee hereunder. When Farmee's gas becomes available for purchase, Farmee shall so advise Farmor in writing and Farmor shall have 60 days thereafter to give Farmee written notice of Farmor's election to purchase the gas at the highest price then being paid in contract in the same field for gas of the same or similar quantity and quality, or if there is no such prevailing price being paid in the same field, the prevailing price being paid in the nearest field, with equivalent provisions for duration, termination, conditions of delivery, price escalations and quality price adjustments. If Farmor does not elect to purchase Farmee's gas as aforesaid, Farmor shall have no other option to purchase such gas hereunder.

6.3 Gas Processing. If Farmor does not elect to purchase Farmee's share of gas under Paragraph 6.2 above, Farmor shall nevertheless have a continuing option to process Farmee's share of gas, including casinghead gas, produced and saved through standard lease separator facilities, to the extent such gas is attributable to the interest assigned to Farmee hereunder, all in accordance with the following provisions:

(a) Farmor may exercise its option at any time, before or after commencement of gas production, by giving written notice thereof to Farmee not less than 60 days before Farmor's processing is to begin. Any agreement made by Farmee for the sale of its gas shall be made expressly subject to Farmor's processing option, whether exercised by Farmor or not.

Section 14

completed. Assignee agrees to perform the aforesaid operations at its sole expense, to be solely responsible for damages in connection therewith and to hold Assignor harmless therefrom from and after Effective Date. Notwithstanding Assignor's indemnity set forth below, Assignee agrees to protect, defend, indemnify and hold Assignor and its employees free and harmless from and against any and all costs, expenses, damages, claims, losses, liabilities, demands and causes of action of every kind and character, including but not limited to pollution and environmental claims arising out of, or in connection with the Assets, plugging requirements or exceptions thereto including bonding requirements, arising out of or in connection with Assignee's or third party(s) operations on said Assets, from and after Effective Date. Assignee's indemnity expressly includes environmental claims which arise as a result of the application of current or future federal, state or local statutes, ordinances, rules or regulations that are enforced retroactively such that operations and conditions that were in compliance with applicable federal, state and local statutes, ordinances, rules and regulations at the time of their occurrence are interpreted on or after the Effective Date to be violations of such retroactively enforced current or future federal, state or local statutes, ordinances, rules or regulations. Assignor agrees to indemnify Assignee for any and all causes of action, claims, losses, liabilities and demands which relate to the Assets arising out of or in connection with Assignor's operations on said Assets prior to the Effective Date.

Assignor shall have a continuing option to purchase Assignee's share of oil and liquid hydrocarbons produced and saved from the Assets. The option may be exercised by Assignor at any time and from time to time while such production continues, by giving written notice thereof to Assignee not less than thirty (30) days before the date on which Assignor's purchases are to commence. The price paid by Assignor for such production shall be equal to the prevailing wellhead market price then being paid in the same field for production of the same or similar grade and gravity, or if there is no such prevailing price being paid in the same field, the prevailing price being paid in the nearest field. Assignor may terminate its purchases by giving written notice thereof to Assignee not less than thirty (30) days before the date of termination. Assignor may exercise its option to purchase oil production on its own behalf or on behalf of an affiliate or other nominee designated by Assignor.

The Assignee and Assignor recognize that the Federal Energy Regulatory Commission Order No. 451 as amended provides for a good faith negotiation process ("GFNP") to amend certain gas sales contracts, which may affect the contractual rights of parties other than the party who initiates the GFNP. Accordingly, if on the date of this Assignment all

Section 15

14.10 Option to Purchase Production. Seller or Seller's designee shall have a continuing option to purchase Buyer's share of oil and liquid hydrocarbons produced and saved from the Assets through standard lease separator facilities to the extent such production is attributable to the Assets. The option may be exercised by Seller at any time and from time to time by giving written notice to Buyer not less than thirty (30) days before the date on which Seller's purchases are to commence. The price paid by Seller for such production shall be equal to the price offered by any bona fide third party purchaser for Buyer's share of the oil or, if there are no bona fide third party offers available, for the prevailing wellhead market price then being paid in the same field for the same quantity and quality production. Buyer shall provide Seller with full disclosure written evidence on the letterhead of the bona fide third party purchaser of any such offer including price and duration. Seller shall have five (5) business days from receipt of written disclosure of any third party offer in which to agree to match the offer of the third party purchaser including the price and duration. Seller shall begin purchasing beginning the first day of the month after such production first becomes available for sale after Buyer has received the written notice from Seller. If Seller does not match the third party offer, then Seller shall not have an option to purchase for the Primary Term of Buyer's and the third party's contract. Seller may terminate its purchases by giving written notice thereof to Buyer not less than thirty (30) days before the date of termination, provided that there are no more than thirty (30) days remaining in the term of the contract. Additionally, Buyer will notify Seller in writing at least thirty (30) days prior to anytime that the commencement of a contract for sale of oil and liquid hydrocarbons which are subject to this Agreement of a duration longer than ninety (90) days is contemplated.

14.11 Counterparts. This Agreement may be executed in any number of counterparts, and each such counterpart hereof shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

Section 16

Notwithstanding anything contained in this Assignment to the contrary, the performance of any of the obligations of Assignee hereunder with the exception of any payment or indemnity obligation shall be suspended while and so long as the Assignee is prevented from complying with such obligations in part or in whole by strikes, lockouts, acts of God, action of the elements, accidents, laws, rules and regulations of any federal, state, county, municipal, or other governmental agency, zoning or land use ordinances of any governmental agency, acts or requests of any governmental officer or agent purporting to act under authority, unreasonable delays in transportation, inability to obtain necessary materials in the open market, inadequate off-lease facilities for the transportation of such materials or for the disposition of production, or other matters beyond the reasonable control of the Assignee whether similar to the matters herein specifically enumerated or not.

IX

This Assignment is granted and accepted without any warranties, express or implied, of title or merchantability or fitness for any particular purpose or otherwise, and without any recourse against Assignor whatsoever. NOTWITHSTANDING ANYTHING CONTAINED IN THIS TERM ASSIGNMENT TO THE CONTRARY, ASSIGNOR SHALL BE UNDER NO OBLIGATION WHATSOEVER TO MAINTAIN OR PERPETUATE SAID LEASES AND MAY RELEASE SAID LEASES, INSOFAR AS THEY COVER ACREAGE NOT COVERED HEREBY, IF SUCH PERPETUATION INVOLVES ANY MONETARY EXPENDITURE, WORK COMMITMENT OR RISK WHICH ASSIGNOR AT ITS SOLE ELECTION DESIRES NOT TO UNDERTAKE. It is expressly agreed that Assignor shall not be required to return any consideration paid herefor or its value or any payments received hereunder or be otherwise responsible to Assignee therefor; provided, however, it is agreed that if, immediately prior to this Assignment, Assignor owned less than a full interest in the oil and gas leasehold estate in any tract of land covered by this Assignment, then the overriding royalty to be paid Assignor applicable to such a tract shall be reduced proportionately. Assignee shall promptly furnish to Assignor copies of all title opinions, papers, materials, and curative work secured by Assignee.

*Assignment Dated 9-3-93 Between Kerr McGee & Mobil Oil Corp
Well: Lowe # Bitter C A/C 2
Andrews Co, TX*

A. Assignor will have the continuing right and option at any time(s) to purchase all or any of the oil and/or other liquid hydrocarbons (including condensate, distillate and other liquids recovered from the well stream by normal lease-separation methods) produced and saved from the Assigned Premises. The price to be paid therefor shall be Assignor's posted price applicable thereto for the crude type (with transportation charges deducted, where applicable) or where Assignor has no such posting for the particular type crude, a mutually agreeable other major company posted price.

However, if Assignee receives a bona fide offer to purchase from an independent party, as herein defined, which exceeds the price that Assignor is currently paying, Assignee shall notify Assignor in writing of the offer. Assignor shall have ten (10) days to indicate, in writing, whether it will match the offer or temporarily waive call for the duration of said offer. Should Assignor not respond within ten (10) days after notification by Assignee then Assignor's call shall be considered temporarily waived until such offer has expired or until such time as Assignor is willing to match the independent party's offer, as applicable.

All notifications and questions regarding the above marketing arrangements should be directed to Mobil Oil Corporation, Manager Field Operations by phone at 214-658-3253, or by mail at P. O. Box 900, Dallas, TX 75221.

Section 17

For a period of ten (10) years after the Effective Date, Seller excepts and reserves unto itself, its successors or assigns, the option and exclusive non-assignable right at any time, at all times and from time to time, to purchase all oil, condensate, and other liquid hydrocarbons produced and saved from or attributable to the Assets assigned to Buyer, as to the interest to Seller assigned herein and any gas processing rights relating to liquid and liquefiable hydrocarbons substances. Payment for all oil, distillate, condensate and other liquid hydrocarbons purchased hereunder shall be made at [REDACTED] posted price for production of similar kind and quality prevailing in the area produced on the date of delivery or, if no such posting exists, then at the highest major posting price for production of similar kind and quality prevailing in the area where produced on the date of delivery, unless Buyer is able to provide Seller with a bona fide written offer at a higher price. If Buyer presents such a bona fide written offer to Seller, then Seller shall have the right to meet that offer or waive its call on such liquids for the term of such offer. If Seller chooses to meet such offer, it shall respond in writing notifying Buyer within ten (10) days after actual receipt of such offer from Buyer. Seller's failure to respond within such ten (10) day period shall be deemed to be a waiver of Seller's right to meet such offer.

Section 18

Section 14.05 Preferential Right to Purchase Production. Seller shall have the continuing preferential right and option, at any time, to purchase all or any of the oil and/or other liquid hydrocarbons produced from the Property on the terms set forth in this Section 14.05.

- (a) **Purchases in Response to Bona Fide Offers.** Each time Seller exercises its preferential right, Buyer may solicit bona fide offers from responsible third parties to purchase production from the Property. If Buyer solicits bona fide offers and Seller wishes to purchase production from the Property pursuant to its preferential right, Seller shall be obligated to purchase such production on terms substantially equivalent to those in any bona fide offer that Buyer submits to Seller within fifteen days after receiving written notice of Seller's exercise of its preferential right. Buyer shall furnish Seller with a copy of the bona fide third-party offer, and Seller shall have fifteen days from the receipt thereof to either elect or decline to purchase. If Seller declines to purchase, the preferential right shall not be enforceable during the primary term of the third-party purchase agreement, if Buyer accepts the third-party offer. If Seller elects to purchase, then Seller shall be entitled to purchase production from the Property during the primary term of the purchase agreement between Seller and Buyer, without meeting any subsequent third-party offers for such production. Buyer must submit bona fide third-party offers to purchase production for periods after the primary term or any renewal term of the purchase agreement between Seller and Buyer at least fifteen days prior to expiration of the primary term or renewal term.
- (b) **Purchases in the Absence of Bona Fide Offers.** If Buyer (i) fails to submit to Seller a bona fide third-party offer within fifteen days after receiving written notice of Seller's exercise of its preferential right, (ii) fails to submit to Seller a bona fide third-party offer at least fifteen days before the expiration of the primary term or any renewal term of any purchase agreement between Seller and Buyer, or (iii) fails to actually sell production from the Property pursuant to any bona fide third-party offer in response to which Seller shall be entitled to purchase production from the Property at Seller's published posted price for hydrocarbon production of similar kind and quality in effect in the area on the date of delivery (or if Seller does not have a posting in the field, then on the basis of the published posted price for hydrocarbon production of similar kind and quality of another major oil company to which the parties agree).
- (c) **Waiver.** Seller's failure to exercise its preferential right at any time or Seller's refusal to purchase production on terms substantially equivalent to a bona fide third-party offer shall not constitute a waiver of Seller's preferential right to purchase production from the Property.